

Public Disclosure Authorized

CONFRONTING ILLCIT TOBACCO TRADE:



A GLOBAL REVIEW OF COUNTRY EXPERIENCES

TECHNICAL REPORT OF THE WORLD BANK GROUP
GLOBAL TOBACCO CONTROL PROGRAM.

EDITOR:
SHEILA DUTTA



CONFRONTING ILLICIT TOBACCO TRADE

A GLOBAL REVIEW
OF COUNTRY EXPERIENCES

CONTENTS

<u>ACKNOWLEDGMENTS</u>	VII
<u>EXECUTIVE SUMMARY</u>	XI
<u>INTRODUCTION</u>	XXV
<u>THE PROTOCOL TO ELIMINATE ILLICIT TRADE IN TOBACCO PRODUCTS</u>	
A Global Solution to a Global Problem	1

AUSTRALIA, CANADA, & EUROPE

<u>AUSTRALIA</u>	
Addressing the Illicit Flow of Tobacco Products in Australia	14
<u>CANADA</u>	
Controlling Illicit Tobacco Trade	50
<u>EUROPEAN UNION</u>	
Confronting Illicit Tobacco Trade: An Update on EU Policies	72
<u>GEORGIA</u>	
Controlling Illicit Cigarette Trade	92
<u>IRELAND</u>	
Addressing the Illicit Flow of Tobacco Products	118
<u>UNITED KINGDOM</u>	
Tackling Illicit Tobacco	162

LATIN AMERICA & THE CARIBBEAN

ORGANIZATION OF EASTERN CARIBBEAN STATES (OECS) AND TRINIDAD AND TOBAGO

Regional Reports on Illicit Tobacco Trade 226

CHILE

Tackling the Illicit Tobacco Trade 254

COLOMBIA

Illicit Cigarette Trade 292

ECUADOR

Addressing Illicit Tobacco Trade 322

MEXICO

Controlling the Illicit Cigarette Trade 344

URUGUAY

Tackling Illicit Tobacco Trade 364

SOUTH ASIA & EAST ASIA

BANGLADESH

Illicit Tobacco Trade 406



INDONESIA

Tackling Illicit Cigarettes 438

MALAYSIA

Addressing the Illicit Flow of Tobacco Products 468

PHILIPPINES

Addressing the Illicit Flow of Tobacco Products 484

SUB-SAHARAN AFRICA



SOUTHERN AFRICA CUSTOMS UNION (BOTSWANA, LESOTHO, NAMIBIA, SOUTH AFRICA, AND ESWATINI) AND ZAMBIA

Addressing the Illicit Flow of Tobacco Products 506

BOTSWANA, LESOTHO, AND SOUTH AFRICA

An Analysis of Alcohol and Cigarette Prices in Maseru,
Gaborone, and Neighboring South African Towns 550

KENYA

Controlling Illicit Cigarette Trade 580

SENEGAL

Addressing Illicit Tobacco Trade 604

TOBACCO TAX ADMINISTRATION

A Perspective from the IMF

628

CONCLUSION

642

Acknowledgments

This report was prepared under the lead of Sheila Dutta (Senior Health Specialist and Co-Coordinator, Global Tobacco Control Program, World Bank Group). Patricio Marquez (Lead Health Specialist and Coordinator, Global Tobacco Control Program, World Bank Group), Paul Isenman (former World Bank Group Director and Principal Economist) and Hana Ross (Professor, University of Cape Town) extensively reviewed and commented upon draft chapters of the report, providing detailed technical inputs and suggestions to enhance the volume's robustness, quality, and conclusions. The report benefited from the editorial contribution of Alexander Irwin.

An international team authored the country/regional case studies and other chapters comprising this book, including (by chapter order):

- » **Chapter 1: WHO Framework Convention on Tobacco Control Protocol to Eliminate Illicit Trade in Tobacco Products: A Global Solution to a Global Problem** (Vera Luiza da Costa e Silva, Head of the Secretariat of the WHO Framework Convention on Tobacco Control)
- » **Chapter 2: Australia** (Robert Preece, Charles Sturt University, Australia)
- » **Chapter 3: Canada** (Robert Schwartz, University of Toronto, Canada)
- » **Chapter 4: European Union** (Filip Borkowski and Clare Twomey, European Anti-Fraud Office, European Commission, Belgium)
- » **Chapter 5: Georgia** (Hana Ross [University of Cape Town, South Africa] and George Bakhturidze [FCTC Implementation and Monitoring Center, Georgia]).
- » **Chapter 6: Ireland** (Alan Cummins, Oliver Gainford, and Peadar O'Lamhna; General Excise and Tobacco, Indirect Taxes Policy and Legislation Division, Office of the Revenue Commissioners, Ireland)

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

- » **Chapter 7: United Kingdom** (Tessa Langley [University of Nottingham], Anna Gilmore [University of Bath], Allen Gallagher [University of Bath], and Deborah Arnott [Action on Smoking and Health])
- » **Chapter 8: Organization of Eastern Caribbean States (OECS) and Trinidad and Tobago** (Karl Theodore, Althea La Foucade, Christine Laptiste, Ewan Scott, Charmaine Metivier, Samuel Gabriel, Daren Conrad, and Malini Maharaj; The University of the West Indies)
- » **Chapter 9: Chile** (Guillermo Paraje, Universidad Adolfo Ibáñez, Chile)
- » **Chapter 10: Colombia** (Blanca Llorente and Norman Maldonado, Fundación Anáas, Colombia)
- » **Chapter 11: Ecuador** (Santiago Trujillo, Servicio de Rentas Internas [SRI], Ecuador)
- » **Chapter 12: Mexico** (Belén Sáenz de Miera Juárez, Universidad Autónoma de Baja California Sur, Mexico)
- » **Chapter 13: Uruguay** (Winston Abascal [International Cooperation Centre for Tobacco Control, WHO FCTC Secretariat, Uruguay] and Alejandro Ramos-Carbajales (Former Planning and Research Director at CIET [Research Center for the Study of the Tobacco Epidemics], Uruguay)
- » **Chapter 14: Bangladesh** (Sadiq Ahmed, Zaidi Sattar, and Khurshid Alam; Policy Research Institute of Bangladesh)
- » **Chapter 15: Indonesia** (Abdillah Ahsan, Vice Director of Center for Islamic Economics and Business and Lecturer of Faculty of Economics and Business, Universitas Indonesia)
- » **Chapter 16: Malaysia** (Noraryana Hassan, Subromaniam Tholasy, Norliana Ismail, Hasazli Hasan, Norashidah binti Mohamed Nor, and Wency Bui Kher Thinng; FCTC and Tobacco Control Unit, Disease Control Division, Ministry of Health, Malaysia)
- » **Chapter 17: Philippines** (Kim Henares [Former Commissioner, Bureau of Internal Revenue, Philippines] and Malou B. Recente [Former Undersecretary, Department of Finance, Philippines])
- » **Chapter 18: Southern African Customs Union (SACU) and Zambia** (Michael Eads, Telita Snyckers, and Ziyaad Butler, Sovereign Border Solutions, South Africa)
- » **Chapter 19: Botswana, Lesotho, and South Africa** (Kirsten van der Zee and Corné van Walbeek, University of Cape Town, South Africa)
- » **Chapter 20: Kenya** (Hana Ross, University of Cape Town, South Africa)
- » **Chapter 21: Senegal** (Mayoro Diop [formerly with National Agency for Statistics and Demography, Senegal] and Aboubakry Gollock, [Cheikh Anta Diop University, Senegal])
- » **Chapter 22: Tobacco Tax Administration: A Perspective from the International Monetary Fund** (Janus Nagy, Fiscal Affairs Department, International Monetary Fund [IMF])

Additional comments and/or peer reviews of specific chapters were provided by the following individuals: Volkan Cetinkaya (World Bank Group), Alberto Gonima (World Bank Group), Prabhat Jha (University of Toronto), Sher Shah Khan (World Bank Group), Blanca Llorente (Fundación Anáas), Janus Nagy (International Monetary Fund), Caxton Ngeywo (Kenya Revenue Authority), Guillermo Paraje (Universidad Adolfo Ibáñez, Chile), Jeremias Paul (World Health Organization), Nicolas Guerrero Peniche (Secretariat of the WHO Framework Convention on Tobacco Control), Robert Preece (Charles Sturt University), Belén Sáenz de Miera Juárez (Universidad Autónoma de Baja California Sur), and Joseph Sirengo (Kenya Revenue Authority).

Zinaida Korableva (World Bank Group) and Akosua Dakwa (World Bank Group) provided administrative support to the preparation of this publication.

Overall technical guidance and oversight were provided by Enis Baris (Program Manager, Health, Nutrition, and Population Global Practice, World Bank Group), and Tim Evans (Senior Director, Health, Nutrition, and Population Global Practice, World Bank Group).

The preparation of this report was carried out under the World Bank Group's Global Tobacco Control Program, supported by the Bill & Melinda Gates Foundation and the Bloomberg Foundation. The support of Kelly Henning (Bloomberg Philanthropies), Jo Birckmayer (Bloomberg Philanthropies), Cynthia Lewis (Bill and Melinda Gates Foundation), and Jean Paullin (Bill and Melinda Gates Foundation) is gratefully acknowledged.

The authors alone are responsible for the views expressed herein and they do not necessarily represent the views, decisions or policies of the institutions with which they are affiliated.

Washington, D.C.
January 18, 2019

EXECUTIVE SUMMARY

Executive Summary

Why is illicit trade in tobacco products a problem?

Tobacco use results in unparalleled health, economic, and social losses worldwide. It is estimated that 1.1 billion people smoke globally, or 21 percent of the world's adult population.¹ Tobacco kills at least half of long-term smokers, accounting for more deaths each year than HIV/AIDS, tuberculosis, and malaria combined. As a result, about 7.2 million people die each year,² and if the current trend continues, tobacco will kill more than 8 million people annually by 2030.³ Low- and middle-income countries, where about 80 percent of these premature deaths occur, disproportionately carry this burden.⁴ The worldwide economic costs of smoking are estimated to reach at least US\$ 1.4 trillion per year, equivalent to 1.8 percent of the world's GDP. Almost 40 percent of these costs occur in developing countries.⁵

Increasing excise tax rates on tobacco to reduce its affordability and, as evidence shows, lower its consumption is a policy measure that can simultaneously save millions of lives, reduce poverty, and increase countries' domestic resources for financing development. Higher tobacco taxes improve public health, increase tobacco tax revenue, and reduce the economic burden associated with tobacco use.⁶ Illicit trade in tobacco products undermines global tobacco prevention and control interventions, particularly with respect to tobacco tax policy.

Illicit trade in tobacco products impacts average prices of these commodities, therefore their affordability; it can increase disparity in tobacco use since the illegal products are disproportionately consumed by low-income populations; it increases the choice of brands, which can increase overall demand; it enhances the access to tobacco products, particularly for youth, as the illegal products are often distributed via unregulated channels; it undermines health warning and ingredients disclosure policies, since the illegal products often do not comply with the local laws; additionally, tax evasion associated with the illegal tobacco market reduces government tax revenue⁷ and can alter attitudes toward paying taxes more generally.⁸

It has been estimated that the illegal cigarette market reduces average cigarette prices by about 4 percent and is responsible for about 2 percent higher cigarette consumption. This translates to about 164,000 premature deaths a year.⁹ There also are concerns about the relationship between illicit tobacco trade, public safety, and governance, since illegal networks both thrive in and contribute to weak governance contexts.

In addition, tobacco business interests often use the presence of illegal tobacco products to advocate for reductions in tobacco control policies and/or to prevent tobacco tax increases. The tobacco industry commonly argues that higher taxes and prices (as well as other tobacco control measures), will motivate customers to buy illegal products rather than smoking less or quitting, and that this will impact tax revenue without a decline in tobacco use. Numerous empirical analyses, across a diversity of countries – including the case studies presented in this report – refute this argument.

What is illicit trade in tobacco products?

Illicit tobacco trade refers to any practice related to distributing, selling, or buying tobacco products that is prohibited by law, including tax evasion (sale of tobacco products without payment of applicable taxes), counterfeiting, disguising the origin of products, and smuggling. Illicit trade can be undertaken both by illicit players who are not registered with relevant government agencies, as well as by legitimate entities whose business operations are contrary to applicable laws and regulations.

In most cases, the prices of illicit tobacco products are lower than the retail price of legal tobacco products, in order to make them more attractive to consumers. For example, the average street price of smuggled cigarettes was 50 percent, 50 percent, 60 percent, and 67 percent cheaper compared to the average price of legal cigarettes in Brazil, Argentina, Uruguay and Paraguay, respectively.¹⁰ In Malaysia, the average price of illegal cigarettes was about 55 percent lower compared to tax-paid cigarettes in 2011.¹¹ Unsurprisingly, the illegal nature of tax evasion makes the task of measuring its scale extremely difficult. Recent consensus among experts estimates the annual revenue loss in tobacco taxation worldwide at US\$40–50 billion, that is, about 600 billion sticks (individual cigarettes), or 10 percent of global consumption¹².

Why is it important to address illicit trade in tobacco products?

As noted above, illicit trade in tobacco products contributes to numerous health, economic, and governance challenges. However, four are most salient.

- » **Illicit tobacco kills.** The fundamental reason to confront illicit trade in tobacco products involves its public health impact. All tobacco products are dangerous to human health,

including those produced and sold in strict legality. However, illicit tobacco harms individual and population health in additional ways. From a public health perspective, illicit trade weakens the effect of tobacco excise taxes on tobacco consumption - and consequently on preventable morbidity and mortality - by increasing the affordability, attractiveness, and/or availability of tobacco products.

- » **Youth and the poor are most impacted.** Illicit cigarettes generally sell for considerably less than their tax-paid equivalents, as evidenced by the case studies presented in this book. They inflict the greatest harm to the most price-sensitive population group, reducing prices to and so encouraging consumption by, in particular, young people and those with low incomes. The availability of inexpensive illicit cigarettes increases the likelihood of young people developing addiction (particularly where illicit imports "glamorize" smoking through aspirational brands). It also encourages the poorest quintiles of the population to continue smoking, rather than choose to quit, even when tobacco taxes and the price of legal cigarettes rise. The poor tend to have higher tobacco consumption levels and consequently are disproportionately impacted by tobacco-related diseases and premature deaths, placing them at higher risk of being pushed into extreme poverty due to costs of treatment and/or loss of income when an income-earning smoker develops a tobacco-related disease. As a result, illicit trade in tobacco products exacerbates equity gaps.
- » **Confronting illicit trade in tobacco products supports improved governance.** Tobacco illicit trade, by definition, reduces revenues that would otherwise be paid to government that could be invested in tobacco control and other priority programs that benefit the population. It also negatively impacts public welfare in other ways. For instance, illicit trade in tobacco is not only inconsistent with the rule of law, but often depends on and can contribute to weakened governance (e.g., through corruption and the presence of organized criminal networks). In contrast, confronting this issue can yield broader benefits for governance - tools and capacities developed to address illicit trade in tobacco products can strengthen overall tax administration, compliance, and enforcement (including for other products subject to excise taxes, such as alcohol and fuel). Controlling illicit trade in tobacco products and enhanced overall governance are mutually reinforcing.
- » **Uncontrolled illicit trade in tobacco provides opportunities for the tobacco industry to misinform public opinion and unduly influence public policy.** As emphasized in this report's country case studies and other recent analyses¹³, the tobacco industry routinely uses inflated estimates of the impact of tobacco taxes on illicit trade to campaign against tobacco tax increases and misinform public opinion. By accurately measuring and better controlling illicit trade in tobacco, governments reduce industry's ability to distort policy priorities supporting improved public health, tax administration, and governance.

What causes illicit trade, and what measures can be used to confront illicit trade in tobacco products?

Contributing factors to illicit trade are complex. However, contrary to tobacco industry arguments, taxes and prices have only a limited impact on the illicit cigarette market share at country level.¹⁴ Evidence indicates that the illicit cigarette market is relatively larger in countries with low taxes and prices while relatively smaller in countries with higher cigarette taxes and prices.¹⁵ Non-price factors such as governance status, weak regulatory framework, social acceptance of illicit trade, and the availability of informal distribution networks appear to be far more important determinants of the size of the illicit tobacco market.¹⁶

Measures controlling the illicit tobacco market are a necessary component of a well-designed tobacco control policy. The degree of government effort to combat illicit trade in tobacco products is motivated both by the potential tax revenue gain and by public health gains due to lower tobacco use. Since illicit trade in tobacco products is determined by multiple factors, an effective strategy to address this issue would need to be explicitly multi-sectoral, involving all relevant agencies of government. Ideally, ministries of finance, trade, industry, foreign affairs, justice, interior, customs, education, and health would be involved, in addition to civil society and the media.¹⁷ Vested interests of key stakeholders and public opinion regarding illicit tobacco trade can influence the degree of tax evasion and, consequently, also need to be examined.¹⁸

Prioritizing and coordinating control of the entire supply chain (from the fields where tobacco leaves are grown, or the port of entry, to the final purchase by the individual consumer) and enforcement of tobacco regulations have proven to be effective measures in reducing tax evasion along with the consumption of tobacco products.¹⁹ Importantly, the WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products defines shared global standards for addressing illicit trade. It should be noted that the approaches to control illicit tobacco trade need to be subject to very regular surveillance, monitoring, and evaluation due to the inherently dynamic and adaptive nature of the illicit market. As emphasized in a recent IMF report on tobacco tax administration and enforcement, even in a single country, solutions that worked once might not work twice.²⁰

What can countries do to successfully confront illicit trade in tobacco products?

Confronting illicit trade in tobacco products is critical to effective tobacco control in all countries. However, addressing this issue poses complex political, legal, and technological challenges. As such, illicit trade is one of the topics on which policymakers and program implementers responsible for national tobacco control most frequently request information and technical collaboration from international organizations.

The country experiences analyzed in this volume make clear that countries can and do contain or reduce illicit trade while advancing other effective tobacco control strategies, including tax increases. Indeed, the opportunities for success are greater now than ever, for countries prepared to take bold action.

In September 2018, the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products entered into force. By providing comprehensive norms and a framework for global cooperation, the Protocol provides countries a game-changing opportunity to advance progress against tobacco-related morbidity and mortality by challenging illicit trade in tobacco. By seizing the opportunity and intensifying action against illicit trade, in line with the Protocol, countries can harness increasing political momentum, forge global and regional partnerships for collaboration and knowledge sharing, and score decisive victories against illicit trade in tobacco in the years ahead.

To fully benefit from the Protocol, policymakers and implementers now seek to connect its normative guidance with empirical data and analysis on countries' illicit trade in tobacco control experiences to date—what has worked, what has not worked, and why. That is where this book comes in.

What this book offers

The reasons to reduce illicit trade in tobacco products are compelling. The question is **how**. In response to demand from senior government officials and other partners, this book provides practical input and guidance based on diverse country experiences. The volume adopts a model of practice-oriented case studies designed to complement the guidelines set forth in the WHO FCTC Protocol, and other normative sources. The aim is to present hands-on facts/guidance that policymakers and implementers can readily utilize, as appropriate. The book also provides resources to inform and empower civil society watchdog and advocacy organizations.

The core contents of this volume are organized as follows. Chapter 1 provides historical, conceptual, and policy foundations of addressing illicit trade in tobacco products and analyzes the WHO FCTC Protocol on the Elimination of Illicit Trade in Tobacco Products, discusses challenges countries will face in implementing the Protocol, and highlights strategies for minimizing tobacco-industry influence over national illicit trade in tobacco products policy.

Part I (Chapters 2-7) looks at illicit trade in tobacco products control efforts in Europe (Ireland, Georgia, European Union, United Kingdom), Australia, and Canada. Part II (Chapters 8-13) presents studies from Latin America and the Caribbean, including Chile, Colombia, Ecuador, Mexico, and the countries of the Organization of Eastern Caribbean States (OECS) and Trinidad and Tobago. Part III (Chapters 14-17) encompasses East Asia and South Asia and includes case studies from Bangladesh, Indonesia, Malaysia, and the Philippines. Part IV (Chapters 18-21) examines at illicit trade in tobacco products in

Sub-Saharan Africa, including studies from Kenya, Senegal, the Southern African Customs Union (SACU) countries and Zambia, in addition to a separate analysis of border zones of Botswana, Lesotho, and South Africa.

Following the detailed exploration of individual country experiences in the case studies, Chapter 22 steps back to propose broadly applicable lessons on strengthening tax administration to confront illicit trade in tobacco products, while reducing tobacco use. Providing a perspective from the International Monetary Fund, the chapter distills lessons from global experience. Based on comparative analysis of all case studies through the lens of the WHO FCTC Protocol, the book's Conclusion identifies key strategic directions that have characterized countries documenting significant advances in the control of illicit trade in tobacco products. Within this broad agenda, the authors highlight action points policymakers and implementers can prioritize to initiate/strengthen/sustain progress in confronting illicit trade in tobacco products.

Strategic steps to reduce illicit trade in tobacco products

How are countries effectively confronting tobacco illicit trade? The following strategic steps emerge from the case studies presented in this book, with respect to lessons from countries that are successfully addressing illicit trade in tobacco products.

- » **Diagnose the different forms of illicit trade in tobacco products:** The cases studies show that illicit trade overwhelmingly involves cigarettes, rather than other tobacco products. Tobacco illicit trade takes a variety of forms, varying in type and severity by country: smuggling across borders; declaring products as for export (and thus not subject to domestic tax) and then selling them on the domestic market; selling undeclared production (e.g. an undisclosed third production shift); producing counterfeits of legitimate brands; producing low-cost unbranded cigarettes destined for illicit markets (so called "illicit whites"); using Free Zones to leak cigarettes to the domestic market; and selling tobacco products via Internet, phone, or mail²¹. Each form of tax evasion has somewhat different implications for needed improvements in tax administration and enforcement.
- » **Understand the causes and drivers of illicit trade in tobacco products:** The case studies confirm findings from the literature that tobacco illicit trade stems from a wide range of causes. These include weaknesses in governance and the regulatory framework, corruption, insufficient capacity of enforcement and judiciary systems, the existence of informal distribution and of organized crime networks, having a border with another country suffering from similar problems; and expected profitability of tobacco illicit trade. The country cases strongly confirm that the most important determinant in illicit trade of tobacco products is tax administration. Countries as different in levels of economic and institutional development as the United Kingdom, Kenya, and Georgia have all

successfully improved the effectiveness of their tobacco tax administration and, by doing so, reduced tobacco illicit trade while increasing tobacco taxes and tobacco tax revenues. Addressing illicit trade and raising tobacco taxes should be viewed as mutually reinforcing and complementary actions.

- » **Strengthen country data, analysis, planning, and implementation processes:** Consistent with Articles 7 and 9 of the Protocol, the UK, Australia, and Ireland case studies visibly demonstrate the importance of reliable data, analysis, planning, and implementation oversight. The process should start with mapping of the supply and demand for tobacco products; what is known about illicit trade in tobacco products; the modus operandi of actors involved in or facilitating illicit trade; the capacity, commitment, and accountability of government agencies; and resultant effectiveness of tax/customs administration. Illicit trade activities, as well as industry activities, require intensive monitoring. In addition, having access to high quality local market data, including smoking prevalence and intensity, is critical. However, not having data regarding the size of the illicit market is *not* an excuse for inaction. The absence of such data has not stopped Kenya, Georgia, or the Philippines, for example, from moving ahead in controlling illicit trade in tobacco products. Country strategies to reduce illicit trade in tobacco products should establish policies, legislation, and regulations appropriate for specific country contexts. It is critical to note that having a strong strategy on paper is important but not sufficient, unless such plans can be operationalized. Additionally, strategies should integrate the strengthening of capacity, incentives, and accountability needed for effective implementation (including enforcement measures).²²
- » **Avoid reliance on the tobacco industry:** The role of the tobacco industry poses a challenge to countries seeking to address illicit trade, since the tobacco industry is often linked to illicit trade in tobacco products, either directly or indirectly.²³ The UK and Ireland case studies emphasize the need to fulfill obligations under Article 5.3 of the FCTC to prevent the tobacco industry from influencing public policy.²⁴ The case studies, including Colombia, Australia, Georgia, and Malaysia, also confirm prior findings that the tobacco industry regularly overstates levels and changes in tobacco illicit trade to oppose tobacco tax reforms. The Georgia and Uruguay case studies show that when the government responds to industry pressure and reduces taxes due to fears regarding tobacco illicit trade, the result is a decline in revenues and an increase in consumption, while the true drivers of illicit trade in tobacco products remain unaddressed.
- » **Build inclusive, political coalitions against illicit trade in tobacco products:** Strong and successfully implemented country strategies require enlisting support and finding champions at top levels of ministries and governments, as demonstrated in Georgia, the Philippines and the UK. Another crucial element of gaining political support is to build alliances with key stakeholders in civil society, including NGOs, think tanks, and the media, as emphasized in the Kenya, UK, Georgia, Columbia, and Bangladesh case studies. Involving the public in addressing illicit trade both supports enforcement and reduces the demand

for illegal products. Issues of political economy also affect enforcement – the Mexico and Kenya case studies highlight the importance of the electoral cycle and the overall national security context on the effectiveness of tax administration and enforcement.

- » **Work across sectoral silos:** The Colombia, Chile and Kenya case studies identified lack of integration across sectors at the national and subnational levels as the major obstacle in controlling illicit trade of tobacco products. These analyses, in conjunction with the Bangladesh, Australia and Mexico case studies, emphasize that success in adopting and implementing strong programs to combat illicit trade and implement tobacco tax reform requires active and coordinated support from numerous ministries/government agencies. Coordination is particularly important in integrating tobacco illicit trade control into strategies for tobacco tax reform and overall tobacco control programs.
- » **Address illicit trade as an integral part of tobacco tax reform and overall tobacco control:** Country cases, including those of the Philippines, the UK and Ireland clearly demonstrate the complementary nature of addressing tobacco illicit trade and implementing tobacco tax reform. Confronting illicit trade in tobacco products should be an integral part of a country's overall approach to tobacco control. The key elements of tobacco tax reform have recently been summarized in the World Bank publication *Tobacco Tax Reform: At the Crossroads of Health and Development*²⁵ and are summarized below:
 - › **Go big, go fast.** Tax strategies should focus on health gains first, then on fiscal benefits. This means going for big tobacco excise tax rate increases starting early in the process.
 - › **Attack affordability.** Tobacco taxes only reduce tobacco consumption if they reduce cigarette affordability.
 - › **Change expectations.** Communication with the public is also critical. Governments must make sure consumers know that cigarette prices will keep going up.
 - › **Tax by quantity.** Tobacco tax rates should be simplified and based on the quantity of cigarettes, not their price.
 - › **"Soft earmarks" can win support.** Although earmarking tax revenues through legislation is criticized by fiscal experts as contributing to rigidities, fragmentation, and eventual distortions in public expenditure, "soft" earmarking of funds (for example, linking increased taxes to increased health spending) has helped generate grassroots support for the tax hikes.
 - › **Regional collaboration can boost results.** Momentum for ambitious tobacco tax reform can be enhanced, and cross-border threats like cigarette smuggling minimized, when countries work together in a regional structure.
 - › **Build broad alliances.** Country leaders face sharp resistance to tax rate increases and other tobacco control measures from the tobacco industry. Countering these pressures requires reliable data and economic analysis, multi-sectoral policy development,

and strong partnerships among key stakeholders at the local, national, and international levels.

- » **Encourage and draw on regional and global cooperation/partnerships:** As recommended in the Protocol (Articles 20 – 31) and the FCTC, countries also should support and draw on regional and sub-regional, as well as global, partnership arrangements when feasible to address illicit trade and to implement tobacco tax reform. This can help, for example, in reducing substantial disparities in tobacco taxes in neighboring countries by pulling countries up to a common higher tax level, as well as in coordinating cross-border/regional efforts to reduce tobacco illicit trade. At the global level, the most effective way a country can benefit from and contribute to promoting international collaboration is to join the FCTC Protocol, discussed below. Ratifying the Protocol has advantages that go beyond knowledge sharing and coordination of enforcement efforts, including access to technical assistance in implementing the Protocol and establishing track and trace systems.
- » **Draw on the Protocol and Guidelines for implementing the FCTC:** Authorities seeking to strengthen tax administration can utilize two important sources of good practice that derive from Section 15 of the FCTC, “Illicit Trade in Tobacco Products.” The first is the WHO’s FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (or the Protocol). As an international treaty, the Protocol also can help generate domestic political support for implementing its measures. The second key source of policy guidance and good practice is constituted by the Guidelines for Implementation of Article 6, on *Price and Tax Measures* of the FCTC (issued in 2014). These guidelines also cover Article 15, on *Illicit Trade in Tobacco Products*. One of its guiding principles is the need for efficient and effective administration of tobacco tax systems, including addressing illicit trade in tobacco products.

Specific actions to confront illicit trade in tobacco products

The discussion above provided broad, strategic directions for enhancing progress in controlling/preventing illicit trade in tobacco products. However, what specific actions can decision makers prioritize to rapidly achieve gains? Findings from the country case studies suggest the following specific actions.

- » *Require licensing for the full tobacco supply chain, as required by Article 6 of the Protocol.* At present there is licensing at least for all manufacturers, importers, exporters, and distributors in almost all country cases. What is needed is for each country to assess its capacity to require licensing the rest of the supply chain, particularly retail. As noted in the Canada case study, the best example of using licensing to control the supply chain is in the province of Quebec, where the entire supply chain is licensed including tobacco

growers, transporters, manufacturers, those who store raw tobacco and/or final products, importers, wholesalers, retailers, as well as those in possession of manufacturing equipment. Tobacco importers are licensed in Malaysia and the Philippines requires suppliers of raw materials to the production process, including those providing tobacco papers and filter components, to be licensed.

- » *Require use of secure excise tax stamps and other product markings to facilitate enforcement and tax collection, as required by Article 8 of Protocol.* These markings should possess multiple layers of security (as implemented in Kenya, Georgia, and the Philippines, for example); they should not be removable; and they should be destroyed when the pack is opened (also to prevent reuse). The absence of secure excise marking in Southern African Customs Union countries, Chile, and Mexico weakens the ability of the tax authorities to collect taxes, as noted in the case studies.
- » *Establish effective track-and-trace systems to follow tobacco products through the supply chain from production or import to sale to consumers (Article 8 of the Protocol).* Secure excise stamps are crucial but not sufficient to prevent tax evasion if there is no downstream verification that cigarettes have tax stamps and that they are authentic. A track-and-trace system would help address, for example, the challenge posed by under-declared domestic cigarette production or production declared for export but then sold on the domestic market. The Mexico, Chile, and Southern African Customs Union case studies identify the absence of a track-and-trace system as the major obstacle to controlling illicit trade in tobacco products. Notably, as detailed in the case studies, Ecuador's tax track-and-trace system for domestically produced cigarettes, alcoholic beverages, and beer was implemented by its Internal Revenue Service in 2017 and is the first track-and-trace to comply with the Protocol to Eliminate Illicit Trade in Tobacco Products.
- » *Establish effective enforcement teams equipped with automated reporting devices, to reduce human discretion in tobacco tax administration (Articles 8 and 19 of the Protocol).* This feature played a major role in improving the level of enforcement in Kenya and Georgia. However, the Kenya case also underlines the importance of enforcement agents with the power to carry out inspections at any time and at any point in the supply chain, to seize illicit products on the spot, and to bring immediate charges against offenders.
- » *Obtain detection equipment and use it effectively at customs posts (Articles 14 and 19 of the Protocol).* Most countries already have access to detection equipment, although not necessarily in adequate quantity. Potential governance challenges, with respect to the use of this equipment, can be further reduced by separating the roles of generating and interpreting scans (as noted in the Kenya case study).
- » *Develop a risk profile to target inspections (Articles 10, 14 and 19 of the Protocol).* The Chile case highlights the use of a risk analysis tool for targeting suspicious cargos and to generate customs alerts.

- » *Set relatively low duty-free allowances (Article 13 of the Protocol and Article 6.2 of the FCTC) for tobacco product purchases, both in terms of amounts (e.g. only two packs, as in Australia) and frequency (e.g. only once every 30 days as in Georgia). Chile shows how the lack of restrictions on frequency led to substantial but legal small-scale tax avoidance.*
- » *Regulate or ban trade in tobacco products in free trade and other special economic zones (Article 12 of the Protocol). The Chile case study illustrates how the relative freedom from regulation in these zones can make them gateways for domestic sale of untaxed tobacco products. In contrast, Colombia and Malaysia both established a strict regulatory framework for free trade zones to prevent this challenge.*
- » *Set and enforce significant financial penalties and penal provisions for illicit trade in tobacco products (Articles 15, 16 and 17 of the Protocol). Seizures, financial penalties, and other punishment severe enough to be a deterrent (unlike some of those reported in the Kenya case study) are important. Criminal prosecutions are particularly important as deterrents, as indicated in both the UK and the Colombia case studies*
- » *Provide for secure and environmentally friendly destruction of seized cigarettes, carried out by the regulatory authorities and not by the tobacco industry (Article 18 of the Protocol). In Mexico, customs officials destroy seized cigarettes, while in the Philippines approval and presence of a Bureau of Internal Revenue representative is required. In contrast to this guidance, in South Africa an industry-representative body is responsible for the destruction of illicit goods.*
- » *Educate the public on the impact of tobacco illicit trade. Getting the public involved supports enforcement and reduces the demand for illegal products. As noted in the case studies, the Philippines and Kenya introduced apps for the public to verify the authenticity of cigarette packs, while the UK ran a public awareness campaign explaining how purchasing illegal cigarettes harms the country and local communities.*

Complementing and supporting the WHO Framework Convention on Tobacco Control's Protocol to Eliminate Illicit Trade in Tobacco Products, the case studies presented in this book detail the manner in which a diverse range of countries have successfully confronted illicit trade in tobacco products. Significantly, these case studies demonstrate the importance - and feasibility - of addressing illicit trade in tobacco products as an integral part of tobacco tax reform and comprehensive tobacco control.

Endnotes

- ¹ Report on the Global Tobacco Epidemic, World Health Organization, 2015
- ² GBD 2015 Risk Factors Collaborators. Global, regional, and national comparative risk assessment of 79 behavioural, environmental and occupational, and metabolic risks or clusters of risks, 1990–2015: a systematic analysis for the Global Burden of Disease Study 2015. *Lancet*, 2016; 388(10053):1659-1724
- ³ Expanding the Global Tax Base: “Taxing To Promote Public Goods: Tobacco Taxes”. Summary Report. World Bank Group, Washington, D.C. May 24, 2016
- ⁴ Expanding the Global Tax Base: “Taxing To Promote Public Goods: Tobacco Taxes”. Summary Report. World Bank Group, Washington, D.C. May 24, 2016
- ⁵ Goodchild, Nargis, and Tursan d’Espaignet. Global economic cost of smoking-attributable diseases. *Tobacco control*. 2017
- ⁶ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>.
- ⁷ Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade — Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015
- ⁸ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.
- ⁹ Joossens L, Merriman D, Ross H, Raw M. How eliminating the global illicit cigarette trade would increase tax revenue and save lives. Paris: International Union Against Tuberculosis and Lung Disease, 2009. Available at <http://tobaccocontrol.bmj.com/content/early/2013/01/14/tobaccocontrol-2012-050788>.
- ¹⁰ Alejandro Ramos. Illegal trade in tobacco in MERCOSUR countries. Working Paper, June 2009.
- ¹¹ Alex C. Liber, Hana Ross, Maizurah Omar, Frank J. Chaloupka. The Impact of the Malaysian Minimum Cigarette Price Law: Findings from the ITC Malaysia Survey. *Tobacco Control* 2015; 24:iii83–iii87. doi:10.1136/tobaccocontrol-2014-052028
- ¹² Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.
- ¹³ Gallagher AWA, Evans-Reeves KA, Hatchard JL, et al. Tobacco industry data on illicit tobacco trade: a systematic review of existing assessments. *Tobacco Control* Published Online First: 22 August 2018. doi: 10.1136/tobaccocontrol-2018-054295
- ¹⁴ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.
- ¹⁵ National Research Council and Institute of Medicine. Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences. Washington DC: The National Academies Press. 2015.

¹⁶ Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. Preventing and Reducing Illicit Tobacco Trade in the United States. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>

¹⁷ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>

¹⁸ Hana Ross. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

¹⁹ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>

²⁰ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

²¹ *Addressed by Article 11 of the Illicit Trade Protocol.*

²² On the importance of incentives and accountability as well as capacity in improving institutional effectiveness, see World Development Report 2017, Governance and the Law, World Bank, 2017(b).

²³ Gilmore AB, Gallagher AWA, Rowell A. Tobacco industry's elaborate attempts to control a global track and trace system and fundamentally undermine the Illicit Trade Protocol. Tobacco Control. 2018

²⁴ Framework Convention on Tobacco Control, WHO, 2003

²⁵ *Tobacco Tax Reform: At the Crossroads of Health and Development*, World Bank 2017

INTRODUCTION

Introduction

Why is Illicit Trade in Tobacco Products a Problem?

Tobacco use results in unparalleled health, economic, and social losses worldwide. It is estimated that 1.1 billion people smoke globally, or 21 percent of the world's adult population.¹ Tobacco kills at least half of long-term smokers, accounting for more deaths each year than HIV/AIDS, tuberculosis, and malaria combined. As a result, about 7.2 million people die each year,² and if the current trend continues, tobacco will kill more than 8 million people annually by 2030.³ Low- and middle-income countries, where about 80 percent of these premature deaths occur, disproportionately carry this burden.⁴ Tobacco-related deaths are not only tragic because they are preventable - they also impose substantive burdens on national economies, and in most cases on economies that can least afford it. The worldwide economic costs of smoking are estimated to reach at least US\$ 1.4 trillion per year, equivalent to 1.8 percent of the world's GDP. Almost 40 percent of these costs occur in developing countries.⁵

Increasing excise tax rates on tobacco to reduce its affordability and, as evidence shows, lower its consumption is a policy measure that can simultaneously save millions of lives, reduce poverty, and increase countries' domestic resources for financing development. A recent World Bank Group publication, *Tobacco Tax Reform: At the Crossroads of Health and Development*, details how this powerful human development and poverty reduction measure remains largely underutilized, especially in low- and middle-income countries (LMICs). As that report highlighted, higher tobacco taxes improve public health, increase tobacco tax revenue, and reduce the economic burden associated with tobacco use.⁶ Importantly, this publication also emphasizes the continuing extraordinary divergence between high-income countries, which are increasingly using price and non-price tools to

lower their death rates from tobacco, and LMICs, where the number of tobacco deaths continues to grow.

Illicit trade in tobacco products undermines global tobacco prevention and control interventions, particularly with respect to tobacco tax policy. It impacts average prices of these commodities, therefore their affordability; it can increase disparity in tobacco use since the illegal products are disproportionately consumed by low-income populations; it increases the choice of brands, which can increase overall demand; it enhances access to tobacco products, particularly for youth, as the illegal products are often distributed via unregulated channels; it undermines health warning and ingredients disclosure policies, since the illegal products often do not comply with the local laws; additionally, tax evasion associated with the illegal tobacco market reduces government tax revenue⁷ and can alter attitudes toward paying taxes more generally.⁸ Moreover, tobacco industry documents provide compelling evidence that the supply of international brands via illegal channels has been an important component of their market entry strategy in Africa, Latin America and in Asian countries.⁹

It has been estimated that the illegal cigarette market reduces average cigarette prices by about 4 percent and is responsible for about 2 percent higher cigarette consumption. This translates to about 164,000 premature deaths a year.¹⁰ There also are concerns about the relationship between illicit tobacco trade, public safety, and governance, since illegal networks both thrive in and contribute to weak governance contexts. In addition, tobacco business interests often use the presence of illegal tobacco products to advocate for reductions in tobacco control policies and/or to prevent tobacco tax increases. The tobacco industry commonly argues that higher taxes and prices (as well as other tobacco control measures), will motivate customers to buy illegal products rather than smoking less or quitting, and that this will impact tax revenue without a decline in tobacco use. Numerous empirical analyses, across a diversity of countries – including the case studies presented in this report – refute this argument.

What is Illicit Trade in Tobacco Products?

There is a substantial literature on issues relating to illicit trade in tobacco products. As a result, this introductory chapter merely drawing on them, outlines key issues/challenges, followed by providing an overview of this report's content. Illicit tobacco trade refers to any practice related to the tobacco supply chain, including distributing, selling, or buying tobacco products that is prohibited by law, including tax evasion. Illegal methods of circumventing tobacco taxes are called tax evasion, as they intend to avoid paying all or some tobacco taxes, and include, for example:^{11,12}

- » Smuggling tobacco products across borders;
- » Illegal tobacco product manufacturing by legal operators;
- » Producing counterfeit ^a, illicit white cigarettes ^b or unbranded tobacco ^c;

- » Distributing and selling any illegal products to the market;
- » Disguising the origin of products to avoid taxes;
- » Selling tobacco products via Internet, phone or mail without paying the appropriate taxes.

Illicit trade can be undertaken both by illicit players who are not registered with relevant government agencies, as well as by legitimate entities whose business operations are contrary to applicable laws and regulations. Dealing in illicit tobacco products can involve small- or large-scale operations. Small-scale operations usually involve moving more than the allowable tax-exempt volume of products across the border more than the allowable limits and/or when products purchased “for personal consumption” in one country are sold for profit in another country, without paying appropriate taxes (i.e., bootlegging).

Large-scale tax evasion generally focuses on avoiding all taxes and involves disguising/hiding products and organized criminal networks. Counterfeits, genuine products with counterfeit tax stamps, illicit “white” cigarettes, undeclared local production, and unaccounted for unbranded tobacco have all been identified as part of large-scale tax evasion schemes. Notably, not all products that have not paid taxes are illegal. Tax avoidance consists of legal activities and purchases in accordance with customs and tax regulations, but in a manner that uses loopholes or other legal means to reduce or eliminates taxes. Tax avoidance is often conducted by individual tobacco users, for example, frequent border crossings to bring in the maximum duty-free tobacco allowance. Tobacco companies can avoid taxes on a much larger scale by, for example, buying tax stamps or sharply building up inventories before scheduled tax increases tax occur.

In most cases, the prices of illicit tobacco products are lower than the retail price of legal tobacco products, in order to make them more attractive to consumers. For example, the average street price of smuggled cigarettes was 50 percent, 50 percent, 60 percent, and 67 percent cheaper compared to the average price of legal cigarettes in Brazil, Argentina, Uruguay and Paraguay, respectively.¹³ In Malaysia, the average price of illegal cigarettes was about 55 percent lower compared to tax-paid cigarettes in 2011.¹⁴

Unsurprisingly, the illegal nature of tax evasion makes the task of measuring its scale extremely difficult. Recent consensus among experts estimates the annual revenue loss in tobacco taxation worldwide at US\$40–50 billion, that is, about 600 billion sticks (individual cigarettes), or 10 percent of global consumption¹⁵.

^a Counterfeit cigarettes are cigarettes manufactured without authorization of the rightful owners of the trademarked brand, with intent to deceive consumers and to avoid paying duty

^b Illicit white cigarettes are brands manufactured legitimately in one country but smuggled and sold in another without duties being paid.

^c Unbranded tobacco is often sold as finely cut loose leaf tobacco. It may involve misrepresentation of the quality and origin, or failure to obtain a license to grow and produce tobacco, and/or failure to register as an importer/exporter.

Why Addressing Illicit Trade in Tobacco Products Matters

As noted above, illicit trade in tobacco products contributes to numerous health, economic, and governance challenges. However, four are most salient.

- » **Illicit tobacco kills.** The fundamental reason to confront illicit trade in tobacco products involves its public health impact. All tobacco products are dangerous to human health, including those produced and sold in strict legality. However, illicit tobacco harms individual and population health in additional ways. From a public health perspective, illicit trade weakens the effect of tobacco excise taxes on tobacco consumption - and consequently on preventable morbidity and mortality - by increasing the affordability, attractiveness, and/or availability of tobacco products.
- » **Youth and the poor are most impacted.** Illicit cigarettes generally sell for considerably less than their tax-paid equivalents, as evidenced by the case studies presented in this book. They inflict the greatest harm to the most price-sensitive population group, reducing prices to and so encouraging consumption by, in particular, young people and those with low incomes. The availability of inexpensive illicit cigarettes increases the likelihood of young people developing addiction (particularly where illicit imports "glamorize" smoking through aspirational brands). It also encourages the poorest quintiles of the population to continue smoking, rather than choose to quit, even when tobacco taxes and the price of legal cigarettes rise. The poor tend to have higher tobacco consumption levels and consequently are disproportionately impacted by tobacco-related diseases and premature deaths, placing them at higher risk of being pushed into extreme poverty due to costs of treatment and/or loss of income when an income-earning smoker develops a tobacco-related disease. As a result, illicit trade in tobacco products exacerbates equity gaps.
- » **Confronting illicit trade in tobacco products supports improved governance.** Tobacco illicit trade, by definition, reduces revenues that would otherwise be paid to government that could be invested in tobacco control and other priority programs that benefit the population. It also negatively impacts public welfare in other ways. For instance, illicit trade in tobacco is not only inconsistent with the rule of law, but often depends on and can contribute to weakened governance (e.g., through corruption and the presence of organized criminal networks). In contrast, confronting this issue can yield broader benefits for governance - tools and capacities developed to address illicit trade in tobacco products can strengthen overall tax administration, compliance, and enforcement (including for other products subject to excise taxes, such as alcohol and fuel). Controlling illicit trade in tobacco products and enhanced overall governance are mutually reinforcing.
- » **Uncontrolled illicit trade in tobacco provides opportunities for the tobacco industry to misinform public opinion and unduly influence public policy.** As emphasized in this report's country case studies and other recent analyses¹⁶, the tobacco industry routinely

uses inflated estimates of the impact of tobacco taxes on illicit trade to campaign against tobacco tax increases and misinform public opinion. By accurately measuring and better controlling illicit trade in tobacco, governments reduce industry's ability to distort policy priorities supporting improved public health, tax administration, and governance. For example, as emphasized in the Colombia chapter, an initial study to quantify the true volume of illicit cigarette trade in the country (notably, the first of its kind not to be sponsored by tobacco companies) was essential to galvanizing support for increased tobacco taxation.

What Causes Illicit Trade?

Contributing factors to illicit trade are complex. However, contrary to tobacco industry arguments, taxes and prices have only a limited impact on the illicit cigarette market share at country level.¹⁷ Evidence indicates that the illicit cigarette market is relatively larger in countries with low taxes and prices while relatively smaller in countries with higher cigarette taxes and prices.¹⁸ Non-price factors such as governance status, weak regulatory framework, social acceptance of illicit trade, and the availability of informal distribution networks appear to be far more important determinants of the size of the illicit tobacco market.¹⁹

Numerous studies confirm that higher taxes lead to higher prices of legal tobacco products, and there is some evidence that the prices of illegal tobacco products also increase in response to higher taxes. Research suggests that a cigarette tax increase can lead to more small-scale tax avoidance and tax evasion.^{20,21} However, since the supply of illegal products via these channels is relatively small, the overall impact on the size of the illicit cigarette market remains minimal.^{22,23} Additionally, higher cigarette taxes lead to overall lower cigarette demand even when illicit products are available.²⁴ As a result, any new tax avoidance/evasion activities do not eliminate the effectiveness of tobacco tax increases in reducing tobacco use and raising revenues.²⁵ For example, South Africa raised excise taxes from 38 percent to 50 percent of the retail price in the 1990s and reported a relatively small response of the illicit cigarette market, but a two-fold increase in excise tax revenue ((this was despite a drop in legitimate sales of 20 percent and resultant health benefits).²⁶ Similarly, the illicit market share in Turkey remained stable at 12 percent five months after a substantial tax increase in January 2013.²⁷

The decision to supply a market with illegal cigarettes seems largely determined by costs associated with overcoming legal and regulatory hurdles, as well as delivery costs. These costs are related to the probability of detection, the certainty of sanction, the size of penalties, the presence of smuggling routes and black markets, and licensing requirements for distributors.²⁸ Delivery costs seem to play a large role as a factor influencing the supply of illegal products, since illicit trade in tobacco frequently is viewed as a low risk operation.²⁹ Large-scale tax evasion, which is responsible for most products on illegal cigarette markets, yields higher profits and is heavily influenced by inadequate governance, existence of criminal networks, and weak tax administration.^{30,31} Small-scale smuggling (bootlegging) generally

involves lower profit and is more responsive to the relative price differences between adjacent jurisdictions, the distance to travel, and the opportunity costs of time (such as foregone income).

Measures to Address the Illicit Trade in Tobacco Products - What Do Countries Do and What Seems to be Effective?

Measures controlling the illicit tobacco market are a necessary component of a well-designed tobacco control policy. The degree of government effort to combat illicit trade in tobacco products is motivated both by the potential tax revenue gain and by public health gains due to lower tobacco use. The revenue gain is positively related to both the size of the problem and the tax level, while the public health gains depend on overall smoking prevalence. This implies that a tax increase should intensify the motivation for addressing tax evasion, while also generating the necessary funds to invest into enforcement of measures controlling the illicit tobacco market.

Since illicit trade in tobacco products is determined by multiple factors, an effective strategy to address this issue would need to be explicitly multi-sectoral, involving all relevant agencies of government. Ideally, ministries of finance, trade, industry, foreign affairs, justice, interior, customs, education, and health would be involved, in addition to civil society and the media.³² The design of an effective system must start with a detailed analysis of all aspects of illicit tobacco products supply and demand, as well as related governance strengths and weaknesses. This analysis (i) should determine any loopholes in existing tax administration, including the degree of legal tax avoidance; (ii) should analyze gaps in law enforcement, provide an overview of anticorruption efforts, assess the certainty, swiftness and severity of punishment if convicted, assess the advantages and disadvantages of using administrative rather than criminal sanctions; and (iii) evaluate the level of coordination and collaboration among different authorities and within the government. Vested interests of key stakeholders and public opinion regarding illicit tobacco trade can influence the degree of tax evasion and, consequently, also need to be examined.³³

Prioritizing and coordinating control of the entire supply chain (from the fields where tobacco leaves are grown, or the port of entry, to the final purchase by the individual consumer) and enforcement of tobacco regulations have proven to be effective measures in reducing tax evasion along with the consumption of tobacco products.³⁴ Importantly, the WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products defines shared global standards for addressing illicit trade (detailed in Chapter 2). **Table 1** (Annex) summarizes common measures aiming to control the supply of illicit tobacco products, including track-and-trace systems that have been identified by the Protocol as a central approach.

As noted above, enforcement is a vital component of any system aimed at prevention and reduction of illicit trade in tobacco products. **Table 2** (Annex) summarizes common features of effective enforcement strategies. In this regard, it is significant to note that tobacco excise taxes usually perform better in terms of compliance, compared to other taxes (e.g., revenue losses due to corporate or individual income tax evasion in many countries are much larger in both absolute and relative terms).^{35,36}

The nature of the illicit trade in tobacco products requires international and cross-border collaboration and coordination. **Table 3** (Annex) lists features of international collaboration aimed at prevention and reduction of illicit trade in tobacco products. Importantly, the approaches outlined in these three tables are not intended as stand-alone interventions for preventing or reducing illicit trade. As with other tobacco control strategies, these measures are most effective when implemented as part of a comprehensive approach to controlling illicit tobacco trade.

It should be noted that the approaches to control illicit tobacco trade need to be subject to very regular surveillance, monitoring, and evaluation due to the inherently dynamic and adaptive nature of the illicit market. As emphasized in a recent IMF report on tobacco tax administration and enforcement, even in a single country, solutions that worked once might not work twice.³⁷

Confronting Illicit Trade in Tobacco: A Tough Fight—That Countries Can Win

Confronting illicit trade in tobacco is critical to effective tobacco control in all countries. However, addressing this issue poses complex political, legal, and technological challenges. As such, illicit trade is one of the topics on which policymakers and program implementers responsible for national tobacco control most frequently request information and technical collaboration from international organizations.

Policymakers may have been told, in particular by representatives of the tobacco industry, that high levels of illicit trade inevitably accompany the implementation of aggressive tobacco control measures, in particular tobacco excise tax increases. This is false. The country experiences analyzed in this volume make clear that countries can and do contain or reduce illicit trade while advancing other effective tobacco control strategies, including tax increases. Indeed, as noted below, the opportunities for success are greater now than ever, for countries prepared to take bold action.

In September 2018, the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products entered into force. By providing comprehensive norms and a framework for global cooperation, the Protocol provides countries a game-changing opportunity to advance progress against tobacco-related morbidity and mortality by challenging illicit trade in tobacco. By seizing the opportunity and intensifying action against illicit trade, in line with the Protocol,

countries can harness increasing political momentum, forge global and regional partnerships for collaboration and knowledge sharing, and score decisive victories against illicit trade in tobacco in the years ahead.

To fully benefit from the Protocol, policymakers and implementers now seek to connect its normative guidance with empirical data and analysis on countries' illicit trade in tobacco control experiences to date—what has worked, what has not worked, and why. That is where this book comes in.

What This Book Offers

In response to numerous country requests, this report marshals evidence from national and regional experiences to inform anti-illicit trade strategies for tobacco products. The book presents country and regional case studies, covering over 30 countries, that detail countries' illicit trade context, legal and policy frameworks, enforcement strategies (and technologies used to address illicit trade), results obtained, and recommendations regarding further strengthening tobacco illicit trade control. Taken together, these studies show:

- » Why illicit trade in tobacco matters to policymakers in all countries
- » What constraints policy makers and implementers face in addressing illicit trade in tobacco products
- » What works to control illicit trade in tobacco products across a diverse selection of countries
- » What prioritized steps countries can take to initiate/sustain/strengthen action against illicit trade in tobacco products.

The book presents information, analysis, and options for national policymakers (and their technical advisers) in the multiple sectors that must work together against illicit trade in tobacco, including health, finance, trade and customs, and law enforcement. The book also provides resources to inform and empower civil society watchdog and advocacy organizations. As the included case studies confirm, civil society's role in monitoring and combating illicit trade in tobacco products is crucial.

Illicit Trade in Tobacco Products Case Studies: Knowledge for Action

As noted above, the reasons to confront illicit trade in tobacco products are compelling. The question is **how**. In response to demand from senior government officials and other partners, this book provides practical input and guidance based on diverse country experiences. The volume adopts a model of practice-oriented case studies designed to complement the guidelines set forth in the WHO FCTC Protocol, and other normative

sources. The aim is to present hands-on facts and good practice guidance that policymakers and implementers can readily utilize, as appropriate.

All included case studies are authored by experts with frontline knowledge of illicit trade in tobacco products control in the respective countries and/or global sub-regions - in some cases, government officials who have themselves been engaged in designing and implementing illicit trade in tobacco products programs, in other instances independent experts with deep understanding of the country or region and its tobacco illicit trade challenges. The case studies adopt varied formats, although each presents data on the following topics: (i) the jurisdiction's political, economic, and epidemiological context; (ii) specific forms of illicit trade in tobacco products; (iii) legal, policy, and institutional measures and reforms introduced to address illicit trade in tobacco products; (iv) enforcement strategies and technological solutions; (v) results; and (vi) lessons learned. Each case study offers concluding recommendations for further strengthening tobacco illicit trade control efforts.

Efforts to confront illicit trade in tobacco products are closely entwined with national and regional tobacco taxation policies, not least because of the tobacco industry's consistent instrumentalization of illicit trade in tobacco products to discourage tax increases. To maintain a clear focus, the case studies in this volume discuss tobacco taxation policies only to the extent required to understand countries' illicit trade in tobacco products challenges, responses, and results.

Structure of This Volume

The core contents of this volume are organized as follows. **Chapter 1** provides historical, conceptual, and policy foundations of addressing illicit trade in tobacco products. Authored by the Head of the Secretariat of the WHO Framework Convention on Tobacco Control (FCTC), the chapter analyzes the WHO FCTC Protocol on the Elimination of Illicit Trade in Tobacco Products, discusses challenges countries will face in implementing the Protocol, and highlights strategies for minimizing tobacco-industry influence over national illicit trade in tobacco products policy.

Part I (Chapters 2-7) looks at illicit trade in tobacco products control efforts in **Europe, Australia, and Canada**. **Australia** broke ground in illicit trade in tobacco products control with its Black Economy Task Force, whose 2017 report analyzed the economic and security threats posed by illicit trade in tobacco products; confirmed the role of organized crime in illicit tobacco; and outlined an agenda to reinforce Australia's detection capabilities and applicable penalties. The **Canada** case study addresses the complex political dynamics of illicit trade in tobacco products in that country, with distinct control models in different provinces; recurrent tobacco-industry instrumentalization of illicit trade in tobacco products to resist tobacco tax hikes; and the challenge of addressing illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. The **European Union**

study details political and technical aspects of the EU's effort to curtail illicit trade in tobacco products through regional legislative and security collaboration, while supporting Member States to adopt EU-defined minimum tobacco tax rates. **Georgia** has brought its illicit tobacco market under greater control, largely due to a far-reaching reform of the country's Revenue and Customs services. The case study documents how, in a relatively short timeframe, Georgia reduced corruption, set up effective tax administration and enforcement, and instituted more robust border controls. Today, ongoing challenges for Georgia include countering tobacco-firm tax avoidance strategies such as "forestalling": i.e., ordering a larger-than-needed quantity of tax stamps just before a tax increase. **Ireland** reduced its illicit trade in tobacco products prevalence over the decade 2007-17 thanks to an aggressive enforcement program including dissuasive fines and custodial sentences for some convicted traffickers, among other features. The country's average fine for illicit trade in tobacco products-related offenses rose from around €600 in 2010 to more than €2500 in 2017. In the first ten years of its illicit tobacco strategy, the **United Kingdom** cut the illicit market share for cigarettes from 22 to 12 percent, even as authorities pursued tobacco tax hikes that have helped substantially reduce smoking rates. Recent threats of a rebound in illicit trade in tobacco products levels in the United Kingdom underscore, meanwhile, that even high-performing national programs can falter, if governments fail to maintain the needed anti-illicit trade in tobacco products investments.

Part II (Chapters 8-13) presents studies from **Latin America and the Caribbean**. **Chile's** average per capita consumption of tobacco products is among the highest in the world. The country lacks a comprehensive illicit trade in tobacco products control strategy but is moving forward with the implementation of a national track-and-trace system. The case study identifies priority actions to strengthen Chile's anti-illicit trade in tobacco products efforts, including: signing and ratifying the Protocol; reducing the political influence of the tobacco industry; producing independent information on the illicit cigarette trade; and applying harsher sanctions to those convicted of involvement in illicit trade in tobacco products. **Colombia** successfully contained illicit trade growth following a major tobacco tax hike in late 2016. However, wide variations in illicit trade in tobacco products prevalence across subnational regions call for more effective collaboration between national and local governments, while plans for a unified national tobacco-product tracking and tracing system remain on hold—a key pending opportunity to strengthen illicit trade in tobacco products control capacities. In 2017, **Mexico** adopted a fiscal mark for cigarettes incorporating unique identifier codes. The approach could signal a qualitative leap in Mexico's ability to control illicit trade in tobacco products. However, the absence of a public bidding process for the development of the technology used to generate codes has raised concerns about the system's vulnerability to manipulation, underlining that rigorous transparency is essential in all illicit trade in tobacco products lawmaking and enforcement processes. The illicit trade in tobacco products response in the countries of the **Organization of Eastern Caribbean States** (OECS) and **Trinidad and Tobago** remain in early stages. However, health officials

and experts in these countries are actively examining options for regional cooperation in tobacco tax policy and illicit trade in tobacco products control. Notably, **Ecuador's** tax track-and-trace system for domestically produced cigarettes, alcoholic beverages, and beer, was implemented by its Internal Revenue Service in 2017. As the first track-and-trace system to comply with the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, Ecuador system has become a benchmark for other countries. After ratifying the WHO Framework Convention on Tobacco Control in September 2004, **Uruguay** has put in place a strong national tobacco control policy implementing a comprehensive set of measures and is increasing focusing on addressing illicit trade in tobacco products.

Part III (Chapters 14-17) encompasses **East Asia** and **South Asia**. Tobacco epidemics and illicit trade in tobacco products challenges vary widely across this vast region, with some Asian countries reporting adult male smoking rates that are among the highest in the world. This context makes confronting illicit trade in tobacco products control all the more vital, particularly given the correlation between inexpensive illicit cigarettes and smoking prevalence among youth. In **Bangladesh**, authorities have successfully engaged civil society and youth in anti-illicit trade in tobacco products efforts and have used administrative innovations such as Mobile Courts to strengthen local enforcement and shorten lag times between illicit trade in tobacco products-related charges, judicial decisions, and the imposition of sanctions. **Indonesia**, with male smoking prevalence above 60 percent, has moved to tighten enforcement against illicit trade, including by raising the weight of anti-illicit trade in tobacco products activities in work contracts and performance evaluations for Customs and Excise personnel. The number of enforcement operations in Indonesia aimed at illegal cigarettes rose from 996 in 2014 to 3,950 in 2017. The estimated share of domestic illicit trade in tobacco products in the total cigarette market shrank from 12.1 percent in 2016 to 7.0 percent in 2018. The main smuggling modality in **Malaysia** is under-declaring or mis-declaring the quantity or value of transported cigarettes. Key illicit trade in tobacco products enforcement activities include inspecting goods entering Free Trade Zones. Special operations, road blocks, and regular land and sea patrols are carried out at strategic locations. Using pre-defined risk rules, inspectors target high-risk consignments. The **Philippines** moved to strengthen illicit trade in tobacco products control in line with the country's 2012 "sin tax" excise hikes on tobacco products and alcohol. Enforcement tools include revenue stamps, licensing, monitoring and surveillance of taxpayers and importers, x-ray machines, audits, and the imposition of stiff penalties for violators. Both the Philippines and Malaysia cases stress the importance of reinforced regional collaboration to take promising illicit trade in tobacco products control results to the next level.

Part IV (Chapters 18-21) looks at illicit trade in tobacco products in **Sub-Saharan Africa**. **Kenya** has invested substantially in illicit trade in tobacco products control and reaped impressive rewards. The country's new excisable goods management system for tobacco and alcohol products was introduced in 2013-14 and has proven both more effective and less expensive than the previous system. This case study emphasizes that the improvement

in Kenya's tobacco tax system and enforcement has not been an exclusively technical endeavor. It involved consensus building, the participation of multiple stakeholders, and comprehensive approaches to address tax evasion, recognizing that piecemeal measures have only short-term effects. A review of policies and enforcement capacities in the **Southern African Customs Union (SACU) countries and Zambia** identifies strengths of current control efforts, along with areas for improvement. High-quality tax stamps and track-and-trace systems are currently lacking across the sub-region, for example. The **Senegal** study shows that regional tobacco tax accords can be a double-edged weapon. The West African Economic and Monetary Union (WAEMU) has set a regional maximum tobacco tax rate, constraining Member States' options to attack cigarette affordability. In contrast, the Economic Community of West African States (ECOWAS), has recently changed its "maximum" tax rule to a "minimum" one, so that, like the EU, it does not restrain countries from going higher. This section also includes an original field study comparing cigarette and alcohol prices and stakeholder attitudes in border zones of **Botswana, Lesotho, and South Africa**. Among other findings, the research brings evidence that Botswana's introduction of substantial levies on tobacco and alcohol has not led to major increases in cross-border smuggling. These empirical findings support the argument that higher taxes alone are not decisive in fueling illicit trade.

Following the detailed exploration of individual country experiences in the case studies, **Chapter 22** steps back to propose broadly applicable lessons on strengthening tax administration to confront illicit trade in tobacco products, while reducing tobacco use. Providing a perspective from the **International Monetary Fund**, the chapter distills lessons from global experience, emphasizing that illicit trade is a context-specific activity (consequently, administrative and control measures need to reflect these realities), and that regional and international coordination can substantially improve the efficiency of national efforts.

Based on comparative analysis of all case studies through the lens of the WHO Framework Convention on Tobacco Control and its Protocol to Eliminate Illicit Trade in Tobacco Products, in addition to the International Monetary Fund perspective in supporting country efforts to control tobacco illicit trade (Chapter 22 of this volume) and the recent World Bank publication *Tobacco Tax Reform: At the Crossroads of Health and Development*, the book's **Conclusion** identifies key strategic directions that have characterized countries documenting significant advances in the control of illicit trade in tobacco products. Within this broad agenda, emphasis is placed on crucial strategic steps and specific actions policymakers and implementers can prioritize to initiate/strengthen/sustain progress in confronting illicit trade in tobacco products.

In sum, the case studies presented in this work demonstrate the importance, and feasibility, of addressing illicit trade in tobacco products as an integral part of tobacco tax reform and comprehensive tobacco control.

Annex

Table 1: Measures to Control the Supply of Illicit Tobacco Products

APPROACH	DEFINITION
Licensing	Official authorization for engaging in any activity within the tobacco supply chain, from tobacco growing to product manufacturing to product transportation, wholesale, retail, and the import/export of tobacco products. It motivates the licensees to follow legal business practices under the threat of losing the license. Linking licensing systems with product markings/stamps, recordkeeping, and a tracking and tracing system makes it more effective. Licensing producers and distributors of acetate tow, cigarette papers, and manufacturing equipment needed to produce tobacco products could control illegal manufacturing.
Product markings/stamps	Counterfeit-resistant, affixed images on product packaging that indicate at least date and location of manufacture, manufacturing facility, and product description. They should have both overt and covert security features. Markings/stamps serve up to three functions for any party in the supply system and the final buyer: a product authentication tool, a tracking/tracing tool, and a revenue collection tool. They are particularly helpful in identifying products on which taxes have been paid. They are usually applied to both domestic and imported products, but also to export if appropriate.
Track-and-trace	Systems combining markers with a national record-keeping structure to enable tracking of tobacco products throughout the supply chain, authentication, and tracing the movement of products by consulting the tracking data kept in a national information-sharing database. The system involves systematic, real-time accounting of all products, random serialization, aggregation, and monitoring of the products' movement through the supply chain. It aids crime-prevention and facilitates investigations by identifying where the originally legal products were diverted into illicit channels. The system is less effective controlling illegal manufacturing facilities or counterfeits, even though it increases the distribution costs of such products and aids their detection in the retail environment.
Bond deposit for export	Requiring export companies to deposit bonds of the same value as the excise tax on the exported products in order to create an incentive to ensure legal distribution of their products by reducing the motivation for illegal re-import of exported products, for example. The bond is released once the proof of goods' arrival at the intended destination is provided.
Controlling internet, mail and phone order sales	Requiring major credit card companies and PayPal to stop processing internet purchases of cigarettes. Collaborate with shipping companies so that they refuse to ship tobacco products.
Eliminating loopholes/ exemptions in the tax law	Sales occurring via virtual channels (e.g. internet, mail, phone) needs to be subject to the appropriate taxes. Eliminating exemptions from tax payments or managing exemptions in a way that prevents their misuse by those involved in illicit tobacco trade. These include, for example, policies addressing sales in territories exempt from taxes and in duty-free shops.
Control of special economic zones	Implementation of effective controls on manufacturing and transactions related to tobacco and tobacco products in special economic zones (SEZs) or free trade zones (FTZs), including tracking and tracing, and the prohibition of the intermingling of tobacco products with non-tobacco products in a single container.

Table 1: Measures to Control the Supply of Illicit Tobacco Products, Cont.

APPROACH	DEFINITION
Due diligence	Requiring parties engaged in the supply chain of tobacco, tobacco products, and manufacturing equipment to exercise due diligence in conducting business including proper identification of customers, monitoring sales to these customers, and reporting any suspicious activities that could result in law violation.
Record keeping	Requiring all parties engaged in the supply chain of tobacco, tobacco products, and manufacturing equipment to maintain complete and accurate records of all relevant transactions such as acquiring materials used in production, intended markets of retail sale and their volumes, the intended shipping routes, volumes kept in stock, under the transit regime or in duty suspension regime.
Supportive legal environment	Adopt legislation that clearly defines unlawful conduct related to the supply of tobacco products, determines what constitutes administrative, civil and criminal offences, and establishes liabilities for such conduct.
Public awareness	Dissemination of information about consequences of engaging in illicit tobacco trade. Educating the public about how to distinguish legal from illegal tobacco products. Dissemination of information about the impact of illicit tobacco trade on society, including easier access to tobacco products by youth, lost revenue, and support for other illegal activities. Avoid the "illegal cigarettes are more harmful" message since it can promote legal tobacco products.

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015; and from Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. Preventing and Reducing Illicit Tobacco Trade in the United States. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013; and Chris Holden. Graduated sovereignty and global governance gaps: Special economic zones and the illicit trade in tobacco products. *Political Geography* 59 (2017) 72-81.

Table 2: Enforcement Measures to Control the Illicit Trade in Tobacco Products

APPROACH	DEFINITION
Commitment to detect illicit trade activities	<p>This requires, for example:</p> <ul style="list-style-type: none"> › Installing detection equipment at customs posts such as x-ray scanners, endoscopes, mirrors, night vision equipment, special tobacco detector equipment, cameras, automatic license plate readers, and use of canines for spot-checks. › Applying physical control measures such as the separation of processing operations from the sealed storage of taxed and untaxed products, presence of an enforcement officer in the production facility, physical escort of products, inland mobile controls, joint patrols, application of radio or satellite tracking systems such as GPS-enabled devices to goods or conveyances/vehicles/containers. › Background checks, enhanced retail inspections, and zero tolerance › Setting a minimum price and ban of loose sale to aid detection › Allowing the use of special investigative techniques such as undercover operations to combat illicit trade in tobacco products. › Staff training focusing on detecting illicit tobacco professionals and anti-corruption programs supported by a code of conduct. › Constantly refining of strategies and using creativity to stay ahead of criminals.
Prosecute and sanction offenders	<p>Subject offenders to effective, proportionate, and dissuasive criminal or non-criminal sanctions, including monetary sanctions. Adopt high/escalating and swift penalties, the criminalization of excise tax/tobacco fraud, imprisonment, license revocation, confiscation of criminal proceeds, publicizing cases, and/or other measures that can be aimed at smugglers, retailers, consumers, and other participants in illicit trade to act as deterrents.</p>
Seizure and disposal of confiscated products	<p>Seizure of illegal products, identifying their geographical origin, demanding seizure payments covering at least the lost taxes from the guilty party, and destroying the products using environmentally friendly methods to the greatest extent possible, or disposing of them in accordance with national law. These need to be transparent and documented processes.</p>
Agencies' coordination	<p>Coordination among agencies within the country to support intelligence gathering, joint customs operations, and sharing of best practices. Formal memoranda of understanding between agencies help to define their respective roles.</p>
Public awareness	<p>Dissemination of information about the risks associated with illicit tobacco trade and about tools available to detect illegal products to motivate support for enforcement activities. Setting up 'hotlines' to report violations and motivate public to report illegal sales.</p>

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015; Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. Preventing and Reducing Illicit Tobacco Trade in the United States. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013; Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

Table 3: International Collaboration to Control the Illicit Trade in Tobacco Products

APPROACH	DEFINITION
Tax harmonization	Adjacent jurisdictions agree to cooperate and try to equalize tax rates to prevent bootlegging as well as legal cross-border shopping. Since a tax reduction due to harmonization could have an adverse impact on public health and revenue that may outweigh any positive effects on reducing the illicit tobacco trade, setting up a high minimum tax floor is the best approach.
Agencies' collaboration and coordination	Collaboration and coordination among agencies across borders as well as international agencies such as Interpol and the World Customs Organization to support intelligence gathering, investigations, joint customs operations, prosecutions, posting of liaison officers, and sharing of best practices. This may require concluding bilateral or multilateral agreements/arrangements
Information sharing	Share information related to import, export, transit, tax-paid and duty-free sales, seizures and modi operandi used in illicit trade. Excise tax bonds on export should be released only after the tax administration in the receiving country confirms that all appropriate taxes for that jurisdiction have been paid.
Synchronization of national laws	Collaborate in combatting criminal offences related to illicit trade in tobacco by synchronizing national laws related to money laundering, mutual legal assistance, and extradition.

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. MMWR Weekly Vol. 64, No. 20 May 29, 2015; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013.

Endnotes

- ¹ Report on the Global Tobacco Epidemic, World Health Organization, 2015
- ² GBD 2015 Risk Factors Collaborators. Global, regional, and national comparative risk assessment of 79 behavioural, environmental and occupational, and metabolic risks or clusters of risks, 1990–2015: a systematic analysis for the Global Burden of Disease Study 2015. *Lancet*, 2016; 388(10053):1659-1724
- ³ Marquez, P.V. Expanding the Global Tax Base: “Taxing To Promote Public Goods: Tobacco Taxes”. Summary Report. World Bank Group, Washington, D.C. May 24, 2016
- ⁴ Marquez, P.V. Expanding the Global Tax Base: “Taxing To Promote Public Goods: Tobacco Taxes”. Summary Report. World Bank Group, Washington, D.C. May 24, 2016
- ⁵ Goodchild, Nargis, and Tursan d’Espaignet. Global economic cost of smoking-attributable diseases. *Tobacco control*. 2017
- ⁶ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>.
- ⁷ Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015
- ⁸ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.
- ⁹ Collin J, Legresley E, MacKenzie R et al. (2004). Complicity in contraband: British American Tobacco and cigarette smuggling in Asia. *Tob Control*, 13 Suppl 2;ii104–ii111.doi:10.1136/tc.2004.009357 PMID:15564212
- ¹⁰ Joossens L, Merriman D, Ross H, Raw M. How eliminating the global illicit cigarette trade would increase tax revenue and save lives. Paris: International Union Against Tuberculosis and Lung Disease, 2009. Available at <http://tobaccocontrol.bmj.com/content/early/2013/01/14/tobaccocontrol-2012-050788>.
- ¹¹ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>
- ¹² Hana Ross. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf <http://documents.worldbank.org/curated/en/docsearch/report/119792>
- ¹³ Alejandro Ramos. Illegal trade in tobacco in MERCOSUR countries. Working Paper, June 2009.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

¹⁴ Alex C. Liber, Hana Ross, Maizurah Omar, Frank J. Chaloupka. The Impact of the Malaysian Minimum Cigarette Price Law: Findings from the ITC Malaysia Survey. *Tobacco Control* 2015; 24:iii83–iii87. doi:10.1136/tobaccocontrol-2014-052028

¹⁵ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

¹⁶ Gallagher AWA, Evans-Reeves KA, Hatchard JL, et al. Tobacco industry data on illicit tobacco trade: a systematic review of existing assessments. *Tobacco Control* Published Online First: 22 August 2018. doi: 10.1136/tobaccocontrol-2018-054295

¹⁷ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

¹⁸ National Research Council and Institute of Medicine. *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences*. Washington DC: The National Academies Press. 2015.

¹⁹ Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. *Preventing and Reducing Illicit Tobacco Trade in the United States*. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>

²⁰ Merriman D, Yurekli A, Chaloupka F (2000). How big is the worldwide cigarette smuggling problem? In: Prabhat J, Chaloupka F, eds., *Tobacco control in developing countries*. Oxford, UK, Oxford University Press, 1-464.

²¹ Chernick H, Merriman D (2013). Using Littered Pack Data to Estimate Cigarette Tax Avoidance in NYC. *National Tax Journal*, 635–668 (June 2013)

²² Paraje G. Illicit cigarette trade in five South American countries: A gap analysis for Argentina, Brazil, Chile, Colombia and Peru. *Nicotine & Tobacco Research* (in print). 2018.

²³ Kaplan B, Navas-Acien A, Cohen JE. The prevalence of illicit cigarette consumption and related factors in Turkey. *Tobacco Control*. 2017

²⁴ *The Economics of Tobacco and Tobacco Control*. National Cancer Institute Tobacco Control Monograph 21. NIH Publication No. 16-CA-8029A. Bethesda, MD: U.S. Department of Health and Human Services, National Institutes of Health, National Cancer Institute; and Geneva, CH: World Health Organization; 2016. <https://cancercontrol.cancer.gov/brp/tcrb/monographs/21>

²⁵ *Effectiveness of Tax and Price Policies for Tobacco Control*. Volume 14, IARC Handbooks, 2011.

²⁶ Masood Ahmed; Global Health Policy Blog; Tobacco Taxes Need to Be a Much Bigger Part of the Fiscal Policy Discussion; Views from the Center; Tobacco, taxes, Finance, 5/12/17; <https://www.cgdev.org/blog/tobacco-taxes-need-be-much-bigger-part-fiscal-policy-discussion>

²⁷ Kaplan B, Navas-Acien A, Cohen JE. The prevalence of illicit cigarette consumption and related factors in Turkey. *Tobacco Control*. 2017

²⁸ Hana Ross. *Understanding and measuring tax avoidance and evasion: A methodological guide*. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

²⁹ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>

³⁰ Joossens L. Smuggling and cross-border shopping of tobacco products in the European Union. London, The Health Education Authority. 1999.

³¹ Council of the European Union (2005). Report on cigarette smuggling in the European Union. Brussels, Council of the European Union.

³² Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>

³³ Hana Ross. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

³⁴ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio V. Marquez and Blanca Moreno-Dodson. World Bank. October 2017. <http://documents.worldbank.org/curated/en/docsearch/report/119792>

³⁵ Feige, Edgar L. and Cebula, Richard. America's Underground Economy: Measuring the Size, Growth and Determinants of Income Tax Evasion in the U.S. Crime Law and Social Change. Apr 2012.

³⁶ Measuring tax gaps 2017 edition. Tax gap estimates for 2015-16. HM Revenue & Customs. October 2017

³⁷ Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

THE PROTOCOL
TO ELIMINATE
ILLICIT TRADE
IN TOBACCO
PRODUCTS

1

The Protocol to Eliminate Illicit Trade in Tobacco Products: A Global Solution to a Global Problem

Vera Luiza da Costa e Silva¹

Chapter Summary

The Protocol to Eliminate Illicit Trade in Tobacco Products was adopted during the fifth session of the Framework Convention on Tobacco Control (FCTC) Conference of the Parties, in 2012. After obtaining its required fortieth ratification, the Protocol entered into force on September 25, 2018.

The Protocol has three core elements:

1. **Prevention:** The treaty aims to secure the supply chain of tobacco products through a series of measures to be taken by governments. Notably, the Protocol requires the

¹ Head of the Secretariat of the WHO Framework Convention on Tobacco Control. The author writes on behalf of the Convention Secretariat technical team. Special thanks to Nicolas Guerrero Peniche, Patrick Musavuli, Yoni Dekker, and Martin Grande.

establishment of a global tracking and tracing regime, comprising national and regional tracking and tracing systems and a global information sharing point. Other measures include licensing and record-keeping requirements, as well as regulation of Internet sales, duty-free sales, and international transit.

2. **Law enforcement:** The Protocol also establishes the unlawful conduct related to trade in tobacco products, including criminal offenses.
3. **International cooperation:** In its third pillar, the treaty aims to boost international cooperation both among Parties and intergovernmental organizations concerned with customs, crime, and trade.

One of the Protocol's most critical measures is the tracking and tracing regime. Its purpose is to assist Parties in determining the origin and legal status of tobacco products and their point of diversion, if applicable, and to monitor and control the movement of tobacco products.

The tobacco industry is active in promoting its own tracking and tracing solutions, which are less rigorous than those stipulated by the Protocol. For example, the industry aggressively promotes its privately developed Codentify tracking and tracing regime. The Codentify system conflicts with the Protocol and does not meet the treaty's requirements that the tracking and tracing system should be "controlled by the Party." In implementing track-and-trace, as in all other aspects of tobacco control, country authorities and regional bodies must maintain an appropriate critical distance from the tobacco industry.

The Protocol will provide the national authorities in charge of fighting illicit tobacco with a forum in which to exchange best practices, examine new challenges, and consolidate trust. Implementation will nurture enhanced domestic and international cooperation between agencies from multiple sectors (including health, law enforcement, customs, trade, and others).

In fighting the illicit tobacco trade, some countries struggle with the lack of an adequate regulatory and legislative framework; weak enforcement mechanisms; insufficient financial resources and expertise; a high level of corruption; conflict or political unrest; and unprotected or porous borders. These problems will not disappear overnight, but can be reduced or better managed through international cooperation under the auspices of the Protocol.

1. Historical Background

In 2007, two years after the entry into force of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), Parties to the Convention determined that it was urgent to strengthen supply-reduction measures. Leaders saw illicit trade as one of the key supply-related areas of the Convention requiring immediate additional attention. Illicit tobacco trade was both a growing concern among governments and an argument used by the tobacco industry to hinder implementation of other provisions of the treaty, especially Article 6.

Parties judged that a platform of international cooperation was needed to tackle illicit trade, a threat that no nation can resolve within its own borders. During the second session of the WHO FCTC Conference of the Parties (COP2), they established an Intergovernmental Negotiating Body (INB) tasked to develop an illicit trade Protocol. Following its adoption by the Conference of the Parties and entry into force, the Protocol would be a treaty in its own right and a major instrument to eliminate illicit trade in tobacco products.

The INB confirmed that a coordinated global approach was necessary to solve the problem of illicit trade in tobacco products. There was consensus among the Parties on the need for a protocol with strong obligations. In five rounds of meetings, a preliminary text was agreed upon. The final text of the Protocol to Eliminate Illicit Trade in Tobacco Products was then adopted during the fifth session of the FCTC Conference of the Parties in Seoul, Republic of Korea, in 2012. This new international legal instrument was the first protocol to be derived from the WHO FCTC. After obtaining its necessary fortieth ratification by the United Kingdom, it will enter into force on September 25, 2018. As of the end of August 2018, the Protocol included 48 Parties.

Throughout the process of developing and ratifying the Protocol, tobacco industry interference has never been far away. While the Protocol could in theory be a beneficial instrument for tobacco firms that operate legally, the tobacco industry has fought to diminish its obligations under the Protocol and to delay the treaty's adoption. Notably, the industry has tried to push for its own tracking and tracing mechanism, Codentify, that is far less transparent than the tool the Protocol stipulates.²

This chapter will explore the objectives and scope of the Protocol, its status as a young international treaty, the tracking and tracing system it requires Parties to establish, and the challenges faced concerning the global illicit trade in tobacco products.

2. Objectives and Scope of the Protocol

The objective of the Protocol is the elimination of all forms of illicit trade in tobacco products.³

Today, the illicit tobacco trade has become a pervasive problem reaching all corners of the globe. It threatens the health of the population, while fostering criminality and reducing tax revenues. Some sources estimate that if the global illicit tobacco trade were eliminated overnight, governments would see an immediate gain of billions of dollars in revenue.⁴

² <https://tobaccocontrol.bmj.com/content/tobaccocontrol/early/2018/06/13/tobaccocontrol-2017-054191.full.pdf> Accessed August 28, 2018.

³ Article 1 of the Protocol defines, in Paragraph 6, illicit trade as "any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase, including any practice or conduct intended to facilitate such activity."

⁴ Financial Action Task Force/Organization for Economic Co-operation and Development, 2012. <http://www.fatf-gafi.org/media/fatf/documents/reports/Illicit%20Tobacco%20Trade.pdf>

Parties to the Protocol enjoy a wide spectrum of benefits, extending from the reinforcement of national security to increased fiscal revenues. Most importantly, these countries are more effectively protecting the health of their people, particularly vulnerable groups.⁵

It is well recognized that the prevalence of smoking is price sensitive, making illicit products particularly attractive to lower-income and younger segments of the population, who constitute most tobacco-product consumers. Eliminating illicit trade in tobacco products ensures the market is composed of taxed tobacco products subject to health regulations and thus reduces tobacco consumption and smoking prevalence, as lower-income and younger people find tobacco more expensive and less attractive. The public-health implications are substantial, ranging from lower chronic disease prevalence to saving funds that would otherwise have been spent on health care for tobacco-related diseases. By accelerating reductions in smoking prevalence among the poor, the fight against illicit trade also strengthens health equity, since lower-income groups tend to suffer disproportionately from tobacco-related health problems.

According to the World Customs Organization, growth in the illicit tobacco trade remains a worrying worldwide phenomenon and an enduring source of funding for illicit activities that undermine social order, good governance, and the rule of law.⁶ Eliminating the illicit trade in tobacco products generates higher revenues from the increase of taxable tobacco products, while upholding and strengthening national tax policies. This fosters improved national security by weakening criminal organizations and reducing corruption.

Key Components of the Protocol

The Protocol has three core elements that together establish the framework of policies for eliminating illicit trade.

1. **Prevention:** In order to prevent this illegal trade, the Protocol aims to secure the supply chain of tobacco products through a series of government measures. It requires the establishment of a global tracking and tracing regime within five years of the Protocol's entry into force, comprising national and regional tracking and tracing systems and a global information sharing point. Other measures include licensing and record-keeping requirements, as well as regulation of Internet sales, duty-free sales, and international transit.
2. **Law enforcement:** Not only technical requirements are needed, but the Protocol also establishes the unlawful conduct related to trade in tobacco products, including criminal offenses.

⁵ World Health Organization. *Illegal Trade of Tobacco Products. What you should know to stop it.* Geneva: WHO, 2015.

⁶ World Customs Organization. *The illicit trade report 2013.* Brussels: World Customs Organization, 2014.

3. **International cooperation:** In its third important pillar, the Protocol aims to boost international cooperation both among Parties and among international intergovernmental organizations concerned with customs, crime, and trade.

The Convention Secretariat, which will also serve as the Secretariat of the Protocol through the stipulated monitoring system, will closely follow the implementation of all provisions of the Protocol. The time-bound provisions foreseen in the treaty are expected to require special attention. They include the establishment of a global tracking and tracing regime within five years⁷; ensuring that cigarette packaging contains unique identification markings within five years⁸; instituting unique marking systems for other tobacco-product packaging within ten years; and conducting research on the relation between duty-free sales and the extent of illicit trade, to be completed within five years.⁹

Like the WHO FCTC, the Protocol includes provisions that raise awareness about potential tobacco industry interference with treaty implementation. In the Preamble to the Protocol, Parties are reminded “to be alert to any efforts by the tobacco industry to undermine or subvert strategies to combat illicit trade in tobacco products.”

3. Status of the Protocol and Plans to Expand Its Reach

The Protocol is still newborn. The treaty encompasses 47 countries and the European Union as of its official entry into force on September 25, 2018.¹⁰ The initial session of the Meeting of the Parties is the first opportunity for Parties to discuss priorities and next steps for implementation.

Considering the ratification from a geographical perspective, one can observe that most Parties are from the European and African regions. To achieve a more global coverage of implementation efforts, promoting further ratifications will be key. For the Protocol to become truly effective and efficient in fighting the global illicit tobacco trade, more Parties are needed.

4. Tracking and Tracing Tools

One of the Protocol’s most critical measures is the global tracking and tracing regime described in Article 8. The purpose of a tracking and tracing system is to assist Parties in determining the origin of tobacco products and their point of diversion, if applicable, and to monitor and control the movement of tobacco products and their legal status. The Protocol

⁷ Art. 8.1 of the Protocol to Eliminate Illicit Trade in Tobacco Products.

⁸ Art. 8.3 of the Protocol to Eliminate Illicit Trade in Tobacco Products.

⁹ Art. 13.2 of the Protocol to Eliminate Illicit Trade in Tobacco Products.

¹⁰ For status updates, consult the UN Treaty collection: https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4-a&chapter=9&lang=en

will allow Parties to obtain information throughout the supply chain, until duties are paid or other obligations discharged.

Article 8 requires Parties to make an extensive body of information available to assist each other in determining the origin and legal status of tobacco products and in monitoring product movements. An effective tracking and tracing system should capture all relevant tobacco product data, including:

- a. Date and location of manufacture;
- b. Manufacturing facility;
- c. Machine used to manufacture tobacco products;
- d. Production shift or time of manufacture;
- e. The name, invoice, order number, and payment records of the first customer not affiliated to the manufacturer;
- f. The intended market of retail sale;
- g. Product description;
- h. Any warehousing and shipping;
- i. The identity of any known subsequent purchaser; and
- j. The intended shipment route, shipment date, shipment destination, point of departure, and consignee.

Technological Considerations: Unique Identifiers and Data Carriers

One of the elements of the tracking and tracing regime of the Protocol is the use of unique identifiers. These consist of a distinctive combination of numbers, letters, or both that are unique for each pack/item. They cannot be used twice and are not predictable. For instance, passports use a combination of letters and numbers that is unique for each person. The attribution of this combination identifies each person and is not predictable. Digital Mass Encryption is a widely used method to make codes less predictable and prevent unauthorized access by establishing a very large population of possible codes, of which only a proportion are valid and used. Valid codes can only be generated if mathematical formulas (algorithms) and secret keys that are used for their creation are known. The representation of the identifier on the package can be readable by the human eye (letters or numbers) or machine readable (barcodes).^{11 12}

¹¹ FCTC. Analysis of the available technology for unique markings in view of the global track and trace regime proposed in the negotiating text for a protocol to eliminate illicit trade in tobacco products. FCTC/COP/IINB-IT/4/INF.DOC./1.

¹² European Commission. EAHC/2013/Health/II Final Report Concerning the Provision of an Analysis and Feasibility Assessment Regarding EU systems for Tracking and Tracing of Tobacco Products and for Security Features. Brussels, March 2015.

In addition to the serialized unique identifier, a data carrier is also required, with a serialized unique identifier and other information available at the time of manufacturing, such as place and time of manufacture. The data carrier should comply with quality¹³ standards (to avoid extracting incorrect data or to access the data even if a portion of the carrier is damaged), be readable by authorized agencies of any Party to the Protocol, and be suitable for high-speed production lines.

Further along the supply chain, any shipping and receiving events should be recorded, for instance the departure of a pallet from the manufacturing site and its arrival with a specific trader. International standards should be established and recommended for the capture and exchange of data and events with due regard to potential tobacco-industry influence on standardization bodies.

Finally, data and events along the supply chain should be stored in an independent database controlled by competent government authorities. At the global level, a multitude of national and/or regional databases need to have the capacity to interrelate to facilitate international inquiries by competent authorities. Similarly, the Protocol stipulates that access to and retrieval of this data need to be controlled by each Party.

Maintaining Independence from the Industry: Concerns about “Codentify”

A very important factor in this system is that generation and encryption linked to a tobacco industry patent should be excluded. The tracking and tracing of cigarettes and other tobacco products should be objective and not biased by financial or economic interests. However, the tobacco industry is active in promoting its own tracking and tracing solutions.

One of these is called Codentify. Strictly speaking, Codentify is not a tracking and tracing system, but is a code generator system installed on the production line that creates unique codes on packs.¹⁴ Codentify uses elements of production-related information (such as production line and time of production) to generate, via a secret “key,” an unpredictable and unique encrypted 12-character combination of letters and numbers. This code can be used to identify and authenticate a pack of cigarettes. The number, linked to a digital signature, can be read by a human or by a computer. By capturing the human-readable code or scanning a machine-readable code, a computer program will determine whether the code is correctly formed or not. If the code is correctly formed, the program can retrieve associated trace information from a database (e.g., details of first customer). Meanwhile, cartons, master cases, and pallets use unique non-encrypted codes to identify the packages, rather than Codentify codes. This combination of Codentify codes on packs and other codes on the

¹³ Bialous SA, Yach D. Whose standard is it, anyway? How the tobacco industry determines the International Organization for Standardization (ISO) standards for tobacco and tobacco products. *Tobacco Control*, 2001;10:96-104, doi:10.1136/tc.10.2.96.

¹⁴ <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3897562/> Accessed: August 28, 2018.

secondary packaging units is presented as a tracking and tracing system and is endorsed by the major transnational cigarette companies.¹⁵

The Codentify system has been criticized as non-transparent. Given that the system is not open source, some observers have suggested that Codentify may contain hidden features known only to the tobacco industry. Codentify is managed and controlled by the industry and protected by a tobacco industry patent, thus it clearly appears conceived to serve the industry's interests.¹⁶ In this sense, some analysts argue, choosing Codentify for track-and-trace operations would be opting for a "black box" system. According to a study commissioned by the WHO FCTC Secretariat and informally circulated at COP6, the Codentify system conflicts with the FCTC Protocol and does not meet the requirements of Article 8.2 that the tracking and tracing system should be "controlled by the Party."¹⁷

Importantly, the Codentify system was designed by the industry specifically to address the issue of counterfeit tobacco. However, this is only a minor part of the overall illicit trade problem. A larger proportion of illicit trade consists of tax evasion by the mainstream tobacco industry itself, along with the cross-border smuggling of cigarettes and other tobacco products.

In contrast to the case of counterfeit pharmaceuticals, for example, all forms of tobacco are harmful to human beings, including both counterfeit cigarettes and those that are manufactured and sold in complete legality. Even in its limited role with counterfeiting, Codentify is an ineffective means of authentication, because the codes are visible and easy to forge. In fact, the so-called validity codes generated by this system can be easily cloned, recycled, or migrated, particularly if the tobacco industry itself were involved in the illicit trade.¹⁸

Multiple track-and-trace solutions exist for a wide variety of products, but concerns have been raised about the efficacy and cost of such systems. At the time of writing, Brazil, Kenya, and Turkey have already implemented specific marking systems for tobacco products, and their experience will be relevant to next steps in the establishment of a tracking and tracing system under the Protocol.

¹⁵ <https://tobaccocontrol.bmj.com/content/tobaccocontrol/early/2018/06/13/tobaccocontrol-2017-054191.full.pdf> Accessed: August 28, 2018.

¹⁶ Joossens L, Gilmore AB. The transnational tobacco companies' strategy to promote Codentify, their inadequate tracking and tracing standard. *Tob Control* 2013;050796. doi:10.1136/tobaccocontrol-2012-050796

¹⁷ FCTC. 6th Conference of the Parties to the WHO Framework Convention. Secretariat study of the basic requirements of the tracking and tracing regime to be established in accordance with Article 8 of the Protocol to Eliminate Illicit Trade in Tobacco Products. Executive Summary, White Paper. Moscow: 2014.

¹⁸ <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3897562/> Accessed August 28, 2018.

5. Challenges Faced in the Implementation of the Protocol

Although the Protocol will only enter into force at the end of 2018, Parties have already been reporting on illegal trade through the requirements linked to Article 15 of the WHO FCTC. The key observations from these progress reports are that:

- » A growing number of Parties confirm having legislation in place to address illicit trade in tobacco products;
- » The implementation of most measures under this article has improved considerably in the period 2016-2018.

According to WHO's 2018 FCTC implementation progress report, over half of all Parties to the WHO FCTC required monitoring and collection of data on cross-border trade in tobacco products, including illicit trade. On the other hand, only 18 percent reported having data on the percentage of smuggled tobacco products within their jurisdiction. Only one-third of all these Parties had developed or implemented a practical tracking and tracing regime to secure the distribution system and assist in the investigation of illicit trade.¹⁹

Resisting Industry Pressures

Many challenges for implementation of the Protocol are linked to potential interference by the tobacco industry and alleged front groups, such as the International Tax and Investment Center (ITIC²⁰). For example, the industry and those that promote its interests have intensified their advocacy for industry-derived tracking and tracing systems (e.g., Codentify).

Country authorities and regional bodies must maintain an appropriate critical distance from the tobacco industry. A positive example comes from Lithuania, which initiated a motion to reject, at European Union level, the Codentify tracking and tracing system proposed by the tobacco industry. The motion was signed by Lithuania's Minister of Health, the Chairperson of the Committee for Health, the Chairperson of the National Health Board, and the President of the National Alcohol and Tobacco Control Coalition.

It appears that the legal tobacco industry would benefit from measures taken against illicit trade, since in theory illegal trade in tobacco products causes the legal industry to lose revenue. However, the reality is more complex. Evidence indicates that the tobacco industry is often one of the biggest suppliers of tobacco products on the illicit market. This way, tax can be evaded, while the industry can still profit from the sale of its highly addictive products in a market without controls.²¹

¹⁹ World Health Organization. 2018 global progress report on the implementation of the WHO Framework Convention on Tobacco Control. Geneva: WHO, 2018.

²⁰ http://seatca.org/dmdocuments/Asia%2014%20Critique_Final_20May2015.pdf

²¹ <https://tobaccocontrol.bmj.com/content/tobaccocontrol/early/2018/06/13/tobaccocontrol-2017-054191.full.pdf> Accessed: August 28, 2018.

Thus, the tobacco industry is not to be regarded as a partner in eliminating the illicit trade in tobacco products, although some contacts with tobacco companies to implement a tracking and tracing system are unavoidable. Some information, in the data carrier for instance, should be provided by the industry, such as place and date of production. However, contacts with the tobacco industry should be strictly limited and transparent in all cases.

Overcoming Challenges through International Cooperation

Controlling the supply chain serves to prevent illicit trade. The Protocol also contains provisions regarding unlawful conduct, including criminal offenses, international cooperation, and finances. Sectors taking a leading role in these provisions may therefore include foreign affairs, finance, and law enforcement authorities.

Governing systems may vary widely between Parties. To determine the roles and responsibilities of different government agencies, it may be useful to establish a multi-sectoral mechanism, composed of potentially relevant government sectors, to review the existing mandate of each sector and determine the roles and responsibilities under the obligations prescribed in the Protocol.

In fighting the illicit tobacco trade, some countries struggle with the lack of an adequate regulatory and legislative framework for tobacco products and the tobacco industry; weak enforcement mechanisms; insufficient financial resources and expertise; a high level of corruption; conflict or political unrest; and unprotected or porous borders. These problems will not disappear overnight, but can be reduced or better managed through international cooperation under the auspices of the Protocol.

6. Conclusion

With the Protocol's entry into force, the international community has at its disposal a new set of tools to fight the illicit trade in tobacco products. The Protocol includes innovative and ambitious mechanisms. At its heart is the tracking and tracing regime, which the Parties have committed to implement within five years. The establishment of a global information-sharing focal point, to be located at the Convention Secretariat, will constitute a technical, political, and financing challenge. However, once operational, this hub will provide Parties with an essential tool to share information and better understand the structure and paths of illicit trade.

The Protocol will also provide the various national authorities in charge of fighting illicit tobacco with a forum in which to exchange best practices, examine new challenges, and consolidate trust. Implementation will nurture enhanced domestic and international cooperation between agencies from multiple sectors (including health, law enforcement, customs, trade, and others). In this way, the Protocol offers Parties an unprecedented opportunity to curb a major public health threat while securing multisectoral benefits at the national level.

As they seize the opportunity, countries will reinforce the rule of law in their own territories and globally, strengthen international ties, boost fiscal revenues, and ensure a healthier future for the generations to come.

**AUSTRALIA,
CANADA &
EUROPE**

2

AUSTRALIA

3

CANADA

4

EUROPEAN UNION

5

GEORGIA

6

IRELAND

7

UNITED KINGDOM

AUSTRALIA

2

AUSTRALIA:

Addressing the Illicit Flow of Tobacco Products in Australia

*Robert Preece*¹

Chapter Summary

Background and Policy Context

In 2018–19, Australia is taking a number of significant steps to address the illicit trade in tobacco. In the context of ongoing aggressive tobacco tax increases, the new measures now rolling out will strengthen the administration of tobacco imports and create a multi-agency taskforce to increase investigatory and enforcement capability, among other advances.

Australia has earned a reputation for innovation in anti-smoking policy, taking global leadership in areas like plain packaging and the indexation of tobacco excise rates to affordability. Australia has adopted numerous non-fiscal tobacco-control measures, many of which are consistent with the Framework Convention on Tobacco Control (FCTC). These strategies were brought together under the *National Tobacco Strategy 2012–2018*. They have included graphic health warnings, advertising bans, and the prohibition of smoking in public spaces.

¹ Charles Sturt University, Australia

Meanwhile, tobacco taxation policy continues to play an important role in reducing demand for tobacco in Australia. The country has accelerated tobacco excise rates, starting with a 25 percent hike in 2010, followed by 12.5 percent annual increases from 2013 through to 2020. These tax increases are additional to the bi-annual indexation of rates each March and September. The overall effect has been a substantial rise in the tax component of retail cigarette pricing. While this brings Australia closer to the 70 percent tax target suggested by the World Health Organization, it may also heighten incentives for criminals to expand the illicit tobacco market.

Historically, Australia has administered tobacco taxes through a series of licensing and permission-based regimes that seek to facilitate dealings by lower-risk entities and to prevent or tightly control commerce involving higher-risk entities. To manage tobacco tax collections, Australia has a set of regulatory controls administered by its domestic tax agency, the Australian Taxation Office (ATO). These controls recognize that tobacco could, in principle, be either grown and manufactured locally, imported as finished goods, or imported as leaf for final manufacture in Australia. In practice, since 2015, the licit tobacco market in Australia is comprised exclusively of imported finished tobacco products (e.g., cigarettes). All legal domestic tobacco growing and manufacture have ceased. Of note, Australia's tobacco-trade controls do not extend to the use of fiscal markings such as tax stamps, or to the application of track-and-trace technologies to confirm the tax status of tobacco products in the supply chain.

Enforcement Agencies and Activities

Tobacco tax administration is supported by enforcement and investigative activity, including the high-profile actions of the Australian Border Force (ABF) Tobacco Strike Team, recently credited with Australia's largest-ever seizure of illicit tobacco. Although imports now represent the only legal channel for tobacco trade in Australia, enforcement still involves dual legislative jurisdictions, as illegal domestic cultivation persists. This has led to complexities: for example, the ABF enforces laws relating to imported tobacco products under customs legislation, while the ATO enforces laws relating to local cultivation and manufacture under excise legislation. Further, these dual legislative jurisdictions are often inconsistent in areas such as the level of intent to be proved and the penalties available. Thus, the origin of suspicious tobacco found in the supply chain needs first to be established to ensure successful prosecution.

Recommendations and Way Forward

A major development in addressing the illicit trade in tobacco was the recent work of the Government's Black Economy Taskforce. The taskforce's 2017 report clearly acknowledged the threats posed by Australia's illicit tobacco market, confirmed the role of organized crime in illicit tobacco, and recognized that existing detection capabilities and applicable penalties must be reinforced. The report presented specific recommendations for strengthening action against illicit tobacco, many of which the Government will implement as of July 1, 2019. However, not all Black Economy Taskforce recommendations on illicit tobacco will

be adopted. Most notably, there will be no introduction of fiscal marking or track-and-trace systems for tobacco products in Australia.

On the positive side, from 2019, the Australian government will tighten its tobacco tax administration by eliminating the status of tax-suspended, or "bonded," tobacco. This will remove an area of significant fraud risk. In addition, an import licensing regime will be introduced, and commercial importation of tobacco will be banned without appropriate licensing. The Government will bolster enforcement capabilities by addressing inconsistencies between import and domestic legislation and will recognize a number of new tobacco-related offenses. Enforcement will be supported by the creation of a multi-agency Illicit Tobacco Taskforce. The new force will build on the existing Tobacco Strike Team by bringing together the legislative powers, intelligence systems capabilities, and resources of several federal law enforcement agencies.

Part A: What Has Been Done to Address the Illicit Trade in Tobacco, How Was It Done, and What Are the Results?

1. Tobacco Control in Australia

Tobacco control began in earnest in Australia in 1992, with the passage of the Tobacco Advertising Prohibition Act, which introduced a range of restrictions on the marketing of tobacco products. Since then, Australia has developed a comprehensive range of measures, both fiscal and regulatory, to address the costs of harm from tobacco consumption. These include high-profile measures that require tobacco products to be sold in plain packaging and that impose graphic health warnings covering most of the surface of cigarette packages. A short summary of key control measures and policy or legislative sources can be found in Table 1.

Tobacco taxation has also become a central component of Australia's tobacco control response. Following an ad hoc 25 percent increase in excise rates in 2010, regular 12.5 percent annual rate increases began in 2013 and will continue through to 2020. In addition to these staged rate increases, there continues to be bi-annual indexation to the base rates. As at 2016, Australia's tobacco excise as a proportion of retail price had reached the range of 52 to 60 percent (DOH 2017; WHO 2017:148). When measured together with the Goods and Services Tax, the total tax as a proportion of cigarette retail price reaches 61 to 69 percent (DOH 2017). Thus, tobacco taxation in Australia is quickly moving the country's tax-to-retail ratio towards the 70 percent target set in the *Guidelines to Implement Article 6.2 of the WHO Framework Convention on Tobacco Control*.

This policy of staged excise tax increases is designed to support the Government's objectives for consumption as outlined in the current *National Tobacco Strategy 2012–2018*

(NTS). These objectives are to reduce adult smoking rates from 19 percent to 10 percent for the general population and to halve smoking rates amongst Aboriginal and Torres Strait Islander peoples. Such excise tax increases, however, can work to stimulate the trade in illicit tobacco products by decreasing the affordability of tax-paid tobacco and increasing profitability for those undertaking illegal activities.

This is recognized by the Government as a risk (Treasury 2016), and funding in recent federal budgets has been directed towards addressing the issue. The tobacco industry has also raised concerns, albeit without providing evidence, that illicit tobacco risks from such tax rate rises will be facilitated by the simultaneous introduction of plain packaging in 2012, which allows illicit traders to more readily conceal their products (BAT 2011; JTI 2011; PMI 2011).

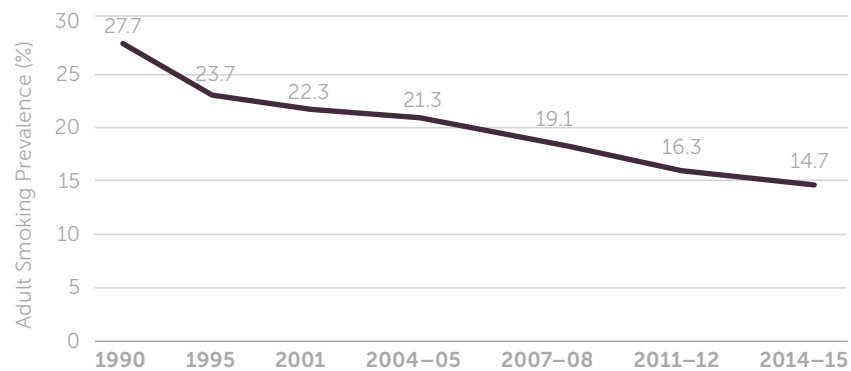
Table 1. Outline of Australia’s Tobacco Control Framework

POLICY INSTRUMENT	MEASURES
<i>Tobacco Advertising Prohibition Act 1992</i>	<ul style="list-style-type: none"> › It is an offence for corporations to publish or broadcast a tobacco advertisement (as defined) unless a prescribed exception applies
<i>Competition & Consumer (Tobacco) Information Standard 2011</i>	<ul style="list-style-type: none"> › Two sets of seven health warnings (rotating over a 12-month period) to cover at least 75 per cent of the front of tobacco packaging, 90 per cent of the back of cigarette packaging, and 75 per cent of the back of most other tobacco product packaging › Warnings in relation to chemical contained in the product › Warnings extended to cigars
<i>Tobacco Plain Packaging Act 2011 (and Regulations)</i>	<ul style="list-style-type: none"> › Color and finish of primary and secondary packaging (cigarette and other) › Marks which may appear › Use of bar-code, details of manufacturer and brand
<i>National Tobacco Strategy 2012–2018</i>	<ul style="list-style-type: none"> › Protect public health policies from tobacco industry interference › Eliminate remaining advertising, promotion and sponsorship of tobacco products › Reduce affordability of tobacco products › Increasing smoke free areas in public places › Strengthening mass media and public education campaigns › Improving access to evidence based cessation services › Consider further regulating tobacco product contents › Midpoint review of progress
<i>Excise taxation (and excise equivalent taxation on like imported tobacco products)</i>	<ul style="list-style-type: none"> › Levied on a “per stick” basis or a “per kilogram” equivalent basis from 2000, where a stick is defined as not being more than 0.8 grams › Indexed bi-annually to average weekly ordinary times earnings › 25% one-off increase in April 2010 › 12.5% increases annually 2013–2017 › Further 12.5% annual increases 2018–2020 › \$7.7m to form ABF Tobacco Strike Team to intercept illicit tobacco
<i>Pharmaceutical Benefits Scheme</i>	<ul style="list-style-type: none"> › Listing of nicotine replacement therapies (e.g., nicotine patches), bupropion, and varenicline for government subsidies, making smoking cessation more affordable for eligible patients

2. Smoking Prevalence and Trends in Australia

The most recent studies in Australia in relation to smoking prevalence are largely positive, with key indicators showing reduced consumption, deferred uptake, and increased cessation. *The National Health Survey* which since 2001 is conducted every three years (having been conducted every five years prior to 2001), identifies a downward trend, with 14.7 percent of adults smoking daily in 2014-15, compared to 22.3 percent in 2001 and 27.7 percent in 1990, when the series started (ABS 2016). The headline smoking prevalence rates can be seen in Figure 1.

Figure 1. Australian Adult Smoking Prevalence, 1990-91 to 2014-15



Source: ABS *National Health Survey: First results 2014-15*

Consistent with the *National Health Survey* are data from the study *Tobacco indicators: measuring midpoint progress reporting under the National Tobacco Strategy 2012-2018*, which analyses specific measures undertaken in the NTS to determine progress against baselines (AIHW 2016). Key results are summarized Table 2.

Table 2 is generally seen as positive. However, in relation to the key or benchmark indicators of prevalence, while the general population is on course for its reduction targets, prevalence rates for the indigenous population remain disappointing. High rates within this group are not falling as quickly as is desired in the NTS.

Table 2. Summary of Certain Key Results at NTS Midpoint

INDICATOR	TARGET TO BE REACHED BY...	BASELINE 2012	MIDPOINT 2016	TREND REPORTED
Benchmark:				
› Adult smoking prevalence	Prevalence = 10%	19.1%	14.8%	Reduction (on target)
› Aboriginal & Torres Strait Islander prevalence	Prevalence halved	44.8%	42.1%	Reduction (below target)
Uptake:				
› School children trying	Reduction	23.3%	19.1%	Reduction
› Adults trying	Reduction	62.5%	57.0%	Reduction
› Age of uptake	Older when start	15.4 years	15.9 years	Older when starting
Exposure to smoke:				
› Women smoking while pregnant	Reduction	13.2%	11.7%	Reduction
› Children at home	Reduction	6.1%	3.7%	Reduction
› Adults at home	Reduction	4.0%	2.4%	Reduction
Cessation:				
› Attempting to cease	Increase	44.8%	46.7%	Increase
› Adults actually cease	Increase	47.4%	51.8%	Increase
› Age when ceased	Reduction in age	35.3 years	35.4 years	No change
Continuation of smoking:				
› School children into young adults	Reduction	3.5%	2.7%	Reduction
› Young adults into adults	Reduction	29.4%	23.2%	Reduction

Sources: AIHW (2016)

3. Tobacco Taxation

Tobacco and tobacco products are subject to a number of layers of taxation, with the exact nature of taxes dependent upon where the product originates and where final manufacture occurs.

3.1 CUSTOMS IMPORT TARIFFS

Customs import tariffs are levied under the *Customs Tariff Act*. Import tariffs in Australia are generally applied for the purposes of protecting domestic industry, and for tobacco import tariffs are now at zero, as there is essentially no longer an Australian tobacco industry. Freeman (2016) describes the end of tobacco growing in Australia by 2006, when the final contracts between growers and tobacco companies ended and all tobacco growing licenses were cancelled by the ATO. Between 2006 and 2015, the “Australian industry” was a simple value-add process, with cigarettes manufactured under bond, using tobacco leaf imported from Brazil, India, the United States, and Zimbabwe.

2015 saw the closure of the last Australian cigarette production lines. All cigarettes and tobacco products lawfully sold are now imported as finished goods. The import tariff, while set at zero, is actually a composite duty rate and contains what is referred to as an “excise equivalent duty.” This is the current tobacco excise tariff rate that would apply to domestic tobacco products and which is applied to similar imported products. (Excise and excise equivalent duty are discussed in Section 3.3 below as Australia’s primary form of tobacco taxation.)

3.2 GOODS AND SERVICES TAX

The Goods and Services Tax (GST) is a broad based, “value-add” consumption tax and so levied on the sale of most goods and services in Australia. This includes the sale of all cigarettes and tobacco products. The current rate of GST in Australia is 10 percent, irrespective of whether the products are sourced domestically or imported.

3.3 EXCISE AND EXCISE EQUIVALENT DUTY

Excise is the primary tobacco taxation instrument and is applied through the *Excise Tariff Act* for tobacco products manufactured in Australia, including manufacture in Australia from imported tobacco leaf. Excise is also payable on imports of cigarettes and other finished tobacco products via the *Customs Tariff Act* as excise equivalent duty. In this case, the rates of excise and excise equivalent duties are the same for like goods, as required in Article III.2 of the General Agreement on Tariffs and Trade (GATT), with both rates indexed twice a year. Prior to 2014, the indexation was based on Consumer Price Index (CPI).

Australia’s tobacco excise has been applied on a specific rate basis since 2000, levied per stick on cigarettes where a stick contains less than 0.8 grams of tobacco. This move was designed to increase the excise tax and price on each cigarette, which, when taxed on a per kilogram basis, had seen manufacturers reduce the weight of each stick to maintain affordability in pricing.²

Tobacco products other than cigarettes in stick form, for example cigars, cigarillos, and roll-your-own tobacco, are still subject to excise taxation on a per kilogram basis, with new legislation now transitioning this per kilogram rate to better align with the per stick rate, so as not to create tax rate differentials between cigarettes and other tobacco products. Over four years beginning in 2017, the per kilogram rate for tobacco products will be adjusted annually so that it equates to a 0.7 gram cigarette stick and not the current 0.8 grams.³

3.4 TOBACCO EXCISE POLICY REFORMS SINCE 2010

There have been several significant excise reforms in recent years, beginning on April 29, 2010, with an immediate 25 percent increase in excise tax on all tobacco products. This

² Explanatory Memorandum Excise Tariff Amendment Bill (No 1) 2000.

³ *The Excise Tariff Amendment (Tobacco Duty Harmonisation) Act 2017* (domestic manufacture) and *Customs Tariff Amendment (Tobacco Duty Harmonisation) Act 2017* (imported finished goods).

followed a recommendation from the National Preventative Health Taskforce (DOH 2018). In 2012, in a move consistent with Article 6.2 of the WHO FCTC, the duty-free allowance for arriving passengers was reduced from 250 cigarettes or 250 grams of tobacco, to 50 cigarettes or 50 grams of tobacco, with excise equivalent duties payable on the entire amount of tobacco, should the passenger exceed this limit (ABF 2012).

In the 2013/14 federal budget, a new approach to indexing tobacco excise rates was announced, in addition to four staged annual tax rate increases. Replacing CPI indexation of rates, tobacco excise was now indexed to Average Weekly Ordinary Times Earnings (AWOTE). This linked the excise rate to income in current prices rather than just to inflation. The budget also set out four annual excise rate increases of 12.5 percent to commence on December 1, 2013 (retrospectively), recurring on September 1 of 2014, 2015, and 2016. The Explanatory Memorandum for the *Excise Tariff Amendment (Tobacco) Bill 2014* and *Customs Tariff Amendment (Tobacco) Bill 2014*, which gave effect to this policy, stated that the measures are designed to make inroads into the affordability of tobacco as a means to address consumption.

Following the final scheduled 12.5 percent rate increase, the 2016–17 federal budget extended the policy by applying a further four hikes to take effect on the 1st of September of each year from 2017 through 2020. In addition, the duty-free passenger concession for tobacco products was further reduced from 50 cigarettes to an “open pack” of 25 cigarettes (or 25 grams equivalent) of tobacco product. In a review of the 2016–17 federal budget, Thomas (2016) quotes government policy as using the 12.5 percent increases which commenced back in 2013 and that will continue through to 2020 to both “battle smoking-related cancer and return the budget to surplus,” indicating the excise rate increases are based on health and revenue outcomes.

It is also important to note that, in recognition of each of these tobacco excise rate increases, these 2016/17 budget measures were supported with \$7.7 million for enforcement initiatives. Primarily, the money was allocated to expand the ABF Tobacco Strike Team, as budget papers acknowledged that, “Changes to taxation arrangements for tobacco have the potential to increase illicit tobacco activity” (Treasury 2016). This initiative is analyzed further in Section 6 below.

At the time of writing, tobacco excise tax rates are as follows (ATO 2018):

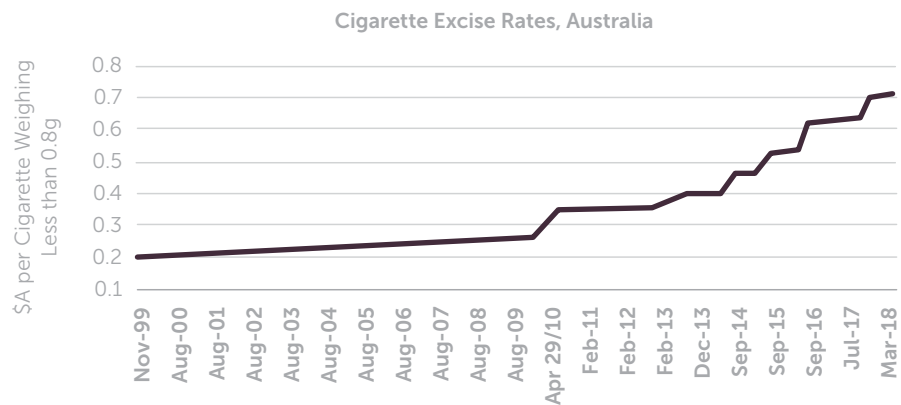
- » In stick form not exceeding in weight 0.8 grams per stick actual tobacco content - \$0.71046 per stick; and
- » Other - \$916.72 per kilogram

These two rates will rise on September 1, 2018, by 12.5 percent plus an indexation against the relevant AWOTE factor. The rate for “other” tobacco will increase further when the per kilogram rate is adjusted for a 0.75 gram stick on the path towards equivalence with a 0.7 gram stick.

Australia's tobacco excise rates since 1999 are graphed in Figure 2 for cigarettes and Figure 3 for other tobacco products. Both figures show a long period of simple CPI-indexed rate increases until the 2010 policy introduced accelerated rate increases, which are scheduled to continue through 2020.

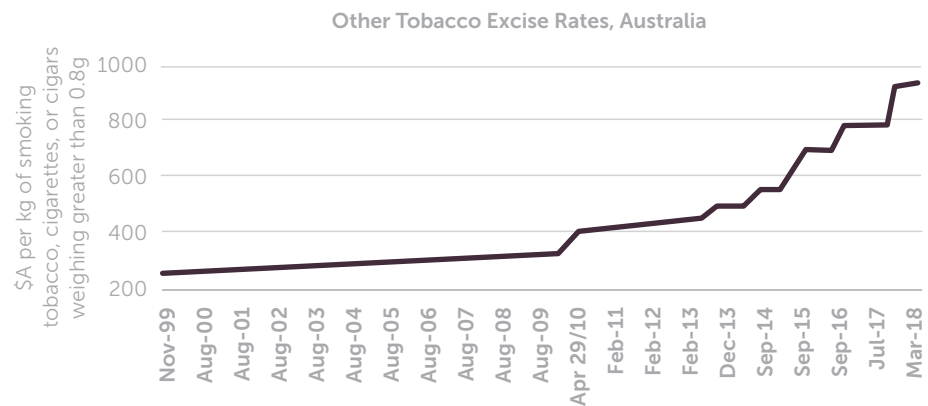
As at 2016, Australia was reported to have the highest price on a 20-stick equivalent pack of cigarettes amongst the OECD countries (OECD 2016) at USD 12.81 per pack, ahead of Norway at USD 12.65 and New Zealand at USD 11.85. As outlined above, with current reforms increasing tobacco excise rates at 12.5 percent per annum, in addition to bi-annual AWOTE indexation, the ratios of excise and total tax to retail price in Australia are expected to increase and start to match those of the country's OECD peers.

Figure 2. Cigarette Excise Rates in Australia 1999–2018



Source: Author adapted from ATO tax rate data (2018)

Figure 3. Other Tobacco (Non-Cigarette) Excise Rates in Australia 1999–2018



Source: Author adapted from ATO tax rate data (2018)

Figure 3 looks at excise rates for tobacco other than in cigarette form. The numbers again show that, in the 2016 OECD rankings, Australia had the highest excise tax rate (in USD per kilogram equivalent) on non-cigarette tobacco products, at USD 498.66, well ahead of Ireland at USD 323.73 per kilogram and the United Kingdom at USD 284.01 (OECD 2016).

4. Framework of Tobacco Taxation Administration

4.1 AGENCIES AND LEGISLATION

The nature of tobacco tax administration in Australia is evolving, due to recent government decisions to transfer the management of much of the excise equivalent duty function from ABF to the ATO. Commercial decisions by the tobacco industry to cease local manufacture have also spurred change. This has led to a somewhat complex administrative arrangement, especially for importers, and has in some cases opened up areas of risk for smuggling and revenue leakage. As such, tobacco tax administration will undergo significant reform in 2019 to address these failings. We will analyze the issues in Section 7, below.

In 2006, all tobacco-growing licenses were cancelled by the ATO, as manufacturers sourced cheaper leaf from off-shore suppliers. Manufacturing then ceased in Australia altogether during 2015, with the closure of the last local production operations by Philip Morris International (PMI), then British American Tobacco (BAT) (Scollo and Bayly 2016). Notwithstanding, all legal provisions which control a domestic tobacco industry remain in place, should the sector restart manufacturing.

Legislation supporting the administration and enforcement of tobacco taxation falls under two federal jurisdictions, namely customs law for the importation of tobacco and excise law for domestic manufacture activities. Customs and excise law is then essentially divided into two areas. The first involves the taxing instruments, which include the *Customs Tariff Act* for imports and the *Excise Tariff Act* for all domestic manufacture. Both laws provide for the authority to levy duties and set out the classification of products and relevant duty rates.

The second main legal area is that of the necessary administrative powers for departmental officials to collect duties and enforce compliance. These powers come primarily from the *Customs Act* (and Regulations) for imports of leaf or finished tobacco products, and the *Excise Act* (and Regulations) for the manufacturing and packaging of finished tobacco products, including local manufacture using imported leaf. Given the decline of all forms of domestic production, the application of the *Excise Act* has become increasingly limited in duty collection, but is still very much in use to ensure compliance and in tackling illicit production.

One area of Australian law which differs from other countries is that of the concept of “excise equivalent duty,” which is a customs duty that is levied on imports of goods which if manufactured domestically would be subject to excise. This includes imported cigarettes and other tobacco products. While this concept of applying identical excise duties to like imports is the

same in most countries, what may differ here is the administration of much of these excise equivalent duties over imports by the domestic tax agency, the ATO, and not ABF.

For the importation of excise equivalent goods, including tobacco products, only the initial importation declaration process (either directly into home consumption or into a bonded warehouse), ex-warehouse declaration process for tobacco products leaving a bond, and the actual duty payment, sit with the ABF.⁴ The ATO then administers all other functions relating to the importation of tobacco and tobacco products (DOHA 2018) which include:

- » Licensing of the bonded warehouses that will store imported products until delivered to home consumption;
- » Issue of permissions to undertake movement of bonded tobacco products between licensed bonded warehouses, or to a place of export;
- » Issue of permissions to deliver tobacco products into home consumption without first passing an entry, and to report and pay duties on such deliveries weekly;
- » Grant where appropriate remissions of duty for any bonded tobacco damaged or otherwise made worthless; and
- » The conduct of any or all audit and compliance activities at bonded warehouses.

In addition to taxation, prior to delivery into home consumption, importers of tobacco products are also required to ensure compliance with the *Trade Practices (Consumer Product Information Standards) (Tobacco) Regulations 2004*, *Competition and Consumer (Tobacco) Information Standard 2011* and the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008*, which support Australia's plain packaging and graphic health warning policies. Compliance with these provisions is self-assessed with non-compliance monitored in the market place. Fines up to \$1.8 million may be applied by the Courts for plain packaging breaches, and up to \$1.1 million for graphic health warning breaches (DOH 2015).

4.2 ADMINISTRATIVE CONTROLS OVER TOBACCO TAXATION

A central component of the tobacco tax administrative control framework in an increasing number of countries is to introduce "sophisticated markers" on tobacco products. These go beyond simply identifying the tax status of the product, for example tax stamps or ink marks, towards markers that are able to authenticate product and track it through the supply chain (Ross 2015: 45). Australia has never adopted the use of any fiscal markings, nor sophisticated track-and-trace technology, rather it has designed and implemented a set of regulatory controls which are designed to reduce the risk around both those who may deal in tobacco and the types of activities that they undertake. These regulatory controls include:

⁴ See *Taxation Laws Amendment (Excise Arrangements) Bill 2000*.

Licensing of those wishing to grow tobacco, manufacture tobacco, or store bonded tobacco

Licensing is perhaps the central control applied to reduce risk. Under the Excise Act, manufacture of excisable goods can only occur with a license to do so.⁵ For tobacco, this extends to the concept of “producing” tobacco material and creates an offense at sub-section 28(1) as follows:

“A person who does not hold a producer licence must not intentionally produce material that is tobacco seed, tobacco plant or tobacco leaf knowing, or being reckless as to whether, the material is tobacco seed, tobacco plant or tobacco leaf.”

The maximum penalty for unlawful possession of tobacco seed and tobacco plant is \$105,000⁶ or two years imprisonment, while for tobacco leaf it is the greater of \$105,000 and five times the value of the excise duty payable on that leaf, or two years imprisonment. This is now a significant provision of the law, as with the cessation of all legal tobacco growing, it is implied that any Australian tobacco seed, plants, or leaf in the market is illicit.

The license for a bonded warehouse to store imported tobacco will be sought by importers under both the *Customs Act* and into the *Excise Act*. Both have identical requirements to be met in order for the licenses to be issued, and the decision-making process is administered by the ATO. To meet the requirements, the applicant must meet general criteria such as fitness, record keeping, and security as set out in Annex 1. These criteria are designed to ensure that only low-risk entities are able to enter the excise tax system and carry the significant duty liabilities.

The excise licensing regime then aims to keep risk levels low by firstly allowing the placement or restrictions and conditions upon the licensee, provided these restrictions and conditions are necessary to “protect the revenue.”⁷ One such restriction may include the ATO requiring the new licensee to deposit a security to cover potential non-compliance. If required, the amount and manner of payment of such a security will be set by the ATO.

Risk levels are also kept at the acceptable level through provisions around the ability to suspend and cancel licenses (although such decisions may be appealed). The suspension or ultimate cancellation of an excise license essentially prevents the business from operating and is seen as a substantial incentive to maintain high levels of compliance. Licenses are valid for a three-year period, after which time they must be renewed, a process which is automatic for licensees with demonstrated compliance.

⁵ See Part III of the Excise Act 1901.

⁶ The financial penalty is set out as 500 penalty units, as defined in section 4AA of the Crimes Act, which at the time of writing was \$210.

⁷ See *Excise Act 1901* paragraph 39A(2)(i).

Permission to move tobacco under bond

An area of considerable risk is the movement of under-bond or "tax-suspended" tobacco from one location to another, such as from the port of importation to a warehouse, between warehouses, or from a warehouse to a place of export, including specialty premises, such as duty-free shops. Such movements are common, and significant volumes can move in normal distribution arrangements as products are positioned nearer the customer, or sold as exports. However, this sheer volume is inherently difficult to monitor and leakage of tax revenue all too common.

Australia has established a permission system to move bonded tobacco products which attempts to restrict such movements to "lower-risk" entities and relies on post-transaction audit of commercial records. Applications for the bonded movement of tobacco products are made to the ATO under the Customs Act or Excise Act (depending on the origin of the tobacco). The ATO may then approve the types of bonded movements for tobacco, as set out in Annex 2.

Prior to approving an application for a single bonded movement, the ATO will apply certain risk criteria, including the size of the duty liability, the compliance record of both parties and the possibility of diversion into the market (ATO 2015). In cases where a risk is perceived to the revenue, the application could be denied or else the applicant asked to "deposit a financial security" in order to protect that revenue (ATO 2018). Exports of tobacco products will also be subject to an Export Declaration process with ABF, and an approved Export Declaration is required for the products to be able to leave the country.

In reality, most bonded movement permissions are issued on a "continuing" basis and recognize the commercial reality of high numbers of these tobacco movements between bonded premises. These continuing permissions, often issued at a "client level" that allows for an owner to move bonded tobacco between multiple sites (ATO 2015), represent the majority of all bonded tobacco movements. This is managed on a largely self-assessed basis, with the stipulation that the applicant raise certain documentation for each individual movement and make an audit trail available for the ATO. The audit trail is used to confirm dispatch and receipt of the goods and the appropriate transfer of duty liabilities from one entity to the other. Instances of non-compliance or increases in duty liabilities in movements may also result in the ATO's requesting the deposit of a financial security (ATO 2015).

Significant penalties support the under-bond movement system, including for situations in which applicants make unintentional errors in the movement of goods or in accounting for the movement process. The relevant provisions of *Customs Act* Section 35A give the ATO an automatic right to recover any duties from goods that cannot be satisfactorily accounted for before, during, or after a bonded movement, whilst Section 33 applies a penalty for "moving, altering or interfering" with goods under the control of customs. The offense may be one of "non-intent," carrying a maximum penalty of \$12,600, while a conviction for intentionally "moving" or "interfering" carries a maximum penalty of \$105,000. The *Excise Act* penalties

mirror the maximum fines of the *Customs Act*, although one difference is that, under excise law, “intent” must be proved.

Permission to deliver goods into home consumption without entering them for that purpose

Bonded tobacco must be kept in a licensed warehouse and must not enter home consumption without fulfilling certain conditions. These may include providing the ABF with an “Ex-warehouse Declaration,” with payment of duties for imported goods, or providing the ATO with an “Excise Return” and payment of duties for locally manufactured goods. Those distributing tobacco on which duties have not been paid must predict sales and ensure that sufficient stock is entered for home consumption and duties paid, so that they can supply customers in a timely manner.

In reality, the *Customs Act* and *Excise Act* recognize that this is an inefficient way for business to operate and as such both laws allow for the ATO to issue permissions to deliver without entry, and bring such deliveries to account and pay duties at the end of an accounting period (usually seven days).⁸ These permissions are tightly conditioned to protect the revenue and link heavily to the record keeping of the owner and operators of the bonded warehouse from which the tobacco products are delivered. Under these permissions, the raising of a commercial invoice of sale to a customer effectively becomes an authority to remove the tobacco from the bonded warehouse, and the date of actual removal is the date used to calculate the duty payable (ATO 2015). These conditions prevent manipulation of changes (increases) to excise rates, also known as “forestalling,” as well as making it difficult for bonded warehouse operators to keep a second set of records, as the legislative process for authorizing deliveries to home consumption and paying duties is intertwined with the business’s commercial systems that interact with customers, transport operators, and internal accounting.

Again, penalties are in place to support the operation of the “delivery without entry” arrangement and include a licensee’s making intentional or unintentional breaches of conditions in the permission. Perhaps the greatest penalty in this context is the loss of the permission itself, which in effect requires both the lodgment of returns and pre-payment of excise before delivery. *The Customs Act* Section 35A again gives the ATO an automatic right to recover any duties from goods that cannot be satisfactorily accounted for in terms of deliveries that cannot be reconciled, or shortages of stock in the bonded warehouse. In terms of actual fiscal penalties on top of duty recovery, in this case the breach or offence is one of “non-intent.” The maximum penalty can be \$21,000, while a conviction for intentional violations carries a maximum penalty of either five times the excise value or \$105,000.

⁸ See Section 69 *Customs Act 1901* and Section 61A *Excise Act 1901*.

5. An Overview of Australia's Illicit Tobacco Market

5.1 NATURE OF THE ILLICIT TOBACCO MARKET IN AUSTRALIA

In its 2015 report on organized crime in Australia, the Australian Crime Commission (ACC) states that, "Organized crime is now entrenched within the illicit tobacco market" and will continue to be, as long as the practice is considered "highly profitable and low-risk" (ACC 2015:68–69). The same report indicates that criminal activity is centered on the importation of genuine and counterfeit brands on which taxes will not be paid. In 2017, law enforcement officials from a range of agencies provided testimony to the Black Economy Taskforce (Treasury 2017:303) that:

"...the illicit tobacco market is growing and is largely the domain of organized criminals. This activity is attractive to criminals because it is highly profitable, the risk of detection is low, and penalties are less severe than for dealing in illicit drugs."

The criminal elements behind the importation of illicit tobacco are seemingly transnational in their organization, and often smuggle both tobacco and narcotics. The significance of the problem was elevated in the words of a senior Federal Police officer, who expressed concern that some proceeds of the illicit tobacco trade may be finding their way back to extremist groups in the Middle East. The officer suggested connections are being made between Middle Eastern crime gangs driving illegal importations and Lebanese charities linked with Hezbollah (McKenzie, 2016). If this is indeed the case, then illicit tobacco may be a national security risk, as well as a tax-revenue and health risk.

The ACC (2015:68) has categorized the illicit tobacco market into three product groupings:

- » "Unbranded" loose leaf product which may also be sold in "tubes" and is often referred to as "chop-chop"; this may be illegally grown locally, or illegally imported;
- » "Counterfeit" cigarettes, which involve the copying of a registered trademark brand without the owner's permission; counterfeit products are made available for sale at a much lower price than the brand being copied, generally without payment of duties and taxes;
- » "Contraband" cigarettes, being any cigarettes on which duties and taxes have not been paid. This category includes "illicit white" cigarettes, being manufactured legally in the country of export but not to the legal requirements of the Australian market, in many cases without lawful plain packaging. This is currently a growing trend, with the Manchester brand representing the largest-selling product in this illicit category.

5.2 ESTIMATES OF THE SIZE OF THE ILLICIT TOBACCO MARKET IN AUSTRALIA

It is apparent that Australia requires credible research to be undertaken, both to set a baseline tobacco tax gap using appropriately identified measures and then to monitor these indicators annually, perhaps in a manner similar to the tobacco gap analysis which has been

published annually since 2013 by HM Revenue and Customs (HMRC) in the United Kingdom. The methodology applied by HMRC is a “top-down” approach. It begins with deriving total consumption from the Office of National Statistics’ commissioned Opinion and Lifestyle Survey, corrected for under-reporting using a measure from the Health Survey for England (HMRC 2018). From total consumption, lawful consumption is then subtracted, with lawful consumption comprising official HMRC tax-paid clearances and declared duty-free sales. This leaves an estimated remainder which is believed to be “non-tax paid” tobacco. Non-tax paid tobacco is then split between cigarettes and hand-rolled, and both measures are expressed in bands, with upper and lower ranges accounting for smokers who consume both types, as well as a central range which represents the longer-term trend.

In terms of an actual attempt at quantifying the Australian illicit tobacco market, government estimates have provided estimates of 3.4 percent for the year 2013 (DOH 2016), and more recently 5.6 percent for the fiscal years 2015–16 (ATO 2018). The 3.4 percent figure from the DOH is included in its most recent report to the WHO on FCTC implementation, citing the 2013 National Drug Strategy Household Survey, which saw 0.8 percent of respondents indicating that they consume illicit products half or more of the time.⁹ The ATO in its estimates was concerned that there may have been under-reporting of illicit consumption in this survey, as respondents may have hidden their use of an illegal product or indeed may not be aware the product was non-tax paid (ATO 2018).

The ATO instead attempted an estimate by studying the various channels in which tobacco enters the market, in what may be termed a “supply-side, bottom-up” approach. This approach analyzed seizures in the import and domestic cultivation channels, as well as non-reconciliation of stock in bonded warehouses to come up with an estimate of total illicit activity, to which total formal clearances were added, so that the illicit quantities could be expressed as a percentage of total consumption, which for 2015/16 was 5.6 percent (ATO 2018). There is, however, very little detail provided by the ATO on how seizures, intelligence, and other data were extrapolated into a total illicit quantity in each channel.

Industry-based estimates of Australia’s illicit tobacco trade are much higher, with the most recent estimate for 2017 suggesting that the illicit tobacco market represents 13.9 percent of total tobacco consumption in Australia (KPMG 2018:6). The KPMG studies which have been conducted annually since 2012, using an empty-pack survey as part of their methodology. However, the sampling technique, which showed bias towards collecting “foreign-looking packaging” in areas more likely frequented by foreign students and tourists, has now been largely discredited (Cancer Council of Victoria 2014:7; DIBP 2016:3).

⁹ See National Drug Strategy Household Survey 2013 <https://www.aihw.gov.au/reports/illlicit-use-of-drugs/2013-ndshs-detailed/data>

5.3 RECENT ILLICIT TOBACCO SEIZURE ACTIVITY

Seizures are publicly reported by both the ABF and ATO, and media releases on significant seizures are often made to highlight the problems associated with illicit tobacco. Table 3 is a summary of seizures by both agencies going back to 2007-08, the ABF making interceptions as illicit tobacco crosses the border, while the ATO pursued illegal local-based cultivation and distribution.

Table 3. Australian Illicit Tobacco Seizures, in Tonnes, 2007/8 to 2016/17

YEAR	ATO (TONNES)	DIBP/ ABF* (TONNES)	TOTAL (TONNES)
2007/8	9.9	287	296.9
2008/9	0	180	180
2009/10	5.7	311	316.7
2010/11	31.1	258	289.1
2011/12	26	177	203
2012/13	0	183	183
2013/14	35	183	218
2014/15	16**	182.3	198.3
2015/16	58.2**	146.8	205
2016/17	30.1**	381.5	419.6
2017/18 (YTD)	32.5**	N/A	N/A
Notes:			
*ABF formed 1/1/2015			
**Calculated from ATO's new reporting format of revenue loss			

Source: DBIP Annual Reports (2015/16; 2016/17); ATO Submission to Parliamentary Inquiry into Illicit Tobacco (2016); ATO (2018; 2018b)

As would be expected, the largest volumes of illicit tobacco are intercepted in sea cargo consignments that have been mis-declared to lower the risk profile and the likelihood of inspection. Consignments may claim to contain items such as "paper cups," "table tops," or "toilet seat covers and trash cans" (ABF 2016; ABF 2018). These tobacco products appear to originate most frequently from China, Korea, and the United Arab Emirates, with involvement of nationals of these countries. The ABF points to the involvement of crime syndicates with links to other forms of serious crime, particularly narcotics. This connection was confirmed again as recently as May 2018, with the detection of 1.6 tonnes of illicit tobacco declared as

dates, leading to the seizure of mature cannabis plants and hydroponic equipment at the premises identified in import documents (ABF 2018c).

The most significant of these sea cargo seizures was 71 tonnes spread over three shipping containers, with two intercepted in Sydney and a third stopped en route in Indonesia under a joint operation¹⁰ between the ABF and Indonesian Customs (DIBP 2016:5; ABF 2018). Based on such precedents, the ABF has approached regional agencies to conduct workshops on addressing and disrupting illicit tobacco supply chains region-wide (DIBP 2017).

Smaller but more frequent seizures are made through international mail centers. For example, in 2016–17, some 128 seizures were made from sea cargo consignments, with yields totaling 264 tonnes, while from international mail there were almost 60,000 seizures yielding a total of approximately 54 tonnes (ABF 2018).

Seizures are also being made from arriving air passengers and imported air cargo consignments, although as yet ABF are not recording these seizures for publication. In some cases, these operations have yielded notable results (DIBP 2016:5–6), including:

- » July 2015, 1.92 million cigarettes from an airfreight container unpacked in a bonded warehouse;
- » August 2015, 5.9 million cigarettes in an air freight consignment; and
- » October 2015, 46,000 cigarettes in the baggage of an arriving passenger, reflecting an emerging threat of “fly in fly out” cigarette smugglers.

The ATO, with its focus on domestically based illicit tobacco, reports conducting 26 raids under warrant since July 1, 2016, destroying crops and seizing tobacco with a potential tax revenue loss of \$179 million (Kenny 2018). To give a perspective on the ATO’s enforcement activity, in 2018, the following illicit tobacco seizures were made (ATO 2018a; ATO 2018b):

- » 53 acres, 28 tonnes and 45,000 seedlings in Bundaberg, Queensland (\$30 million);
- » 20 acres of crop under cultivation in Telopea Downs, Victoria (\$9 million);
- » 16 acres of crop under cultivation in Mooroopna, Victoria (\$7 million);
- » 12 acres of crop under cultivation in Dunnstown, Victoria (\$6 million);
- » 1.3 tonnes of dried leaf (and re-plantings) in Oaklands Junction, Victoria (\$1.3 million)

5.4 ENFORCEMENT FRAMEWORK

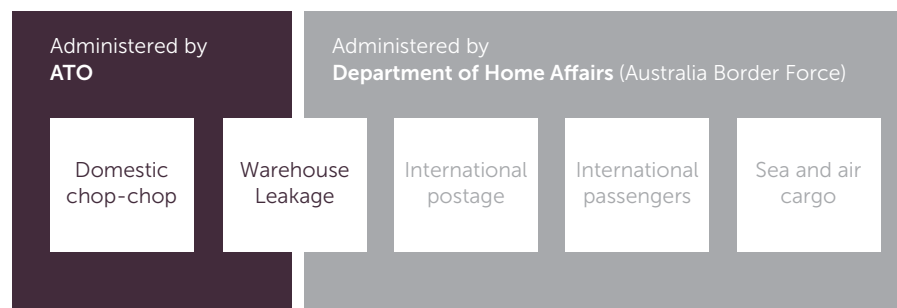
The “dual” character of the administration of tobacco taxation is also reflected in enforcement and investigation, which similarly depends upon the origin of the tobacco and whether it is imported or grown locally. Imported tobacco falls under the *Customs Act* and the jurisdiction of the ABF, although once the product is transferred to a bonded warehouse, responsibility for ensuring compliance shifts to the ATO. In addition, the ATO has

¹⁰ Known as Operation Wardite, this collaboration prevented the loss of \$27 million in duties.

responsibility for enforcing the *Excise Act* in relation to the cultivation and/or manufacture of tobacco domestically. The framework as summarized on the ATO's website is reproduced in Figure 4.

There is a level of coordination between the ABF and the ATO, which also involves interaction with other government policy bodies and law enforcement agencies, as well as with the tobacco industry, both distributors and retailers.

Figure 4. Tobacco Enforcement Jurisdiction



Source: ATO website, accessed 23 May 2018.

The ATO chairs what is known as the Tobacco Stakeholder Group (ATO 2018c), which meets bi-annually. From the government side, this body includes the Department of Home Affairs (DOHA, which includes the ABF), DOH, Treasury, and the Australian Competition and Consumer Commission. From the tobacco industry side, importation and distribution are represented by PMI Limited, BAT Australia, Imperial Tobacco Australia, and Richland Express. The Alliance of Australian Retailers and Australian Retailers Association represent the interests of those involved in the retail sale of tobacco products. The stakeholder group has a wide Terms of Reference that includes "adding value" to the administration of tobacco taxation. The issue of tackling illicit tobacco has been on the agenda of the group's most recent meetings and has been raised regularly by industry since at least 2015 (ATO 2018c).

Similarly, the DOHA chairs the Illicit Tobacco Industry Advisory Group, which has an identical membership of government and industry representation. The last documented meeting, in November 2017, was jointly chaired by the ATO and DOHA and appears to have been a joint meeting of both stakeholder forums. Previous to this, the Illicit Tobacco Industry Advisory Group had met bi-annually, with a very specific focus on "continuing to prevent, deter, and disrupt the illicit trade in tobacco" (DOHA 2018). While the DOHA affirms that this group is part of a "commitment to work with industry," the agency states that interactions will be guided by the obligations of Article 5.3 of the FCTC.

5.5 THE ABF TOBACCO STRIKE TEAM (TST)

The establishment of the TST from October 1, 2015, was an indication of the priority that the DOHA placed upon the interception of illicit tobacco being smuggled into Australia. Early successes, including Australia's largest illicit tobacco seizure of 71 tonnes, saw the Government announce a \$7.7 million "boost" to the TST as part of the 2016–17 federal budget (Dutton 2016). The Minister's announcement shed some light regarding next steps for the TST, stating that the additional funds were to be used to:

"establish two new specialist investigation teams comprising 14 personnel. It will also allow the ABF to build stronger ties with key international law enforcement partners involved in combating tobacco smuggling at various points along the supply chain."

Thus the TST was moving beyond a simple interception role at the border and taking on an investigatory role to identify the criminal elements behind the importation of illicit tobacco. Further, the team was to look beyond the border and work with countries that are part of the illicit tobacco supply chain. The TST applies what it refers to as an "intelligence-led model" (DIBP, 2016:5), suggesting that it identifies risk through various sources, which for the most part would appear to involve building partnerships with domestic and international law enforcement agencies and other stakeholders. From the information obtained, the TST develops appropriate "responses" and "opportunities" for the detection of illicit tobacco and the undertaking of enforcement activities related to the identified risks and risk responses.

The ABF recently summarized the TST's results to Parliament. The Commissioner of the ABF stated that, since its creation in October 2015, the TST had:

- » Seized over 100 tonnes of tobacco leaf;
- » Seized over 247 million cigarettes;
- » Prevented tobacco duty evasion of over \$300 million;
- » Charged 115 people with offenses under the *Customs Act*; and
- » Seen 69 of those people found guilty of the charges.

Further, thanks to the TST, in conjunction with the Criminal Assets Confiscation Taskforce, some \$6 million has been forfeited as "proceeds of crime," and another \$3 million is subject to a forfeiture process (ABF 2018b).

Meanwhile, however, senior ABF staff expressed the view that the TST did not have sufficient powers to be fully effective under current legislation. TST officers were, for example, unable to "use tracking devices, conduct certain types of raids, or make certain arrests" (Mckenzie, 2016). This analysis was supported by the Black Economy Taskforce, which suggested the formation of a multi-agency taskforce so that a full set of legislative powers could be marshaled to maximize law enforcement responses (Treasury 2017:309).

Perceived legislative constraints on agencies' current capacity to investigate illicit tobacco offenses suggest an agenda for improving Australia's approach to the illicit tobacco trade. These issues are at the center of the next part of this case study.

Part B: What Can and Will Be Done in the Future to Better Address the Illicit Trade in Tobacco?

6. A New Enforcement and Regulatory Framework

This question of "What can be done in the future?" with regard to illicit tobacco is currently being addressed in Australia, with significant measures being introduced to strengthen both enforcement capabilities and tobacco tax administration. Following the work of the Black Economy Taskforce, the Government has responded by announcing a range of new measures which include:

- » An upgrade of the TST to a multi-agency Illicit Tobacco Taskforce;
- » Heavier penalties for illicit tobacco offenses;
- » Eliminating the requirement to prove the origin of illicit tobacco for prosecution;
- » Creating additional new illicit tobacco offenses;
- » Banning tobacco imports that fail to comply with a new licensing regime; and
- » Moving the taxing point for imported tobacco (i.e., all legal tobacco products in the market) from ex-bond to point of importation (Treasury 2018:18).

The anticipated revenue return from these measures is \$3.6 billion over the four-year "forward estimates" of the federal budget to fiscal year 2021/22. However, it should be emphasized that approximately \$3.2 billion will be a one-off receipt, obtained as bonded warehouses holding tobacco products under bond are required to pay their excise duties on that bonded stock (Budget 2018:12).

The Black Economy Taskforce offered a number of recommendations that have either been "noted" or explicitly "disagreed with" by the Government, the most salient being the use of track-and-trace technology (Treasury 2017: 310–311). Regarding track-and-trace, the Government has opted for a wait-and-see approach, preferring to review at a later date the success or otherwise of the other control measures just described (Treasury 2018: 35).

6.1 THE ILLICIT TOBACCO TASKFORCE

In May 2018, the Treasurer and Minister for Home Affairs jointly announced the establishment of the Illicit Tobacco Taskforce (ITT), a new multi-agency force to be headed by the ABF. The Ministers described this move as reflecting the "marked success of the ABF's Tobacco Strike Team." The new force seeks to build upon and enhance the effectiveness

of this proven dedicated-team approach. In this case, the enhancement of capabilities will come through the streamlining of offenses to enable simpler prosecution; the definition of certain new offenses; and, importantly, the ability to access the greater investigative powers of the non-ABF agencies joining the ITT.

In relation to the streamlining of offenses, one critical area identified by the Black Economy Taskforce was that of technical risks to prosecution due to the need to positively identify the source of intercepted illicit tobacco (Treasury 2017: 307). This reflects an underlying jurisdictional issue, in that the ABF must limit its role to imports of illicit tobacco and the ATO to domestically grown illicit tobacco. A seizure of tobacco in the illicit supply chain does not necessarily reveal that tobacco's origins, and today the absence of this information can delay or derail prosecution. This difficulty will now be overcome by a new *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*, under which prosecutors will no longer be required to prove the origin of illicit tobacco. The Bill also aligns penalties between the *Customs Act* and *Excise Act*. Discordance between these laws has meant that two offenders arrested with the same quantities of illicit goods in the same circumstances have faced different penalties following successful prosecution.¹¹

On the issue of penalties, the Bill will now set "penalties at a level to deter illegal activity." Tobacco smuggling and tax evasion had been seen as a "soft crime," with the Black Economy Taskforce concerned about the relationship between risk and return for illicit tobacco, as compared to narcotic drugs (Treasury 2017:306). The Taskforce wrote:

"...We have been informed that cocaine with a street value of \$2.3 million here will have a cost of about \$150,000, with heroin being similarly priced. The penalty for smuggling both is imprisonment. Whereas smuggling tobacco costing \$150,000, with a street value of \$10 million here, would, under current sentencing practices, generally result in a modest fine..."

In this regard, the Bill will increase maximum penalties and will include a number of possible custodial sentences of up to 10 years imprisonment, in addition to maximum fines over \$200,000.

There will now also be a new concept of "reasonable suspicion that excise duty was not paid," rather than the need to establish criminal intent, as well as a new offense of being in possession of equipment used to manufacture illicit tobacco. This follows a recommendation by the Black Economy Taskforce to ban the importation of equipment such as cigarette tube filling machines that are used to convert domestic "chop-chop" tobacco into stick form (Treasury 2017:307–308).

In addition to new criminal offenses, there is also a civil offense consisting of the possession of two kilograms of tobacco without documentary evidence of how that tobacco came

¹¹ See the Explanatory Memorandum to the *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*.

into the person's possession. This civil offense can be dealt with by infringement notice or summarily. New and revised offenses and their new penalties for illicit tobacco crimes are listed in Annex 2.

Parallel to the introduction of the *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018* will be the *Customs Amendment (Illicit Tobacco Offences) Bill 2018*. This Bill on its passage will confirm that the changes made to the domestic excise and taxation laws in terms of offenses and penalties will apply equally to imports of illicit tobacco in customs law. Of note however, are amendments unique to the *Customs Act*. For example, authorities can invoke the concept of "recklessly" importing tobacco without payment of duties, removing the need for "intent" to be proved, and the new legislation gives ABF officers the power to arrest without warrant, where there are reasonable grounds to impute a reckless attempt to import tobacco without payment of duties.

Previously, the ABF could only arrest suspects when, in addition to grounds to impute criminal intent, officers had plausible reasons to believe suspects might subsequently fail to appear in court, or that they might interfere with evidence and witnesses. New provisions will loosen these constraints and assist the ABF in future investigations.

However, the main benefit arising from the creation of an inter-agency ITT is that each agency brings unique sets of investigatory powers. Under the leadership of the ABF, other key partner agencies will include the ATO, Australian Federal Police (AFP), Australian Criminal Intelligence Commission (ACIC), Austrac, and Commonwealth Department of Public Prosecutions (CDPP), as well as other operational areas of MOHA as required (ABF 2018).

Previously, key investigatory tools such as access to surveillance devices were denied to the ABF, whose officers either were required to seek external assistance from the AFP or undertake inefficient and resource-intensive physical surveillance (Maher 2017; Treasury 2017). Under the new partnership, improved surveillance technologies will soon be available to the ITT. The ACIC, with its immediate access to all law-enforcement databases and power to coerce evidence, as well as Austrac, with its capacity to monitor movements of cash, will significantly boost the team's intelligence and evidence-collecting capabilities (ACIC 2018).

6.2 AMENDMENTS TO TOBACCO TAXATION ADMINISTRATION

In addition to the enforcement initiatives through the new Illicit Tobacco Taskforce there will be a number of significant changes to the arrangements for the administration of tobacco taxes.

Moving the taxing point from delivery ex-bond to importation

As detailed above, the current taxing point for tobacco is where it is delivered into home consumption, either from the place of importation or from a bonded warehouse. Given the extent of excise duties, the taxing point was invariably a delivery from a bonded warehouse located closest to the customer, to allow for these duties to be deferred as long as possible. Deliveries from a bonded warehouse are made under the "periodic settlement permissions,"

also described above, meaning that duties are subsequently reported and paid on the Monday following the actual delivery of the tobacco products from bond.

This opportunity to bond tobacco into a warehouse will cease from July 1, 2019, date after which importers will be required to identify their duty liabilities at time of import and bring that to account immediately (Budget 2018:12). There will be no credit terms available to importers, and full payment of duties and taxes to the ABF will be made prior to a release of any tobacco products into the country. This approach was justified on the basis that it will “reduce the potential for leakage from bonded warehouses in the black market.”¹²

Despite the cessation of all domestic manufacture, the *Excise Act* will have a similar amendment to that applied to imports, and excise will be payable upon manufacture at the licensed manufacturing site. This will prevent any change to distribution arrangements by importers, such as manufacturing cigarettes with imported leaf to overcome the loss of duty deferral capacity at the border.

One issue to manage will be that of cigarettes and tobacco products already in bond on July 1, 2019. Measures will include a transition arrangement for such goods that will run for 12 months. It is assumed importers will be required to settle the duties on all bonded stocks on hand before June 30, 2020.

As of June 30, 2020, there shall be no cigarettes or other tobacco products in the domestic supply chain that are bonded, and thus opportunities to divert bonded product from these warehouses without duty payments will disappear. This measure directly targets imports, and there will be additional resources committed to the illegal local growing and manufacture of tobacco. For this, the ATO will receive additional resources of \$4 million in 2020–21, rising to \$7 million in 2021–22 (Budget 2018:12). This commitment is expected to yield an additional \$12 million and \$17 million, respectively, in excise duties that would not otherwise have been paid for the illicit cultivation during these years.

New import license

In addition to moving the taxing point, there will also be a new requirement for those wishing to import tobacco to first obtain the proper license. This will be achieved by making tobacco a “prohibited import,” as of July 1, 2019. There will, however, be an exemption from the prohibition for travelers who have cigarettes and tobacco products within the prescribed duty-free allowance limit, which at present is set at 25 grams of tobacco product or cigarette-stick equivalent (MOHA 2017).

Australia’s *Customs (Prohibited Import) Regulations* are the expected mechanism, as these instruments set out Schedules of differing prohibitions and restrictions, with tobacco likely to be prescribed within Schedule 2. Schedule 2 of the regulations is a listing of goods for which import is banned unless written permission (i.e., a permit or license) has been granted.

¹² See Joint Press Release Treasurer and Minister for Home Affairs 6 May 2018.

This is proposed to make it easier for the ABF to take enforcement action and seize tobacco on which the proper duties and taxes have not been paid (Budget 2018:13). The effect of this provision is that any quantities of tobacco intercepted in the supply chain by the ABF or ITT will need to be accompanied by a license, and where such a license cannot be produced by the entity in possession of the tobacco, this establishes a "reasonable suspicion" that duties were not paid.

7. What Else Could Be Considered

There can be no doubt that Australia has affirmed its intent to address illicit tobacco. However, a number of notable anti-tobacco measures have not yet been adopted, and other key strategies have not even been openly discussed as potential options. Several of these measures are contained in the WHO FCTC Protocol to Eliminate the Illicit Trade in Tobacco Products. The Protocol has not yet come into force, and at the time of writing, a further four parties must still ratify the Protocol and deposit their ratifying instruments with the Depository, in order for the instrument to become law.¹³ Australia's last stated position on the Protocol indicated that the country is unable to accede until certain domestic legislative and regulatory changes are made, but that a process was underway to "inform the decision as to whether to accede" (DOH 2016:4).

The main area to consider is that of track-and-trace mechanisms for tobacco products. These are discussed in Article 8 of the Protocol. While considered and recommended by the Black Economy Taskforce, track-and-trace was "put on hold" by the Government, while awaiting the impact of other measures, which some believe might make a track-and-trace system superfluous. There are, however, multiple potential benefits in introducing a track-and-trace system. For example, such a system can support the investigative component of illicit tobacco seizures, given that data held in the track-and-trace tag can be used to confirm characteristics such as the authenticity of the product, product description, manufacturer, first customer, and intended market of consumption.¹⁴

Notwithstanding, Australia is also part of regional and global tobacco supply chains, albeit largely at the consumer end. Given the aspirations of Article 8 to build regional and global tracking and tracing, the lack of a national track-and-trace system in Australia also creates a gap in the control of global tobacco supply chains.

Another area of interest to the author is that of the concept of "due diligence," considered in Article 7 of the Protocol. In the context of Article 7, due diligence imposes greater responsibility on the tobacco industry itself and makes it more accountable in respect of commercial decisions by importers and distributors. It is reasonable to expect that importers

¹³ The Depository for lodging instruments is the UN. See Article 46 of the Protocol.

¹⁴ See paragraph 4.1 of Article 8 of the Protocol

and distributors could readily identify unusual or suspect business transactions or purchase requests, and elect not to proceed with those operations. This can extend to regular commercial relationships in which unusual supply requests are made.

The Government could establish guidelines or regulations which may assist by specifying the nature of transactions to be avoided. These rules might initially be based on the guidance of the Protocol. They might, for example, include requiring importers or distributors to confirm:

- » Customers hold the appropriate licensing to acquire tobacco products;
- » Bona-fides for first time customers, including whether customers have been black-listed by authorities;
- » Payments in cash or kind are not permitted;
- » Market of intended sale;
- » Quantities are not irregular or unusual volumes; and
- » Market where product sold is usual market.

The same regulations can also require importers and distributors to report to the appropriate authority (e.g., ABF or ATO) any business dealings in which problematic points have arisen.

Finally, certain aspects of licensing could be introduced to fully implement Article 6. The manufacture of tobacco products is subject to a licensing regime, as are tobacco imports, as of July 1, 2019. However, other aspects of the supply chain are not subject to licensing: in particular the import and possession of manufacturing equipment, as well as wholesale and retail sales.

“Possession of equipment being used in the manufacture of illicit tobacco” is now defined as a specific offense, but this is not tied to a licensing arrangement. The new offense should facilitate tackling illicit domestic production of cigarettes and “chop-chop.” This is important, given the unclear fate of cigarette-making equipment following the closure of local PMI and BAT manufacturing plants. BAT’s 2016 Annual Report discussed the sale of land and buildings after these closures, but not the actual cigarette manufacturing equipment (BAT 2016:101).

Australia also lacks nationally consistent licensing of wholesale and retail sales businesses. A DOH-sponsored study in 2002 found that, among Australian states, only South Australia, Tasmania, and the Australian Capital Territory had wholesale and retail licensing regimes at that time. Other states simply regulated the activities of such operators.¹⁵ Since 2002, Western Australia has also introduced licensing.¹⁶ However, to date, no nationally coordinated wholesale and retail licensing approach is in place to ensure that a standard “fit and proper” test is applied to entities and persons selling tobacco products at the end of the supply chain.

¹⁵ The DOH contracted the Allen Consulting Group to study the ‘Licensing of tobacco retailers and wholesalers’ in 2002. See [http://health.gov.au/internet/main/publishing.nsf/Content/51D4A401FD339C40CA257BF000212035/\\$File/license.pdf](http://health.gov.au/internet/main/publishing.nsf/Content/51D4A401FD339C40CA257BF000212035/$File/license.pdf) (Retrieved 21 June 2018).

¹⁶ See the *Tobacco Products Control Act 2006*.

Notwithstanding such gaps, many of Australia's current and proposed responses to the illicit trade in tobacco are positive. Yet the country still experiences revenue leakage, as a certain percentage of tobacco consumed locally has clearly by-passed domestic and import based controls and found its way into the market without duties and taxes being paid. The next point to watch in the Australian environment will be the July 2019 tobacco taxation reforms. At that time, the new Illicit Tobacco Taskforce will have been in operation for 12 months, with its enhanced investigatory capabilities to prosecute a new range of offenses with greater penalties.

References

Australian Competition and Consumer Commissions. 2018. *Tobacco health warnings*. Retrieved 7 May 2018 from <https://www.productsafety.gov.au/standards/tobacco-health-warnings>

ACC (Australian Crime Commission). 2015. *Organised Crime in Australia*. Retrieved 3 June 2018 from <https://www.acic.gov.au/sites/g/files/net1491/f/2016/06/oca2015.pdf>

Australian Criminal Intelligence Commission. 2018. *Illicit Tobacco*. Retrieved 3 June from <https://www.acic.gov.au/illicit-tobacco>

AIHW (Australian Institute of Health & Welfare). 2016. *Tobacco indicators: measuring midpoint progress reporting under the National Tobacco Strategy 2012–2018*. Drug statistics series no. 30. PHE 210. Canberra: AIHW

ABF (Australian Border Force). 2016. *Four million illicit cigarettes seized*. Retrieved 22 May 2018 from <http://newsroom.border.gov.au/releases/four-million-illicit-cigarette-seized>

ABF (Australian Border Force). 2017. *Two years of ABF: 400 Tonnes of Tobacco Seized*. Retrieved 22 May 2018 from <http://newsroom.border.gov.au/releases/two-years-of-abf-400-tonnes-of-tobacco-seized>

ABF (Australian Border Force). 2018. *Melbourne man arrested over 10 tonne illicit tobacco haul*. Retrieved 2 June 2018 from <http://newsroom.border.gov.au/channels/Border-Operations-hidden/releases/melbourne-man-arrested-over-10-tonne-illicit-tobacco-haul>

ABF (Australian Border Force). 2018a. *Illicit Tobacco Industry Advisory Group*. Retrieved 2 May 2018 from <https://www.homeaffairs.gov.au/busi/engaging-with-the-department/Illicit-Tobacco-IG>

ABF (Australian Border Force). 2018b. *Commissioner's opening statement to Senate Estimates, Legal and Constitutional Affairs*. Retrieved 24 May 2018 from <http://newsroom.border.gov.au/releases/commissioner-s-opening-statement-to-senate-estimates-legal-and-constitutional-affairs>

ABF (Australian Border Force). 2018c. *Adelaide illicit tobacco investigation reveals cannabis crop*. Retrieved 2 June 2018 from <http://newsroom.border.gov.au/releases/adelaide-illicit-tobacco-investigation-reveals-cannabis-crop>

ABS (Australian Bureau of Statistics). 2015. *National Health Survey: First Results 2014-15* Catalogue 4364.0.55.001, Canberra

ADH (Australian Department of Health). 2002. *Plain packaging of tobacco products in Australia: frequently asked questions*. Retrieved 21 June 2018 from <http://health.gov.au/internet/main/publishing.nsf/Content/tobacco-res-license>

ADH (Australian Department of Health). 2015. *Plain packaging of tobacco products in Australia: frequently asked questions*. Retrieved 7 May 2018 from [https://www.health.gov.au/internet/main/publishing.nsf/Content/822B369C0196CB1CCA257D140082A22F/\\$File/TPP%20General%20FAQs.pdf](https://www.health.gov.au/internet/main/publishing.nsf/Content/822B369C0196CB1CCA257D140082A22F/$File/TPP%20General%20FAQs.pdf)

ADH (Australian Department of Health). 2016. Core Questionnaire of the Reporting Instrument of WHO FCTC: Survey Response No. 1. Retrieved 7 May 2018 from http://apps.who.int/fctc/implementation/database/sites/implementation/files/documents/reports/australia_2016_report_0.pdf

ADH (Australian Department of Health). 2016b. Submission to Parliamentary Joint Committee on Law Enforcement – Inquiry into Illicit Tobacco, Canberra. Retrieved 2 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/Illicit_tobacco/Submissions

ADH (Australian Department of Health). 2017. Tobacco Control Key facts and Figures: Smoking prevalence rates. Retrieved 1 May 2018 from <http://www.health.gov.au/internet/publications/publishing.nsf/Content/tobacco-control-toc~smoking-rates>

ADH (Australian Department of Health). 2017. Tobacco policy and programs to improve the health of all Australians by eliminating or reducing their exposure to tobacco in all its forms. Retrieved 1 May 2018 from <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco>

ADH (Australian Department of Health). 2018. The history of tobacco excise arrangements in Australia since 1901. Retrieved 3 May 2018 from <http://www.health.gov.au/internet/main/publishing.nsf/content/tobacco-tax>

ADHA (Australian Department of Home Affairs). 2018. *Excise equivalent goods administration*. Retrieved 7 May 2018 from <https://www.homeaffairs.gov.au/busi/cargo-support-trade-and-goods/importing-goods/excise-equivalent-goods-administration>

ADHA (Australian Department of Home Affairs). 2018. *Illicit Tobacco Industry Advisory Group*. Retrieved 24 May 2018 from <https://www.homeaffairs.gov.au/busi/engaging-with-the-department/Illicit-Tobacco-IAG>

Australian Department of Immigration and Border protection. 2012. Tobacco duty free limits reduce 1 September. Retrieved 4 May 2018 from <http://newsroom.border.gov.au/releases/Tobacco-duty-free-limits-reduce-1-September>

Australian Department of Immigration and Border Protection. 2016. Submission to Parliamentary Joint Committee on Law Enforcement – Inquiry into Illicit Tobacco, Canberra. Retrieved 2 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/Illicit_tobacco/Submissions

Australian Department of Immigration and Border Protection. 2017. Annual Report 2016-17 Retrieved 22 May 2018 from <https://www.homeaffairs.gov.au/ReportsandPublications/Documents/annual-reports/complete-annual-report-2016-17.pdf>

ATO (Australian Taxation Office). 2015. Excise guide-lines for the tobacco industry. Retrieved 9 May 2018 from <http://law.ato.gov.au/atolaw/view.htm?locid=%27SAV/TOBACCO/5.6%27>

ATO (Australian Taxation Office). 2016. Submission to Parliamentary Joint Committee on Law Enforcement – Inquiry into Illicit Tobacco, Canberra. Retrieved 2 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/IllicitTobacco45/Submissions

ATO (Australian Taxation Office). 2017. *ATO seizes tobacco worth \$1.5 million* Retrieved 8 May 2018 from [https://www.ato.gov.au/Media-centre/Media-releases/ATO-seizes-tobacco-worth-\\$1-5-million/](https://www.ato.gov.au/Media-centre/Media-releases/ATO-seizes-tobacco-worth-$1-5-million/)

ATO (Australian Taxation Office). 2018a. Record tobacco bust in Bundaberg, Queensland. Retrieved 23 May <https://www.ato.gov.au/Media-centre/Media-releases/Record-tobacco-bust-in-Bundaberg,-Queensland/>

ATO (Australian Taxation Office). 2018. Tobacco tax gap. Retrieved 21 May 2018 from <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/>

ATO (Australian Taxation Office). 2018b. More than 20 million dollars of illegal tobacco goes up in smoke. Retrieved 1 May 2018 from <https://www.ato.gov.au/Media-centre/Media-releases/More-than-20-million-dollars-of-illegal-tobacco-goes-up-in-smoke/>

ATO (Australian Taxation Office). 2018c. Tobacco Stakeholder Group. Retrieved 24 May 2018 from <https://www.ato.gov.au/general/consultation/consultation-groups/stakeholder-relationship-groups/tobacco-stakeholder-group/#Minutes>

ATO (Australian Taxation Office). 2018d. Excise rates for tobacco. Retrieved 4 May 2018 from <https://www.ato.gov.au/business/excise-and-excise-equivalent-goods/tobacco-excise/excise-rates-for-tobacco/>

ATO (Australian Taxation Office). 2018. Moving excisable goods. Retrieved 9 May 2018 from <https://www.ato.gov.au/Business/Excise-and-excise-equivalent-goods/Alcohol-excise/Moving-excisable-goods/#Exportmovementpermissions>

Bagshaw, E. 2017. *Inside Sydney and Melbourne's illegal tobacco hotspots that are costing the economy millions* Retrieved 8 May 2018 from <https://www.smh.com.au/politics/federal/inside-sydney-and-melbournes-illegal-tobacco-hotspots-thats-costing-the-economy-millions-20170928-gyqas3.html>

Bittoun, R. 2004. *The Medical Consequences of Smoking "Chop-Chop" Tobacco*. Prepared for the Commonwealth Department of Health and Ageing. Retrieved 8 May 2018 from <http://www.health.gov.au/internet/main/publishing.nsf/Content/phd-pub-tobacco-chopchop-cnt.htm>

BAT (British America Tobacco). 2011. *British America Tobacco Australia Submission on the Tobacco Plain Packaging Bill 2011* Parliament House, Canberra. Retrieved 3 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1112a/12bd035

BAT (British America Tobacco). 2016. Annual Report 2016. Retrieved 6 June 2018 from [http://www.bat.com/group/sites/uk__9d9kcy.nsf/vwPagesWebLive/DO9DCL3B/\\$FILE/medMDAKAJCS.pdf?openement](http://www.bat.com/group/sites/uk__9d9kcy.nsf/vwPagesWebLive/DO9DCL3B/$FILE/medMDAKAJCS.pdf?openement)

Bayly, M. 2016. 10.4 *Other importers operating in the Australian market*. In Scollo, M and Winstanley, M [editors]. *Tobacco in Australia: Facts and issues*. Melbourne: Cancer Council Victoria. Retrieved 8 May 2018 from <http://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-4-other-importers-operating-in-the-australian>

Budget. 2018. *Budget Paper No. 2: Budget Measures* Retrieved 28 May 2018 from <https://www.budget.gov.au/2017-18/content/bp2/html/>

Cancer Council of Victoria. 2014. Analysis of KPMG LLP report on use of illicit tobacco in Australia (Unpublished) Retrieved 22 May 2018 from http://www.cancervic.org.au/downloads/mini_sites/Plain-facts/analysis-kpmg-llp-report-illicit-tobacco-aust-2013.pdf

Dutton, P. 2016. *Expansion of ABF Tobacco Strike Team* Retrieved 24 May 2018 from <http://minister.homeaffairs.gov.au/peterdutton/2016/Pages/expansion-abf-tobacco-strike-team.aspx>

Freeman, B. 2016. 10.1 The tobacco growing industry. In Scollo, MM and Winstanley, MH [editors]. *Tobacco in Australia: Facts and issues*. Melbourne: Cancer Council Victoria; 2016. Available from <http://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-1-the-tobacco-growing-industry>

Grace, C. 2016. Legislation to ban smoking in public spaces. In Scollo, MM and Winstanley, MH [editors]. *Tobacco in Australia: Facts and issues*. Melbourne: Cancer Council Victoria; 2016. Retrieved 4 May 2018 from: <http://www.tobaccoinaustralia.org.au/chapter-15-smokefree-environment/15-7-legislation>

JTI (Japan Tobacco International). 2011. *Japan Tobacco International's response to the Australian Government's Consultation Paper on the Tobacco Plain Packaging Bill 2011 Exposure Draft*. Parliament House, Canberra. Retrieved 3 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1112a/12bd035

Kenny, M. 2018. *Government 'butt-squad' to chase billions in criminal tobacco fraud*. The Sydney Morning Herald 6 May 2018. Retrieved 23 May 2018 from <https://www.smh.com.au/politics/federal/government-butt-squad-to-chase-billions-in-criminal-tobacco-fraud-20180505-p4zdiv.html>

Hickey, P. 2018. Perth baker made plenty of dough smuggling two tonnes of tobacco. The Age. Retrieved 1 May 2018 from <https://www.theage.com.au/national/western-australia/perth-baker-made-plenty-of-dough-smuggling-two-tonnes-of-tobacco-20180314-p4z4b3.html>

Hirono, K and Smith. 2017. Australia's \$40 per pack cigarette tax plans: the need to consider equity. *Tobacco Control* 0.1136/tobaccocontrol-2016-053608. Retrieved 1 May 2018 from <http://tobaccocontrol.bmj.com/content/tobaccocontrol/early/2017/04/07/tobaccocontrol-2016-053608.full.pdf>

HMRC (HM Revenue & Customs). 2018. Tobacco tax gap estimates. Retrieved 21 June 2018 from <https://www.gov.uk/government/statistics/tobacco-tax-gap-estimates>

KPMG. 2016. *Illicit Tobacco in Australia: full year report 2015* (Unpublished). Retrieved 3 May 2018 from <https://home.kpmg.com/content/dam/kpmg/pdf/2016/04/australia-illicit-tobacco-2015.pdf>

Mather, J. 2017. *Border Force urges more power to stop illegal tobacco smugglers* Australian Financial Review Retrieved 2 June 2018 from <https://www.afr.com/business/legal/border-force-urges-more-power-to-stop-illegal-tobacco-smugglers-20170824-gy3f4n>

McKenzie, N. 2016. *A national security risk: Australian Border Force warns illegal tobacco trade may be fuelling terrorism*. Retrieved 7 May 2018 from <http://www.abc.net.au/news/2016-12-05/illegal-tobacco-trade-fuelling-drug-trafficking-and-terrorism/8075174>

Ministry of Home Affairs. 2017. *Changes to Australia's Duty Free Allowance* Retrieved 2 June 2018 from <https://www.homeaffairs.gov.au/News/Pages/changes-to-australias-duty-free-tobacco-allowance.aspx>

OECD. 2016. *Consumption Tax Trends 2016: VAT/GST and excise rates, trends and policy issues* Retrieved 22 May 2018 from <http://www.oecd.org/tax/consumption/consumption-tax-trends-19990979.htm>

- Parliament of Australia. 2014. *Explanatory Memorandum – Excise Tariff Amendment (Tobacco) Bill 2014* and Customs Tariff Amendment (Tobacco) Bill 2014 Retrieved 21 May 2018 from: http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r5172_ems_78ed6212-03a3-4669-9947-c3fc17c8b5e0/upload_pdf/391349.pdf;fileType=application%2Fpdf#search=%22legislation/ems/r5172_ems_78ed6212-03a3-4669-9947-c3fc17c8b5e0%22%29
- Parliament of Australia. 2018. *Explanatory memorandum – Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*. Retrieved from 1 June 2018 from http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6049_ems_7d941399-f916-400d-b044-97f2830340f8/upload_pdf/663268.pdf;fileType=application%2Fpdf
- PMI (Philip Morris International). 2011. *Commoditising tobacco products through plain packaging will harm public health, violate treaties, and does not meet the test of "evidence-based policy"* Parliament House, Canberra. Retrieved 3 May 2018 from https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1112a/12bd035
- Ross, H. 2015. *Controlling illicit tobacco trade: international experience* Economics of Tobacco Control Project, School of Economics, University of Cape Town and Tobaccconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago. Retrieved 9 May 2018 from <http://tobaccoecon.org/publications/reports/>
- Scollo M, Zacher, M, Durkin S, et al. 2014. Early evidence about the predicted unintended consequences of standardised packaging of tobacco products in Australia: a cross-sectional study of the place of purchase, regular brands and use of illicit tobacco. *BMJ Open* 2014; 4: e005873. doi:10.1136/bmjopen-2014-005873
- Scollo, M, Zacher, M, Coomber, K et al. 2015. Use of illicit tobacco following introduction of -standardised packaging of tobacco products in Australia: results from a national cross-sectional survey. *Tobacco Control* 2015;24: ii76–ii81.
- Scollo, M, Bayly, M. 2016. 10.3 The manufacturing and wholesaling industry in Australia—major international companies. In Scollo, M and Winstanley, M [editors]. *Tobacco in Australia: Facts and issues*. Melbourne: Cancer Council Victoria. Retrieved 8 May 2018 from <http://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-3-the-manufacturing-and-wholesaling-industry-in-australia>
- Thomas, M. 2016. *Tobacco excise increase* Budget Review 2016–17 Index, Parliament House, Canberra. Retrieved 4 May 2018 from https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201617/Tobacco
- Tobacco Asia. 2018. *Thailand Tobacco Monopoly bravely soldiering on*. Retrieved 6 June 2018 from <http://www.tobaccoasia.com/features/thailand-tobacco-monopoly-bravely-soldiering-on/>
- Treasurer and Minister for Home Affairs. 2018. *New Illicit Tobacco Taskforce and Tobacco Duty Measures to Fight Organised Crime* [Press Release]. Retrieved 7 May 2018 from <http://kmo.ministers.treasury.gov.au/media-release/049-2018/>
- Treasury. 2016. *Promoting health by reducing smoking* Tax Fact Sheet 09 Budget 2016 http://budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Tax/09-TFS-Tobacco.pdf
- Treasury. 2017. *Black Economy Taskforce: Final Report October 2017* The Australian Government, The Treasury, Canberra
- Treasury. 2018. *Tackling the Black Economy: Government response to the Black Economy taskforce final report*. The Australian Government, The Treasury, Canberra

WHO (World Health Organization). 2011. *Guidelines for the Implementation of Article 6.2 of the WHO Framework Convention on Tobacco Control*. World Health Organization, Geneva

WHO (World Health Organization). 2017. *WHO report on the global tobacco epidemic, 2017: monitoring tobacco use and prevention policies*. World Health Organization, Geneva

WHO (World Health Organization). 2018. *Six More Parties Needed for Illicit Trade Protocol Ratification*. Retrieved 10 June 2018 from <http://www.who.int/fctc/mediacentre/news/2017/nine-more-parties-for-protocol-ratification/en/>

Annexes

Annex 1

Licensing Requirements: Manufacture of Tobacco Products

1. EXCISE ACT CRITERIA TO OBTAIN A LICENSE TO STORE BONDED TOBACCO PRODUCTS UNTIL 1 JULY 2019

CRITERIA	REQUIREMENT
Fit and proper (person or corporation)	<ul style="list-style-type: none">› In the past 12 months has not been charged with an offence under the <i>Excise Act</i> or any Commonwealth, State or Territory Acts that carries a penalty in excess of \$105,000› In the past 10 years has not been convicted of an offence under the <i>Excise Act</i> or any Commonwealth, State or Territory Acts that carries a penalty in excess of \$105,000› History of compliance under any tax law in past four years› No previous cancellation of a licence› Sufficient financial resources, and› Not in receivership
Skills and experience of key staff	<ul style="list-style-type: none">› Sufficient to run the bonded operations
Physical security of premises	<ul style="list-style-type: none">› Appropriate for the nature of the goods› Appropriate for the type of premises› Procedures in place to secure premises
Plant and equipment	<ul style="list-style-type: none">› Appropriate to support the operations of the business
Market	<ul style="list-style-type: none">› A viable market for the products exists
Accounts	<ul style="list-style-type: none">› Sufficient for an audit to be conducted which can confirm the duty liabilities have been properly acquitted
Duty payment timing	<ul style="list-style-type: none">› Not solely to store goods so as to defer duty

Source: Author adapted from ATO Industry Guide-lines (2018) for licensing under the *Customs Act and Excise Act*.

2. TYPES OF UNDER-BOND MOVEMENT AVAILABLE FOR TOBACCO UNTIL 1 JULY 2019

TYPE OF MOVEMENT	PURPOSE	CONDITIONS
Single movement	Ad hoc or one-off need	May require security
Continuing	Contractual commercial relationship between parties dispatching and receiving Intra-company movement	Evidence of relationship Cannot change ownership in transit Record keeping
Export (single)	Ad hoc or one-off sale to overseas customer	May require security Export Declaration with ABF
Export (continuing)	Contractual commercial relationship with export customer	Evidence of relationship Record keeping Export Declaration with ABF
Tobacco seed and plants (single)	Ad hoc or one-off need	May require security
Tobacco seed and plants (continuing)	Contractual commercial relationship between grower and manufacturer	Evidence of relationship Cannot change ownership in transit Record keeping
Export of tobacco seed and plants (single)	Ad hoc or one-off sale to overseas customer	May require security Export Declaration with ABF
Export of tobacco seed and plants (continuing)	Contractual commercial relationship with export customer	Evidence of relationship Cannot change ownership in transit Record keeping Export Declaration with ABF

Source: Author based on data/information from ATO website (2018) on movement permissions

Annex 2

New Offenses and Penalties for Illicit Tobacco Crimes

PROPOSED OFFENSES AND PENALTIES FOR ILLICIT TOBACCO

OFFENCE	PENALTY
1. The possession, buying or selling by a person in Australia (excluding the external territories) of tobacco, in the quantities set out, for which there is a reasonable suspicion that excise or excise -equivalent customs duty has not been paid.	<ul style="list-style-type: none"> › 500 kg or more – five year’s imprisonment, or the higher of 1,000 penalty units or five times the amount of duty on that tobacco, or both; › 100 kg or more – two year’s imprisonment, or the higher of 500 penalty units or five times the amount of duty on that tobacco, or both; or › 5 kg or more – the higher of 200 penalty units or five times the amount of duty on that tobacco. <p>NB: penalty unit currently set at \$210 per unit.</p>
2. The possession, manufacture or production by a person in Australia (excluding the external territories) of a thing that is tobacco, for which the full amount of excise duty has not been paid.	<ul style="list-style-type: none"> › 500 kg or more – ten year’s imprisonment, or the higher of 1,500 penalty units or five times the amount of duty on that tobacco, or both; › 100 kg or more – five year’s imprisonment, or the higher of 500 penalty units or five times the amount of duty on that tobacco, or both; or › 5 kg or more – the higher of 500 penalty units or five times the amount of duty on that tobacco. <p>NB: penalty unit currently set at \$210 per unit.</p>
3. The possession by a person in Australia (excluding the external territories) of tobacco that equals or exceeds 2kg without documentation indicating how the person obtained the tobacco.	<ul style="list-style-type: none"> › Civil penalty of 100 penalty unit. <p>NB: penalty unit currently set at \$210 per unit.</p>
4. Possessing equipment used or for use in producing or manufacturing illicit tobacco.	<ul style="list-style-type: none"> › One year’s imprisonment or 120 penalty units. <p>NB: penalty unit currently set at \$210 per unit.</p>

Source: Explanatory Memorandum *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018*

CANADA

3

CANADA:

Controlling Illicit Tobacco Trade

Robert Schwartz¹

Chapter Summary

The tobacco industry instigated illicit tobacco trade in Canada in the 1990s in response to tobacco tax increases at both the federal and provincial levels. To illegally avoid these taxes, tobacco companies exported tobacco products over the border to the United States and engaged some Indigenous communities adjacent to the border in smuggling these products back into Canada and selling them untaxed. The tobacco companies admitted to this activity in an out-of-court settlement with the Canadian government and paid fines totaling \$1.7 billion.

To curb illicit tobacco activity in the 1990s, Canadian governments lowered taxes considerably, resulting in confirmed substantial increases in youth initiation and tobacco consumption.

The involvement of some Indigenous communities makes Canada's illicit tobacco market distinctive. Nation-to-Nation sensitivities between Indigenous communities and Canadian governments and the exemption of First Nations people from paying sales taxes on tobacco products constitute an important backdrop against which the illicit tobacco market operates. The Royal Canadian Mounted Police estimates that some 80 percent of illicit tobacco

¹ Dalla Lana School of Public Health, University of Toronto.

originates in border reserves in the provinces of Ontario and Quebec, while most of the remainder is counterfeit product shipped from ports in Asia to the province of British Columbia on Canada's west coast.

Government estimates of the size of the illicit tobacco market are sporadic and outdated. After control efforts all but eliminated illicit tobacco trade following the initial spike in the 1990s, independent estimates suggest that a substantial increase in illicit tobacco use occurred between the early 2000s and around 2008, followed by a gradual decline. Official estimates from Statistics Canada indicate that illicit tobacco reached 39 percent of total tobacco sales in 2008/9 and decreased to 32 percent in 2010/11. More recent estimates from independent non-governmental sources suggest that illicit tobacco has decreased to somewhere around 15 percent of the market in recent years.

Federal and provincial governments have implemented a panoply of policies to curb illicit tobacco, including: licensing; marking/labeling; export taxation; allocation/quota and refund/rebate systems for reserves where First Nations people are exempt from sales taxes on tobacco; tax harmonization agreements with reserves; and, enforcement efforts.

While anti-illicit tobacco measures have done much to reduce and contain the problem, illicit tobacco continues to constitute a substantial share of the tobacco market. The tobacco industry uses fears of stimulating illicit activity to dissuade Canadian governments from substantial tobacco tax increases and from advancing other tobacco control policies.

Canadian governments have been hesitant to adequately address illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. This is apparently due to understandable sensitivities around Nation-to-Nation relations and fears of sparking violent confrontations.

More can be done by Canadian governments to curb the illicit tobacco market, including: instituting tax refund/rebate systems for on-reserve retailers in Ontario and Quebec to replace the allocation/quota systems; working with affected Indigenous communities to develop alternative sources of revenue; enforcing existing stipulations in cooperation with the leadership and enforcement arms of relevant Indigenous communities; implementing an effective track-and-trace system not influenced by the tobacco industry; and publishing annual reports on the size of the illicit market and on measures to combat illicit tobacco.

1. Introduction

Canada has a non-illustrious history of trade in illicit tobacco and of policy measures to curb illicit activity. Partially it is a story of tobacco-industry instigation and manipulation. Partially it is about uninformed, insufficient, and ineffective government policy response. Some of Canada's Indigenous communities play a major role in the unfolding drama. Nation-to-Nation sensitivities between Indigenous communities and Canadian governments constitute an important backdrop against which the story plays out. Incremental and symbolic policy

solutions have recently yielded some positive results. However, illicit tobacco continues to affect the Canadian market. Policy players have yet to take the thoughtful and courageous steps needed to solve the problem, and ultimately to save the lives of tens of thousands of Canada's people. Canada has yet to sign the Framework Convention on Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products.

2. Unique Characteristics of Illicit Tobacco in Canada

Illicit tobacco presents considerable challenges to Canadian tobacco control efforts. Even conservative analyses estimate that illicit tobacco constitutes some 15 percent of the market. According to the Royal Canadian Mounted Police (RCMP), the lion's share of untaxed tobacco trade occurs in central Canada. Some indigenous communities engage in manufacture, distribution, and sale of illicit tobacco, "often exploiting the politically sensitive relationship between those communities and various governments and enforcement agencies" (Royal Canadian Mounted Police 2008). Certain indigenous communities in the vicinity of the borders of southwest Ontario, southeast Quebec, and New York State are at the epicenter of this activity. Supply from these areas reaches as far as the Atlantic and Northwest regions of the country. Counterfeit cigarettes present a much smaller, though not insubstantial, challenge in British Columbia, where ports facilitate commerce with Asia (Sweeting, Johnson & Schwartz 2009).

In Canada, a majority of illicit cigarettes are reportedly manufactured on four aboriginal reserves located in areas that border Ontario, Quebec, and New York State (Physicians for a Smoke-Free Canada 2010; Non-Smokers' Rights Association 2009). Government sources suggest that these manufacturers are the source for over 90 percent of contraband seizures in Canada (RCMP 2008; Framework Convention Alliance 2008). Cigarettes made and/or sold on reserves can cost substantially less than those bought from traditional retail outlets: as little as \$6 versus an average of \$80 in Ontario and \$73 in Quebec for a carton of 200 cigarettes (Non-Smokers Rights' Association 2012).

Under Canadian law, First Nations people purchasing cigarettes on reserves are exempt from direct taxes on personal property which include provincial tobacco taxes (paid by consumers) and both federal and provincial sales tax. Non-First Nations people purchasing cigarettes, even on reserves, are subject to all taxes. There is no First Nations exemption from the Federal Government's excise tax, paid by manufacturers. In order to regulate the supply of tax-exempt tobacco products on reserves, Ontario uses an allocation system that predetermines the quantity of tax-exempt products to be distributed to reserve retailers, based on population and consumption estimates. However, this policy is often circumvented by shipment of products manufactured on reserves to reserve retailers (Sweeting, Johnson & Schwartz 2009). The federal and provincial governments have undertaken measures to

decrease the supply of illicit tobacco, but the impact and consequences on contraband use are unknown (Schwartz & Johnson 2010).

3. Estimating and Guestimating the Extent of the Problem

There are wide variations in estimates of the prevalence of illicit tobacco use in Canada, with reports using different definitions and a variety of methodologies. No research has examined potential self-reporting bias associated with contraband tobacco; given its illegality, smokers may under-report illicit tobacco use. As in other countries, the tobacco industry and its allies publish estimates which independent review suggests are unreliable. Euromonitor estimates are also suspect, as studies suggest that they have been adjusted to accord with industry claims that increases in tobacco taxation have led to increases in illicit tobacco (Guindon, Burkhalter and Brown 2017).

An independent Canadian source, Physicians for a Smoke-Free Canada, estimates illicit consumption by comparing government data on tax-paid cigarettes sales with self-reported survey data on number of cigarettes smoked. According to these estimates, the proportion of illicit cigarettes consumed across Canada grew from 10 percent in the early 2000s, peaked at some 30 percent in 2007/8, and decreased to as little as 11 percent in 2011 (Guindon, Burkhalter and Brown 2017; Physician for a Smoke-Free Canada 2010). Estimates from Statistics Canada, the official government agency, suggest a somewhat different trend, with illicit sales as a share of total tobacco sales increasing to about 39 percent in 2008 and 2009, then decreasing to about 32 percent in 2010 and 2011 (in Guindon, Burkhalter and Brown 2017). The upward trend to 2007 and 2008 is supported by analysis of survey data reporting the source of respondents' last cigarette purchase as being a First Nations reserve. The proportion of respondents indicating that their last purchase occurred on a reserve increased from 2 percent in 2002 to 10 percent in 2007/8 (Guindon et al 2014). Guindon, Burkhalter and Brown (2017) note that:

Recent estimates suggest conflicting trends. One set of self-reported data suggested a steep increasing trend in cigarette contraband in Canada, and Ontario in particular, peaking at about 40 percent in late 2014, while other estimates suggested that cigarette contraband in Ontario actually declined by more than 1/3 from 2008 to 2012.

A recently published critical re-analysis of data from several sources concludes that Canada experienced a substantial increase in illicit tobacco use between the early and late 2000s and that, since then, there has been a decline, particularly in the province of Quebec (Guindon, Burkhalter and Brown 2017).

In both Ontario and Quebec, the two provinces where the bulk of the problem lies, estimates of the size of the illicit tobacco market vary widely. The population of Ontario and

Quebec combined is 22.6 million, some 62 percent of the entire Canadian population of 36.7 million (Statistics Canada 2018). The number of smokers in these two provinces was recently estimated to be 3.16 million, compared with 5.04 million across Canada (Ontario Tobacco Research Unit 2018). In Ontario, estimates of the prevalence of the illicit market range from 14 to 42 percent of all cigarettes bought by adult smokers (Luk et al. 2009; Physicians for a Smoke-Free Canada, 2010). One Ontario study found that 11.5 percent of current smokers usually bought cigarettes on reserves, and 25.8 percent had bought cigarettes from reserves in the past 6 months (Luk et al. 2009). In Quebec, illicit trade prevalence estimates range from 31 percent in 2007 and 20 percent in 2010-11 to 37 percent (Commission des finances publiques 2012). A representative survey conducted in 2010 by Institut de la Statistique du Québec (ISQ) estimated illicit tobacco consumption at 13 percent among those aged 15 and older (Laprise & Bordeleau 2010). This survey showed 52 percent of contraband users purchased baggies (Ziploc bags of 200 cigarettes) (Laprise & Bordeleau 2010). According to 2010 CTUMS data, 14 percent of Canadian current smokers reported purchasing cheaper cigarettes on First Nations reserves in the past 6 months and 2 percent reported purchasing smuggled cigarettes in the past six months (Tobacco Informatics Monitoring System (TIMS) 2012).

Evidence about the role of socio-economic status (SES) and other demographic factors in illicit tobacco behaviors is mixed and inconclusive. In an Ontario study, smokers of illicit cigarettes were more likely to be over the age of 45, female, have lower educational attainment, live in a rural area, be highly nicotine dependent, have no intention to quit, and to perceive themselves as highly addicted (Luk et al. 2009). A Quebec study, however, found that males were more likely than females to smoke illicit cigarettes (17 percent vs 8 percent). Survey data suggest that youth may be particularly prone to using illicit tobacco. According to one survey-based estimate, daily smokers in Ontario of high school age obtained 43 percent of their cigarettes from illicit sources (Guindon, Burkhalter and Brown 2017).

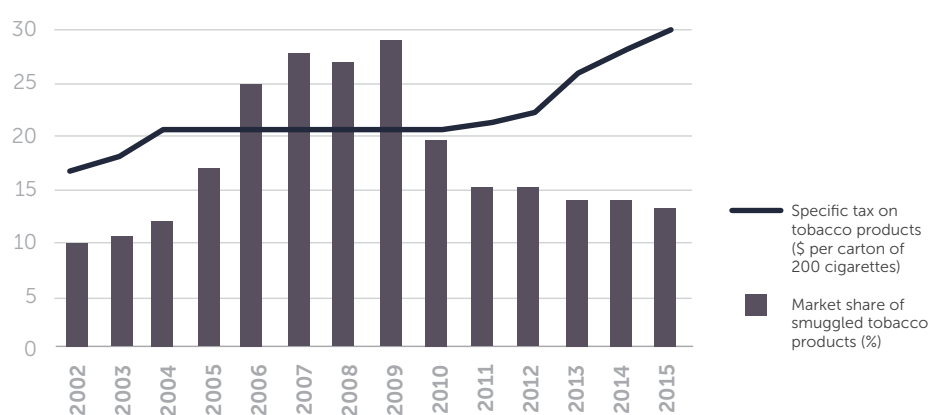
In 2008, Ontario's Auditor General found that the illegal tobacco trade cost the province \$500 million in foregone revenue - enough to cover the provincial budget deficit for the year (Schwartz and Johnson 2010).

Quebec's relative success in decreasing illicit tobacco consumption has been attributed to a concerted and coordinated enforcement effort with substantial funding (see below, Enforcement). The ACCES Tabac (Actions Concertées Pour Contrer les Économies Souterraines / Concerted Action Program to Counter the Underground Economies) Tobacco Program initiative aims to dismantle smuggling networks and to reduce tax revenue losses associated with illicit tobacco trade. The Quebec government credits ACCES Tabac with making substantial inroads in decreasing smuggling and in increasing tobacco tax revenue. According to the Quebec Ministry of Finance, tobacco tax revenue increased from \$654 million in 2008-2009 to \$1,026 million in 2013-2014 – a period during which the prevalence of tobacco use did not increase (Zhang & Schwartz 2015). The illicit market share decreased, according to the Quebec Ministry of Finance, from some 30 percent in 2009

to less than 15 percent in 2012 (Figure 1). It has held steady or declined slightly more since 2012 despite three tax increases (Zhang & Schwartz 2015), providing strong evidence that efforts to improve tax administration and enforcement are much more important than taxes in determining the illicit market share.

Figure 1. Change in the Rate of the Specific Tax on Tobacco Products and in the Market Share of Smuggled Tobacco Products, Quebec, 2002-2015

(dollars per carton of 200 cigarettes and per cent)



Sources: Statistics Canada, Sureté du Québec and Ministère des Finances du Québec.

4. Tobacco Control in Canada – A Brief Summary

Since the 1990s, Canada has gradually adopted a fairly robust spectrum of tobacco control measures. On most of the WHO MPOWER indicators, Canada scores fairly well. MPOWER consists of six indicators that include monitoring prevalence data (M), smoke-free policies (P), cessation programs (O), health warnings on cigarette packages and anti-tobacco mass media campaigns (W), advertising bans (E), and taxation (R). The distribution of power between national and provincial/territorial governments leaves considerable authority for tobacco control in the hands of provincial and territorial governments (Canada has 10 provinces and 3 territories.) The federal government regulates tobacco products, restricts marketing, and charges excise taxes. It also invests in research, surveillance, and public education and in promoting cessation and prevention programming. Provinces and territories have taken the lead in smoke-free policies, cessation programming, prevention measures, and tobacco sales taxes while also investing in public education. Moreover, municipal governments play a major role, particularly in relation to protection from second-hand smoke and to a degree regarding retail sales.

Federal agencies are charged with preventing smuggling across international borders and work with provincial agencies in combatting illicit tobacco activity.

A 2014 analysis gave Canada a score of 24 out of 29 on an MPOWER scale, demonstrating that Canada has largely met minimum standards in the areas of monitoring, smoke-free policies, health warnings on cigarette packages, and advertising bans, but fared somewhat less well on anti-tobacco mass media campaigns and taxation (Dubray et al. 2014).

Canada has been a pioneer and an early adopter of some of the most important tobacco control measures that are both included in and go beyond MPOWER. It was one of the first countries to introduce graphic warning labels and among the first to extend smoking restrictions to all indoor public places and workplaces, to ban point of sale promotion, and to implement retail display bans. Recently, Canada implemented bans on flavored and menthol tobacco. Plain packaging legislation has passed and will also soon be implemented.

Of note, Canada's most populous jurisdictions do not meet the minimum MPOWER standard for taxation. For example, in Ontario, federal and provincial tobacco and sales taxes combined account for 65.1 percent of the retail price of a carton of cigarettes, well below the 75 percent required to meet the highest scoring category in the MPOWER scale (Ontario Tobacco Research Unit 2017).

5. Origins: Tobacco Industry-Induced Illicit Trade

Until the early 1990s, illicit tobacco was not a major challenge in Canada. Trade in illicit tobacco emerged following substantial tax increases in the year 1991, at both the federal and provincial levels. Responsibility for the rapid development of Canada's illicit tobacco market at this time rests with the legal tobacco industry (Cunningham 1996; Non-Smokers' Rights Association 2007-6). It is estimated that illicit tobacco captured more than one-quarter of the overall tobacco market (Schwartz & Johnson 2010).

Following the tax increases, tobacco companies exploited the lack of an export tax on cigarettes and Canada's permeable border with the United States to develop a large-scale smuggling operation. They legally exported cigarettes to the United States where they were stored in duty-free warehouses in New York State. Working with networks of criminal groups, the cigarettes were then smuggled back into Canada and sold illicitly, thus avoiding the high federal and provincial taxes. This allowed tobacco companies to sell cigarettes more cheaply to consumers while still reaping considerable profits (Cunningham 1996; Schwartz & Johnson 2010). Tobacco companies worked primarily with smuggling networks based on three First Nations reserves: The Akwesasne Mohawk First Nation reserve, which strategically straddles the borders between the Canadian provinces of Ontario and Quebec and the US state of New York; the Kahnawake reserve near Montreal, Quebec, and the Six Nations reserve near Brantford, Ontario (Cunningham 1996).

Importantly, observers even at this stage of Canada's illicit tobacco history noted that, even though the government knew where the sources and distribution channels were, officials "were reluctant to conduct seizures, due to the multi-jurisdictional context of the problem,

as well as the impact of the 'Oka Standoff,' which was a conflict between the Mohawks of Oka and the Quebec police" (Sweeting, Johnson and Schwartz 2009).

Recognizing the dramatic increase in illicit tobacco, the federal government implemented, in 1992, a substantial export tax of \$8 on a carton of 200 cigarettes. Exports immediately decreased by 60 percent. In 1992, the tobacco industry exercised considerable political clout to ensure its ability to continue its illegal practice, and the export tax on cigarettes was rolled back, enabling the industry to continue its smuggling operations (Cunningham 1996). Rather than addressing the illegal activity of the tobacco industry and its associates, federal and provincial governments eventually instituted dramatic tobacco tax cuts. This followed considerable political pressure, including Quebec vendors' openly selling illicit tobacco to dramatize the challenges they faced in not being able to compete with cheap, smuggled tobacco (Cunningham 1996). Federal tobacco taxes were reduced by \$10 per carton and provinces followed suit with tobacco tax cuts of their own. The tobacco export tax was also reinstated (Cunningham 1996; Zhang et al 2006).

While these measures effectively ended the illicit tobacco trade of the early 1990s, they had an overall long-term effect of increasing the prevalence of smoking and cigarette consumption. Epidemiologic studies attribute large increases in tobacco initiation to the domestic tobacco tax cuts of the mid-1990s (Canadian Cancer Society et al. 1999; Waller et al. 2003; Zhang et al. 2006). These studies highlight that the tax cut led to increased smoking, particularly among youth.

Moreover, tobacco industry and government actions and inactions throughout the 1990s allowed for the development of an illicit tobacco supply chain that continues to pose challenges to this day. Eventually, tobacco companies pled guilty in a lawsuit in which they were charged with exporting tobacco products in order to smuggle them back into Canada for sale on the illicit market (Canadian Cancer Society 2017). Claims made by the federal and provincial governments in the legal proceedings totaled \$5,279,631,667 (Canadian Cancer Society 2017). Eventually, the Canadian government settled for a much smaller amount, and the tobacco companies paid fines of \$1.7 billion to the Government of Canada (Canadian Cancer Society 2017).

6. Illicit Tobacco in the 21st Century

By the early 2000s, illicit tobacco once again started to emerge as a serious challenge to Canada's tobacco control efforts. The epicenter of illicit trade was the same as in the 1990s, with the border First Nations reserves in Ontario and Quebec being the source of more than 90 percent of illicit tobacco seizures (Schwartz and Johnson 2010). In the new manifestation of large-scale illicit trade, there is no apparent direct role of the tobacco industry. It does not involve the tobacco industry's exporting its own manufactured cigarettes to the United States and then having them smuggled back into Canada. Rather:

Over the past 20 years the cultivation of tobacco, and the manufacture, distribution and sale of tobacco products on reserves in Ontario has emerged. The on-reserve tobacco industry has not only emerged but, in some communities, solidified itself as an important economy. (Lickers and Griffin 2016)

According to the Royal Canadian Mounted Police (RCMP), illegal manufacture of cigarettes occurs primarily on a handful of First Nations reserves and in particular on the United States side of the Akwasasne reserve that straddles the borders of the Canadian provinces of Ontario and Quebec and the American state of New York (RCMP 2011). The RCMP notes that much of the illicit tobacco activity in the 2000s occurs in the same places it developed in the late 20th century:

In particular, the vicinity of Valleyfield, Quebec, and Cornwall, Ontario, which was the centre of tobacco smuggling operations in Canada in the late 1980s and early 1990s, remains as a critical passageway for the illicit tobacco trade in Canada; smugglers exploit the geography of the area, which borders the St. Lawrence Seaway, moving contraband goods from the U.S. to Canada (RCMP 2011).

While the lion's share of illicit tobacco sales appear to be in the provinces of Ontario and Quebec, the RCMP notes that illicit tobacco from these provinces is also sold in the Atlantic and Northwest regions of Canada and as far west as the Pacific Ocean province of British Columbia. It is estimated that illicitly manufactured and smuggled cigarettes from this region constitute over 80 percent of the contraband tobacco market in Canada. Most of the remainder appears to be counterfeit product shipped from Asia to ports in British Columbia. In 2010, the RCMP reported seizing 51,000 cartons of counterfeit cigarettes (RCMP 2011).

7. Panoply of Federal and Provincial Policies to Curb Illicit Tobacco

Federal and provincial governments have adopted and implemented numerous measures to combat illicit tobacco and, periodically, continue to announce incremental changes. A comprehensive report of anti-contraband measures, published in 2009, discusses several such measures; others are identified in a 2017 Canadian Cancer Society summary of tobacco control legislation in Canada. They include: 1) licensing, 2) marking/labeling, 3) export taxation, 4) allocation/quota systems for Indigenous reserves, 5) refund/rebate systems for reserves, 6) tax harmonization and Indigenous tax agreements/compacts, and 7) enforcement (Sweeting, Johnson and Schwartz 2009, Canadian Cancer Society 2017).

Licensing: Tobacco manufacturers require a manufacturer's license from the federal government. Manufacturers in the provinces of Ontario and Quebec also require a license from these provincial governments (Canadian Cancer Society 2017). In addition, the province of Quebec has licensing requirements for tobacco "importers, wholesalers, retailers,

transporters (including transporters of leaf tobacco), growers, storers/warehouseurs, and persons in possession of manufacturing equipment" (Canadian Cancer Society 2017). A related measure, taken by the federal government and by the provinces of Ontario and Quebec, is restricting the supply of leaf tobacco to licensed manufacturers. As of January 2018, Ontario has also restricted the supply of cigarette filter materials to licensed manufacturers (Canadian Cancer Society 2017).

Marking / labeling: Cigarette packages in Canada must bear a tax stamp indicating that taxes have been paid. Separate tax stamps in different colors indicate that federal and then respective provincial taxes have been paid. There is a separate marking for cigarette packages intended for sale on First Nations (Indigenous) reserves for which federal excise tax has been paid by manufacturers and which are exempt from direct provincial tobacco tax and sales taxes (see below).

Export taxation: General trade practice is that exported goods are not subject to taxes or duties. However, Canada, along with some other countries, has imposed an export tax (federal) on cigarettes to combat the phenomena of untaxed exports of cigarettes being sold in bordering countries and smuggled back into the country to be sold illicitly (with domestic tax unpaid) (Sweeting, Johnson and Schwartz 2009). Canada maintains its export tax on cigarettes at the rate of 8 dollars per carton of 200.

Allocation / quota systems for reserves: Canada's First Nations (Indigenous) people are exempt from sales taxes on tobacco as part of treaty rights that exempt them from taxation of personal property, in accordance with Section 87 of the *Indian Act* (Sweeting, Johnson and Schwartz 2009). The availability of tax-exempt tobacco product for use by First Nations people has created an opening for illicit purchases by non-Indigenous people. Each province and territory has devised its own system for addressing the purchase by non-Indigenous people of tax-exempt tobacco intended for consumption by Indigenous people. Five provinces and one territory (British Columbia, Manitoba, New Brunswick, Nova Scotia, and Northwest Territories) use quotas, based on formulas that take into account the number of adult residents and the number of cigarettes per resident, to allocate shipments of tax-exempt cigarettes to each reserve (Canadian Cancer Society 2017). Sweeting et al (2009) note that quota allocation systems are imperfect mechanisms for controlling the illicit purchase of non-taxed cigarettes by non-Indigenous consumers:

Allocation systems, where tax-exempt products are limited based on a formula that takes into account population and consumption averages, appear to be ineffective, because allocation formulas are often generous, and provide no mechanism to ensure that non-eligible consumers cannot purchase the product. Key informants in Ontario noted that the allocation system in the province of Ontario was particularly ineffective, as products manufactured on First Nations reserves were often shipped to reserves in excess of the allocation formula, therefore undermining the premise of the allocation policy

altogether. If stringent controls and tight allocations cannot be guaranteed, quota systems become irrelevant.

In 2015, the Government of Ontario commissioned an independent external review of its allocation system. The resulting report reviews critical perspectives of a variety of stakeholders. It clarifies that the allocation system does not take into account the emergence of substantial amounts of tobacco that are now cultivated and manufactured on reserves:

First Nations are able to acquire First Nation manufactured brands through trading channels that do not depend upon the allocation regime. This conduct Ontario views as illegal under the TTA (Tobacco Tax Act). There is currently only one on-reserve manufacturer that is also a licensed wholesaler/distributor within the current allocation system. First Nation retailers do not rely upon the allocation amounts to draw against this company's products. Why deplete their quota when they can secure these First Nation products in any event (Lickers and Griffin 2016)?

The review outlines several options for improving Ontario's system. Two years after the report was written, the Ontario Ministry of Finance website, accessed in August 2018, notes that, "The Ministry of Finance is currently reviewing the facilitators' final report and carefully considering each of the recommendations." (<https://www.fin.gov.on.ca/en/tax/tt/fncigaretteallocation.html> - accessed on 12.08.18)

Refund / rebate systems for reserves: Six provinces and one territory apply a refund/rebate system to handle tax-exempt sales on reserves (Alberta, Saskatchewan, Manitoba, Quebec, New Brunswick, Prince Edward Island, and Northwest Territories) (Canadian Cancer Society 2017). Manitoba, New Brunswick, and Northwest Territories combine quota allocation and refund/rebate systems (Canadian Cancer Society 2017). Refund/rebate systems place the onus on on-reserve retailers. The price of tobacco products that are shipped to them includes the amount equivalent to the taxes that would be required of non-Indigenous consumers. The product is then sold to Indigenous consumers, with appropriate identity cards, at a price that does not include the taxes. Retailers then send a form to the provincial government with the amount sold and name of the consumer in order to get reimbursed for the tax amount (Canadian Cancer Society 2017). Some provinces also restrict the amount of tax-exempt product that an Indigenous consumer can purchase in an attempt to decrease their ability to resell to non-Indigenous people (Sweeting, Johnson and Schwartz 2009).

Ontario's independent review report includes a refund/rebate system as one option for policy change, noting that it could utilize the "Certificate of Exemption" recently developed for on-reserve gasoline purchases. The report cautions that an electronic system for real-time transaction tracking would be expensive and might encounter challenges of internet connectivity as well as opposition from Indigenous stakeholders (Lickers and Griffin 2016).

8. Tax Harmonization - First Nations Tax Agreements

Tax harmonization is an often-mentioned measure to counter illicit tobacco sales. Harmonization schemes aim to decrease tax avoidance by ensuring similar tax rates in neighboring jurisdictions so as to reduce or eliminate cross-border trade in cheaper tobacco (Sweeting, Johnson and Schwartz 2009). The availability of non-taxed tobacco products for purchase by non-Indigenous people on First-Nations reserves is akin to two provinces, states, or countries having substantially different tobacco tax rates. Tax harmonization in this case comes in the form of Tax Agreements between First Nations communities and Canadian governments.

Three Canadian provinces have negotiated Tax Agreements with First Nations communities. New Brunswick refunds 95 percent of taxes that First Nations collect on the sale of tobacco and of gasoline to non-Indigenous people making purchases on reserves (Lickers and Griffith 2015). In Manitoba, 59 First Nations are party to Tax Agreements under which they collect tobacco taxes at the province's rate on tobacco products sold to both Indigenous and non-Indigenous people. They then receive back from the provincial government the revenues emanating from purchases by Indigenous people (Lickers and Griffith 2015). Some British Columbia First Nations collect their own levies on tobacco sales and use revenues to cover the cost of community services. For example, the Cowichan Tribes have imposed a levy equivalent to 80 percent of the provincial tobacco tax (Sweeting, Johnson and Schwartz 2009).

Negotiation of Tax Agreements can be a lengthy process. The Government of Ontario signed agreements-in-principle with two First Nations communities only after five years of discussions. Notably, in 2017, an agreement-in-principle was signed with the community of Akwesasne, which is one of the border reserves identifies as being a major source of illicit tobacco. The language of the government press release highlights that the agreement-in-principle is far from being an actual Tax Agreement:

... [T]he Mohawk Council of Akwesasne has begun the internal consultation and legal work to examine how community-based regulation could advance public health priorities while growing its economy. The purpose of the agreement-in-principle is to guide negotiations as Ontario and the Mohawk Council of Akwesasne work toward an agreement.²

² From (<https://news.ontario.ca/mof/en/2017/12/ontario-signs-tobacco-agreement-in-principle-with-mohawk-council-of-akwesasne.html>) Archived News Release. Ontario Signs Tobacco Agreement-in-Principle With Mohawk Council of Akwesasne Province Partnering with First Nations to Support Community Growth and Prosperity. December 20, 2017 2:30 P.M. Ministry of Finance.

9. Enforcement

Since 2007, the federal government has renewed its efforts to tackle illicit tobacco as part of the Federal Tobacco Control Strategy (Guindon, Burkhalter and Brown 2017). Measures taken include the establishment of the “First Nations Organized Crime Initiative,” the RCMP’s Contraband Tobacco Enforcement Strategy, and the Task Force on Illicit Tobacco Products (Guindon, Burkhalter and Brown 2017).

Quebec has taken the lead in pioneering considerable efforts at the provincial level. These include legislation to track and control raw leaf tobacco, increased fines, and empowering municipal governments (Guindon, Burkhalter and Brown 2017). Noteworthy is Quebec’s substantial investment in enforcement efforts through the special collaborative initiative ACCES Tabac cited earlier. Partners in ACCES Tabac include: The Ministry of Finance (MFQ); The Ministry of Health and Social Services (MSSS); The Sûreté du Québec (SQ); The Police Service of the City of Montreal (SPVM); Association of Quebec Police Directors (ADPQ); and the Royal Canadian Mounted Police (RCMP). With an annual budget of \$18 million, ACCES Tabac is able to devote considerable resources to its two strategic activities: 1) Point-of-sale inspections to ensure that illicit tobacco is not being sold; and 2) investigations to “detect and dismantle illegal supply and distribution networks for tobacco product” (Ministere de la Securite Publique Quebec 2018).

Ontario has also been active in announcing measures to curb illicit tobacco. In 2014, Ontario required new tobacco stamps on cigarette packages and fine cut tobacco to improve identification of illicit product. In 2015, the Province improved oversight of raw leaf tobacco, and in 2016 it established a new Contraband Tobacco Enforcement Team in the Ontario Provincial Police Organized Crime Enforcement Bureau. The aim was to improve enforcement by increasing capacity to investigate smuggling and trafficking of illicit tobacco (Smoke-Free Ontario Scientific Advisory Committee 2016). A further enforcement enhancement step is an information-sharing agreement between the Ontario Ministry of Finance and the Alcohol and Gaming Commission of Ontario, providing for suspension of lottery licenses to vendors who sell illicit tobacco. Raw leaf tobacco oversight now includes “baling or packaging, labelling, transportation, record-keeping and reporting requirements and exemptions for raw leaf tobacco registrants” (Smoke-Free Ontario Scientific Advisory Committee 2016)

10. Additional Measures

The Canadian Cancer Society’s (2017) summary of Canada’s legislative stipulations related to illicit tobacco lists several additional measures that are in place in Canadian jurisdictions:

1. Requiring the provision of a bond/security that could be forfeited in the event of non-compliance, as some governments have done.

2. Requiring that importers into a province pay to the government an amount equal to tobacco tax at the time of importation rather than at a subsequent point, such as at the point of sale within the province.
3. Allowing local police to keep fines arising from enforcement action, thus providing greater resources and incentives to local police for enforcement. Quebec has done this.
4. Prohibiting the sale or offering for sale at a price lower than the total amount of federal and provincial tobacco taxes. Quebec has done this.
5. Authorizing tickets to be issued for infractions. Several provinces have done this.
6. Prohibiting individuals from possessing more than a specified quantity of cigarettes/ tobacco products. Several provinces prohibit possession of more than 5 cartons (1000 cigarettes). As an example, Manitoba's possession limit is 5 units, with a unit being 200 cigarettes, or 50 cigars, or 200 grams of any other type of tobacco product.
7. Prohibiting the sale or purchase of more than a specified quantity at any one time, or per day. One or more provinces have done this. At example might be to prohibit more than 2 cartons (400 cigarettes) from being sold / purchased at any one time.
8. Establishing a maximum daily or weekly tax-exempt purchase limit on reserves, such as one carton. Saskatchewan has a limit on purchasing of 200 units of tax-exempt tobacco products per week, and a limit on possessing 800 units of tax exempt tobacco products. A unit includes one cigarette, one cigar, one tobacco stick, or one gram of other tobacco products.
9. Requiring importing consumers to pay tobacco taxes to the government, but setting allowable quantity exemptions. For example, Saskatchewan allows importing consumers to bring in tax-free 200 cigarettes, 200 tobacco sticks, 200 grams of tobacco and 50 cigars provided that the products are marked for sale in another province, or the products are an allowable tax-exempt importation when entering Canada.
10. Cross appointing health inspectors to be inspectors under tobacco tax legislation. This is useful, for example, so that health inspectors can seize illegal product immediately without having to call and wait for a tobacco tax inspector (who might even be in a different city).
11. Requiring a provincial government identification card to be presented to be able to purchase tax-exempt products on reserve.
12. Requiring record keeping for on-reserve retailers selling tax-exempt tobacco products. Saskatchewan and some other provinces have done this.
13. Providing for the ability to suspend a driver's license when a motor vehicle was used as part of a contraband offence. Several provinces have done this.
14. Providing that seized contraband is forfeited to the government. Several provinces have done this. (Canadian Cancer Society 2017)

11. Gaps: What is Missing from Canada's Effort to Curb Illicit Tobacco?

What is clear to observers of Canada's illicit tobacco market is that Canadian governments have largely been unwilling to deploy the tools at their disposal to address the sources and channels for the bulk of the illicit tobacco supply in Ontario and in Quebec. Licensing, tax stamps, allocations systems, rebate systems, and enforcement efforts neglect the cultivation and manufacture of tobacco on some First Nations reserves and its distribution and untaxed sale through channels on multiple reserves and off-reserve (Lickers and Griffin 2016). First Nations representatives participating in an Expert Focus Panel in 2009 indicated that First Nations would oppose government action to control this activity, on the grounds that it is their right to produce and sell tobacco and that the economic benefits are such that taking away the revenues from this activity would create severe hardship (Sweeting, Johnson and Schwartz 2009). This, they agreed, applied equally to efforts at tax harmonization (tax agreements) which they thought "would keep communities trapped in the cycle of poverty." The Government of Ontario's inaction on implementing recommendations of the independent review of the allocation system which it commissioned, and the fact that after five years of negotiating with two First Nations communities, it has still not reached Tax Agreements, demonstrate the challenges to moving forward in this way.

Internationally, tracking and tracing has been a central element in efforts to curb the illicit tobacco trade. Notably, Canada does not have a tracking and tracing system in place (Canadian Cancer Society 2017). Tracking and tracing mechanisms use machine-readable markings on tobacco packages containing information about the product, such as its origin and destination. In a comprehensive tracking and tracing regime, authorities are able to track the movement of the product along the supply chain. During inspections or seizures, inspectors are able to scan the marking on the package, both to trace the origin of the product and to determine the last point at which the product was scanned. This provides investigators with a clear view of where the product came from, where it was destined to go, and at what point the product was diverted from its intended route. Similar to enhanced tax-paid markings, tracking and tracing markings also allow authorities to quickly determine whether a package of cigarettes is counterfeit (Sweeting, Johnson and Schwartz 2009).

The absence of a tracking and tracing system in Canada is a major deficiency, that should be addressed. However, a recent evidence-informed article indicates that many jurisdictions have relied on the tobacco industry (specifically the Codentify system developed and made available by PMI) to develop and implement tracking and tracing systems that are highly suspect in their ability to identify illicit tobacco (Gilmore, Gallagher and Rowell 2018):

Governments should assume the TI seeks to control T&T systems in order to avoid scrutiny and minimise excise tax payments and that any T&T system based on Codentify, on intellectual property currently or previously owned

by the TI, or being promoted or implemented by companies with TI links, is incompatible with the ITP and would not serve to reduce illicit trade.

12. Industry Harnessing of Illicit Trade Concerns to Fight Tobacco Control

Canada has seen some success in curbing illicit tobacco trade. Government measures have undoubtedly contained illicit activity, and global evidence suggests that government spending on anti-smuggling is effective (Yurelki & Sayginsoy 2010). However, even in the province of Quebec, where enforcement efforts have been strongest, illicit tobacco still accounts for some 15 percent of the overall tobacco market (Figure 1). The tobacco industry exploits the continued illicit tobacco problem in Canada through direct and indirect efforts aimed at preventing governments from adopting effective tobacco control measures. This particularly applies to substantial tobacco tax increases. Industry spokespersons have been largely successful in propagating a belief that tax hikes on tobacco products cause (large) increases in illicit tobacco activity. This perception has likely contributed to Canada's two most populous provinces' maintaining tobacco tax rates below minimum standards set out in the World Health Organization's MPOWER platform. Both international published literature and a recent analysis of the relationship between tobacco tax rates and illicit tobacco trade have clearly demonstrated that tax increases do not necessarily lead to substantial and sustained increases in illicit tobacco consumption (Schwartz and Zhang 2016).

Moreover, Canadian research reveals the tactics employed by the tobacco industry in spreading myths about the current size of the illicit tobacco market and its expected growth, should governments raise taxes on tobacco products or adopt other rigorous tobacco control policies. This happens in three ways: 1) unsubstantiated over-estimates of the size of the illicit market; 2) influence on media sources; and 3) the industry's funding think tanks to publish reports warning that tax increases will lead to high levels of illicit tobacco.

Invalid estimates. The tobacco industry routinely commissions research and publishes results that inflate, sometimes grossly, the size of the illicit market in Canada. Only partial descriptions of methods are typically published. What is published has been sharply criticized by academic researchers (Zhang and Schwartz 2015; Smith et al. 2017).

Influence on media sources. Smith et al (2017) conducted a media analysis of articles related to illicit tobacco in Canadian newspapers over a five-year period (2010-2015). They found that illicit tobacco is most commonly presented in ways that favor the tobacco industry. Articles quote organizations with both known and unrevealed links to the tobacco industry. Examples are the Canadian Convenience Store Association, the Taxpayer's Federation, and the Reason Foundation, all of which receive support from the tobacco industry (Smith et al 2017).

Purchasing the services of think tanks. In the past few years, reports by two generally respected think tanks, the Fraser Institute and the C.D. Howe Institute, came out strongly against raising taxes on tobacco products, citing the risk of large increases in illicit tobacco sales. Neither organization revealed that it had received funding from tobacco companies. The evidence in the Fraser Institute Report has been independently assessed and found to be incorrect or misleading as presented (Zhang and Schwartz 2015).

13. Recommendations

To further decrease the illicit tobacco market in Canada, several measures might be considered:

1. Ontario and Quebec should adopt a refund/rebate system that puts the onus on on-reserve retailers for collecting sales taxes on tobacco purchased by people other than Indigenous people who are entitled by law to not pay these taxes. Technological and administrative solutions should be sought to minimize challenges that this would pose to on-reserve retailers.
2. The federal and provincial governments should work with Indigenous communities where illicit tobacco constitutes an important revenue source to develop alternative sources of revenue to replace lost income.
3. The federal and provincial governments should enforce existing stipulations regarding licensing, manufacture, and distribution of tobacco products for which not all taxes have been paid. Where this involves Indigenous communities, this should be done in cooperation with their leadership and enforcement agencies. The relative success of Quebec's ACCES Tabac efforts, including its larger investments, might serve to inform action by other jurisdictions, such as Ontario.
4. The federal government should require tobacco manufacturers and distributors to implement an effective track-and-trace system not related to the tobacco industry.
5. The federal government should publish annual reports on the size of the illicit market and on measures taken to combat illicit tobacco.

14. Conclusion

Illicit tobacco trade in Canada and efforts to control it have a convoluted history. The problem has been exacerbated by the encouragement given to illicit trade by the tobacco industry itself in the 1990s. Ironically, it is now the tobacco industry that fans the flames of anti-illicit tobacco anxieties in order to dissuade Canadian governments from substantial increases in taxes on tobacco products and from adopting other effective tobacco control policies. As the evidence cited above demonstrates, Canadian governments first raised taxes substantially and then reversed them in light of the contraband problem created by the tobacco industry in the 1990s. This policy reversal resulted in large numbers of young

people initiating tobacco use, many smokers refraining from cessation, and ultimately in a great deal of avoidable morbidity and mortality.

A consequence of large-scale tobacco industry-instigated smuggling of exported tobacco in the 1990s was the engagement of some First Nations communities in illicit tobacco activity. Some of these communities have subsequently become centers of the illicit tobacco market. Canadian governments have been hesitant to adequately address illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. While this is apparently due to understandable sensitivities around Nation-to-Nation relations and fears of sparking violent confrontations, there is more that could be done, as discussed above, to reduce illicit production and sales.

The unfortunate outcome is that illicit tobacco has a negative influence on Canada's tobacco control policy: both directly and indirectly, through tobacco industry efforts. It is important to remember that tobacco use remains a severe health epidemic in Canada. More vigorous tax and other tobacco control policies could reduce the current annual initiation of tobacco use by some 50,000 young Canadians – who are price-sensitive and heavy users of cheap, illicit cigarettes. Stronger tax and other control measures would lead more of Canada's 4 million smokers to quit, reducing the billions of dollars in social and healthcare costs that stem from tobacco use. While a series of incremental measures to curb the illicit tobacco trade have met with some success, illicit trade continues to constitute some 15 percent of the market, and misinformation disseminated by the tobacco industry has prevented substantial tax increases that could rapidly and dramatically decrease tobacco consumption (Jha and Peto 2014).

References

- Canadian Cancer Society et al. 1999. *Surveying the Damage: Cut-Rate Tobacco Products and Public Health in the 1990s*. Canadian Cancer Society, Non-Smokers' Rights Association, Physicians for a Smoke-Free Canada, Quebec Coalition for Tobacco Control. October 1999.
- Canadian Cancer Society. 2017. Overview Summary of Federal/Provincial/Territorial Tobacco Control Legislation in Canada. October 2017 (unpublished report)
- Cunningham, R. 1996. *Smoke and Mirrors: The Canadian Tobacco War*, Chapter 11 Taxation and Smuggling. Ottawa: International Development Research Centre.
- Dubray J, Schwartz R, Chaiton M, O'Connor S. 2014. The Effect of MPOWER on smoking prevalence. *Tobacco Control* TC Online First, published on December 9, 2014 as 10.1136/tobaccocontrol-2014-051834
- Framework Convention Alliance. 2008. *How Big Was the Global Illicit Tobacco Trade Problem in 2006?* Framework Convention Alliance, February 2008. Available at: <http://www.fctc.org/docs/documents/fca-2008-inb-illicit-trade-inb1-factsheet-how-big-was-illicit-trade-2006-en.pdf>. Accessed 11 September, 2012.
- Gilmore AB, Gallagher AWA, Rowell A. 2018. Tobacco industry's elaborate attempts to control a global track and trace system and fundamentally undermine the Illicit Trade Protocol. *Tobacco Control* Epub ahead of print: [16 April 2018]. doi:10.1136/tobaccocontrol-2017-05419
- Guindon GE, Burkhalter R, Brown KS. 2017. Levels and trends in cigarette contraband in Canada. *Tobacco Control* 26:518–525.
- Guindon GE, Driezen P, Chaloupka FJ, et al. 2014. Cigarette tax avoidance and evasion: findings from the International Tobacco Control Policy Evaluation (ITC) Project. *Tobacco Control* 23(Suppl 1):i13–22. http://www.nsr-aadnf.ca/cms/file/files/pdf/Contraband_Spring2009.pdf. Accessed 12 September 2012.
- Jha P and Peto R. 2014. Global Effects of Smoking, of Quitting, and of Taxing Tobacco, *N Engl J Med* 370:60-8. DOI: 10.1056/NEJMr1308383
- Laprise P, Tratoré I, Bordeleau M. 2010. *Enquête sur les habitudes tabagiques des Québécois*, 2010. Cahier technique : Livre de codes et définition des indices, Québec, Institut de la statistique du Québec, 124p. Available at: <http://www.stat.gouv.qc.ca/sad/pdf/cahier-tech-metho-habitudes-tabagiques.pdf>. Accessed 12 September 2012.
- Lickers, K and Griffin P. 2016. First Nations Cigarette Allocation System: Independent Review, March 2016.
- Lickers, K and Griffin P. Review of the First Nations Cigarette Allocation System in Ontario, Discussion Paper 2.0 August 2015.
- Luk R, Cohen JE, Ferrence R, McDonald PW, Schwartz R, Bondy SJ. 2009. Prevalence and correlates of purchasing contraband cigarettes on First Nations reserves in Ontario, Canada. *Addiction* 104(3): 488-495.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

- Ministere de la Securite Publique Quebec. Fight against the illegal trade in tobacco: Concerted Actions to Counter Underground Economies – Tobacco. <http://www.gouv.qc.ca/FR/Pages/Accueil.aspx>, accessed August 6th, 2018.
- Non-Smokers' Rights Association (NSRA). 2012. *Cigarette Tax Map*. Available at: http://www.nsra-adnf.ca/cms/file/files/pdf/120424_map_and_table.pdf. Accessed 5 September 2012.
- Non-Smokers' Rights Association (NSRA). 2009. *Contraband Tobacco*. Available at:
- Non-Smokers' Rights Association/Smoking and Health Action Foundation. 2006. *It's Time for Action on Tobacco Smuggling and Contraband*. Toronto: Non-Smokers' Rights Association/Smoking and Health Action Foundation.
- Ontario Tobacco Research Unit. *Smoke-Free Ontario Strategy Monitoring Report*. Toronto: Ontario Tobacco Research Unit, Special Report, March 2017.
- Ontario Tobacco Research Unit. 2018. Tobacco Informatics Monitoring System, <http://tims.otru.org/#results> – accessed 290818.
- Physicians for a Smoke-Free Canada (PSFC). 2010. *Estimating the volume of Contraband Sales of Tobacco in Canada*. Available at: http://www.smokefree.ca/pdf_1/2010/
- Royal Canadian Mounted Police (RCMP). 2011. *Contraband Tobacco Enforcement Strategy Third Progress Report (2010-2011)*.
- Royal Canadian Mounted Police (RCMP). 2008. *Contraband Tobacco Enforcement Strategy*. Available at: http://www.rcmp-grc.gc.ca/fio/tobacco_strategy_2008_e.htm. Accessed 12 September 2012.
- Schwartz R and Zhang B. 2016. Debunking the Taxation–Contraband Tobacco Myth, *Canadian Medical Association Journal*. January 18, 2016, cmaj.150492 <http://www.cmaj.ca/content/early/2016/01/18/cmaj.150492>
- Schwartz R, Johnson T. 2010. Problems, policies and politics: A comparative case study of contraband tobacco from the 1990's to the present in the Canadian context. *Journal of Public Health Policy* 31:342-354.
- Smith J, Thompson S, Lee K. 2017. Death and taxes: The framing of the causes and policy responses to the illicit tobacco trade in Canadian newspapers. *Cogent Social Sciences* 3: 1325054 <https://doi.org/10.1080/23311886.2017.1325054>
- Smoke-Free Ontario Scientific Advisory Committee, Ontario Agency for Health Protection and Promotion (Public Health Ontario). 2016. *Evidence to guide action: Comprehensive tobacco control in Ontario*. Toronto, ON:
- Sweeting J, Johnson T, Schwartz R. 2009. *Anti-Contraband Policies: Evidence for Better Practice*. Toronto, ON: The Ontario Tobacco Research Unit, Special Report Series. June 2009.
- Statistics Canada. 2018. <https://www150.statcan.gc.ca/n1/pub/12-581-x/2018000/pop-eng.htm>. Accessed 290818.
- Tobacco Informatics Monitoring System (TIMS). 2012. Ontario Tobacco Research Unit www.tims.otru.org
- Waller B J, Cohen J E, Ferrence R, Bull S, and Adlaf E M. 2003. "The early 1990s cigarette price decrease and trends in youth smoking in Ontario." *Canadian Journal of Public Health* Jan/Feb 2003.

Yurelki A and Sayginsoy O. 2010. "Worldwide organized cigarette smuggling: an empirical analysis." *Applied Economics* 42, 545–561

Zhang B and Schwartz R. What Effect Does Tobacco Taxation Have on Contraband? Debunking the Taxation - Contraband Tobacco Myth. Toronto: Ontario Tobacco Research Unit, Special Report, February 2015.

Zhang, B., Cohen, J., Ferrence, R. and Jurgern, R. 2006. The impact of tobacco tax cuts on smoking initiation among Canadian young adults. *American Journal of Preventative Medicine* 30(6): 474–479.

**EUROPEAN
UNION**

4

EUROPEAN UNION:

Confronting Illicit Tobacco Trade: An Update on EU Policies

Filip Borkowski and Clare Twomey¹

Chapter Summary

The illicit tobacco trade is of pressing concern to the European Union (EU). It results in lost revenue for governments and taxpayers, as well as undermining health policies. The European Anti-Fraud Office (OLAF) estimates that the illicit trade in tobacco products drains EUR 10 billion annually from EU and national budgets. Despite control efforts, the prevalence of cigarette smuggling in the EU has remained broadly stable since 2005. Detected illicit tobacco production within the EU is also on the rise. Meanwhile, the involvement of organized crime groups in illicit tobacco trade in the EU has become increasingly evident.

The EU has recently taken action to strengthen its institutional framework, specifically focusing on tackling crime. Enforcement against organized crime when this is connected to the protection of the EU's financial interests will soon be steered by the European Public Prosecutor's Office (EPPO). Linked to the establishment of the EPPO, the European Commission has proposed to adapt and strengthen OLAF's legal framework for

¹ See disclaimer at the end of the chapter.

investigations. Steps have also been taken to strengthen sanctions against those guilty of defrauding the EU's financial interests, including public officials involved in corruption affecting the financial interests of the Union (for example, in relation to cigarette smuggling).

The EU played a strong role in negotiating the Protocol to Eliminate Illicit Trade in Tobacco Products. Tackling cross-border smuggling requires international cooperation, and the Protocol will facilitate this engagement. Along with the Protocol, the EU's tobacco control policy has been shaped by the Union's 2014 Tobacco Products Directive (TPD).

The traceability of tobacco products is envisaged under TPD Article 15. Traceability of finished products can be construed as the ability to track a product forward through specified stages of the supply chain down to the consumer, and simultaneously to retrace the history and locations of the product back to its origin. The newly introduced EU system of tobacco traceability requires all unit packets of tobacco products manufactured in or imported into the EU to be marked with a unique identifier and their movements to be recorded throughout the supply chain. Information on recorded movements will be stored by third-party data storage providers independent from the tobacco industry. This data will be fully accessible to EU and Member State authorities for enforcement purposes.

In functional terms, the new EU tracking and tracing system is primarily characterized by its broad coverage of the supply chain, including the collection of data on the supplies dispatched to retail outlets. The system design embeds several elements that together provide public authorities with full control over operations. In this respect, the key aspects are the independence from the tobacco industry of the generation of unique identifiers and of the system's data storage, along with the independence criteria and rules on structuring and reporting traceability data. An impact assessment conducted by the European Commission anticipates multi-billion-euro social and economic benefits from the traceability system. Expected benefits will stem mainly from (1) better collection of taxes and (2) at least a partial reduction in the artificially cheap supplies of illegal tobacco products that have been found to affect the uptake and general prevalence of tobacco consumption.

1. Introduction

The illicit tobacco trade is of pressing concern to the European Union (EU). It results in lost revenue for governments and taxpayers, as well as undermining health policies. It is closely linked to organized crime gangs and as such causes significant societal damage.

The EU has been at the forefront in fighting cross-border illicit tobacco trade over the past years. The illicit tobacco trade tends to have a cross-border dimension, so unified and coordinated action at EU level among various agencies can facilitate the steps taken to tackle the problem more effectively.

In this respect, the European Commission published a comprehensive strategy to step up the fight against cigarette smuggling.² This report elaborated measures to address the incentives behind the illicit tobacco trade, controlling the legal supply chain and strengthening enforcement. This was followed by a report on the implementation of these measures and the impact on the illicit tobacco landscape in Europe.³

This chapter will outline certain aspects of the scope and scale of the illicit tobacco trade at EU level, as well as the institutional and regulatory framework designed to tackle this phenomenon. The newly introduced EU tracking and tracing system will be outlined in detail.

2. Scope and Scale of the Illicit Tobacco Trade at EU Level

The illicit tobacco trade encompasses the smuggling of genuine tobacco products (contraband), counterfeit tobacco products, and so called “illicit whites,” as well as the illegal manufacturing of tobacco products within the EU.⁴

For the purposes of this overview, “contraband cigarettes” refers to authentic goods imported or exported illegally, evading regulatory duties. “Counterfeit cigarettes” refers to production under a certain brand without the brand owner’s approval. “Illicit whites” are cigarettes legitimately manufactured in one country and subsequently smuggled into and sold in another country, typically without a legal distribution network in that country.

The illicit tobacco trade, by its nature, is a clandestine activity which is constantly evolving, increasing the challenge of estimating its scope with accuracy. A relatively comprehensive picture of the illicit market is needed at EU level to assist in improving strategic activities, such as threat assessments. The European Anti-Fraud Office (OLAF) recently launched a research study tender to identify a methodology for improving the measurement of the illicit tobacco market.⁵

OLAF currently estimates that the illicit trade in tobacco products drains EUR 10 billion⁶ annually from EU and national budgets, relative to the situation if all smuggled tobacco products had been sold legally and appropriately taxed. From a purely economic perspective, the magnitude of these losses is very significant and deprives governments of the opportunity to use the foregone revenue for other policies.

² COM(2013) 324 final.

³ COM(2017) 235 final - Progress report on the implementation of the Commission Communication “Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013).”

⁴ COM(2013) 324 final – “Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products – A comprehensive EU Strategy,” p. 4.

⁵ Supplement to the Official Journal of the European Union, 2018/S 044-095213.

⁶ The estimation is based on seizures reported by the Member States, which amounted to 4.5 – 4.6 billion cigarettes per year between 2005 and 2011 – see COM(2013) 324 final, p. 4.

OLAF monitors tobacco seizures across the EU as reported by Member States. This can result in a more comprehensive picture of what illicit tobacco is being seized in the Member States. Seizure reports can give insight into the scale of the problem faced, as well as reflecting and informing the activity of customs and other law enforcement agencies.

Cigarettes remain the most-seized tobacco product at EU level, amounting to 3.78 billion in 2015.⁷ According to seizures reported by the Member States to OLAF, over a five-year period, seizures of cigarettes far outweigh seizures of other tobacco products.⁸ This is perhaps unsurprising, given that an EU survey conducted in 2017 shows that boxed cigarettes are clearly the most popular tobacco product in all Member States.⁹ The European Commission also found that cigarettes accounted for 24 percent of all detained articles (not just tobacco-related articles) at the EU external border in 2016.¹⁰

Despite efforts to curb the problem, overall the prevalence of illicit cigarette smuggling in the EU has remained broadly stable since 2005.¹¹ Smuggling of genuine product in large-scale seizures has decreased in the past years,¹² but does still remain a problem EU-wide. In the past years there has been an increase in the prevalence of cheap whites, which dominate large-scale seizures reported by Member States to OLAF.¹³

Detected illicit tobacco production in the EU is also on the rise. This may be a response to increased controls at the EU border and a lower risk of detection by customs.¹⁴ These illicit factories within the EU itself pose a significant threat and tend to have huge production capacities. For instance, an illegal factory dismantled in March 2018 in Ireland had the capacity to produce a quarter of a million cigarettes per hour, according to a press release by the Revenue Commissioners in Ireland.¹⁵ Illicit factories require access to raw materials, machines, and expertise. It is clear that law enforcement agencies will have to diversify their efforts to tackle illicit production, in addition to their focus on the transportation of illicit goods across the EU border.

For some years now, the involvement of organized crime groups in the illicit tobacco trade in the EU has become evident. These groups often utilize sophisticated cross-border networks. The illicit tobacco trade cannot be disassociated from its connections as a major source of revenue for organized crime groups and even terrorist organizations.

⁷ COM(2017) 235 final, p. 5.

⁸ *Ibid.*

⁹ Special Eurobarometer 458: Attitudes of Europeans towards tobacco and electronic cigarettes, summary, p. 5.

¹⁰ Report on EU customs enforcement of intellectual property rights, Results at the EU border 2016, Directorate-General for Taxation and Customs Union, p. 10.

¹¹ COM(2017) 235 final, p. 7.

¹² COM(2017) 235 final, p. 8.

¹³ *Ibid.*

¹⁴ Europol and the European Union Intellectual Property Office, "2017 Situation Report on Counterfeiting and Piracy in the European Union," p. 38.

¹⁵ Revenue Department, Republic of Ireland, "Revenue and An Garda Síochána dismantle illicit cigarette factory in Jenkinstown, Co. Louth." March 15, 2018. <https://www.revenue.ie/en/corporate/press-office/press-releases/2018/pr-150318-illegal-cigarette-factory-jenkinstown-louth.aspx>

Not only is the illicit tobacco trade funding criminal organizations, but their involvement can increase the difficulty of detecting illicit tobacco trade. In cases of large-volume smuggling, the criminals involved tend to be experienced and go to great lengths to conceal their activities, including establishing legitimate businesses and various other concealment tactics. Smuggling of lower-volume amounts is increasing¹⁶ and can be even more difficult to detect.

The deep entrenchment of organized crime groups in the illicit tobacco trade is not yet well known among the general public in Europe. A Eurobarometer survey in 2016¹⁷ noted that a majority of EU citizens surveyed do not realize that smuggled cigarettes are a main source of revenue for organized crime. The enduring public perception that the illicit tobacco trade is a victimless crime is cause for concern. This disconnect between perception and reality needs to be tackled effectively in order to raise awareness of the serious criminal activities benefitting from the proceeds of the illicit tobacco trade. Greater public awareness should correspondingly reduce the demand for illicit tobacco products.

The incentives behind the lucrative business of illicit tobacco trade can be largely linked to its perceived low-risk, high-reward nature as a comparatively safe activity with high profit yields.¹⁸ This risk level is in part linked to substantially divergent administrative and criminal sanctions for tobacco smuggling at Member-State level.¹⁹ High profits are linked to the substantial price divergence of tobacco products among EU Member States, which smugglers can exploit. Although prices have converged over the last decade,²⁰ there are still appreciable differences. The weighted average price for a pack of 20 cigarettes ranges from EUR 2.55 to EUR 10.07.²¹ This is even more pronounced when considering the price difference with some of the EU's neighboring countries, where weighted average prices can be as low as EUR 0.43.²²

3. Institutional Framework

In terms of operational activities to tackle the illicit trade in tobacco products, it is clear that robust enforcement by customs, police, and border forces will always play a central role. This is primarily the task of customs. However, customs authorities rely on close cooperation with other enforcement agencies, including the police, in tackling organized crime. This is also reflected at EU level, with several institutions currently involved in fighting the illicit tobacco trade.

¹⁶ Europol and the European Union Intellectual Property Office, "2017 Situation Report on Counterfeiting and Piracy in the European Union," p. 43.

¹⁷ Special Eurobarometer 443: Public perception of illicit tobacco trade, summary, p. 6.

¹⁸ European Union Serious and Organised Crime Threat Assessment, SOCTA 2013, European Police Office, p. 26.

¹⁹ COM(2017) 235 final, p. 4.

²⁰ Eurostat: Price convergence in the EU-28 by product groups https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Price_convergence_in_the_EU-28_by_product_groups_2007_-2017.png

²¹ Weighted average price of cigarettes in Bulgaria and Ireland, respectively. See KPMG Project Sun 2017, Executive summary, p. 13.

²² Weighted average price of cigarettes in Belarus. See KPMG Project Sun 2017, Executive summary, p. 13.

OLAF has a unique mandate²³ to investigate matters relating to fraud, corruption, and other offenses concerning EU revenue. According to its annual report, OLAF supported the seizure of over 1 billion cigarettes in 2016 and 2017.²⁴ An example of such support is a complex fraud scheme involving an international contraband network that OLAF recently uncovered. The fraud involved the export to non-EU countries of cigarettes that were subsequently smuggled back into the EU, to be sold without payment of the applicable EU taxes. OLAF assisted law enforcement agencies in Italy and Germany in dismantling the network.²⁵

OLAF also engages in Joint Customs Operations (JCOs), which are implemented by national customs authorities. JCOs are operations of a limited duration targeting smuggling of goods and can be very effective in coordinating targeted customs checks at European level.²⁶

JCO "Magnum II" is such an example. Organized by OLAF, it involved 14 Member States, the European Border and Coast Guard Agency (FRONTEX), and the European Police Office (EUROPOL) and culminated in 11 million cigarettes being seized over a two-month period.²⁷

EUROPOL²⁸ is also active in this area and, upon request, supports the Member States' law enforcement agencies in combating serious crime against the financial interests of the Union. This includes fighting against illegal manufacture and distribution of tobacco products in the EU. Tackling excise fraud, with the aim of disrupting the capacity of organized crime groups involved, is a priority for EUROPOL. EUROJUST²⁹ supports cooperation between the competent judicial authorities of the Member States in order to render their investigations and prosecutions of serious crimes more effective. FRONTEX³⁰ also coordinates operations with EU Member States to tackle cross-border crime at the EU border. This includes working with customs authorities to tackle the smuggling of tobacco products.³¹

Effective cooperation among these institutions involved in fighting the tobacco smuggling phenomenon at EU level is of particular importance.

3.1 Strengthening Institutions

The EU has recently taken action to strengthen its institutional framework, specifically focusing on tackling crime. Enforcement against organized crime will soon be steered by the European Public Prosecutor's Office (EPPO).³² The establishment of EPPO aims to alter

²³ Regulation (EU, Euratom) 2013/883 Official Journal of the European Union L 248, 18.9.2013, p. 1–22.

²⁴ The OLAF report 2017. https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf

²⁵ OLAF Press release 02/2018 https://ec.europa.eu/anti-fraud/media-corner/news/27-03-2018/convictions-italy-major-international-contraband-case-uncovered-olaf_en

²⁶ https://ec.europa.eu/anti-fraud/policy/joint-customs-operations-jco_en

²⁷ OLAF Press release no. 18/2017 https://ec.europa.eu/anti-fraud/media-corner/news/05-12-2017/joint-customs-operation-magnum-ii-real-time-intelligence-exchange-leads_en#_ftn1

²⁸ Regulation (EU) 2016/794 Official Journal of the European Union L 135, 24.5.2016, p. 53–114.

²⁹ Regulation (EU) 2017/1939 Official Journal of the European Union L 283, 31.10.2017, p. 1–71.

³⁰ Regulation (EU) 2016/1624 Official Journal of the European Union L 251, 16.9.2016, p. 1.

³¹ <https://frontex.europa.eu/media-centre/news-release/23-smugglers-arrested-drugs-and-cigarettes-seized-during-frontex-led-operation-Plk7rS>

³² Council Regulation (EU) 2017/1939 OJ L 283, 31.10.2017, p. 1–71.

current patterns, which can involve coordinated operational activities at EU level but fragmented judicial prosecutions at national level. The EPPO will be tasked with fighting criminal offenses against the EU budget. As recognized in the Office's establishing regulation, investigation and prosecution of such offenses at national level can be insufficient. At the time of writing, 22 Member States are participating in the EPPO.

Linked to the establishment of the EPPO, the European Commission recently put forward a proposal³³ to adapt and strengthen OLAF's legal framework for investigations. OLAF will continue to investigate and cooperate with national authorities and other agencies. These initiatives aim to ensure a more robust legal framework for tackling fraudulent activities, including those related to the illicit tobacco trade.

3.2 Strengthening Sanctions

At EU level, steps have also been taken to strengthen sanctions for those involved in defrauding the Union's financial interests. This is intended to have a deterrent effect on potential criminals. The Directive on fighting fraud against the Union's financial interests by means of criminal law ("PIF Directive")³⁴ contains several provisions which are relevant to tackling the illicit tobacco trade. The PIF Directive harmonizes sanctions among Member States regarding crimes affecting the financial interests of the Union, for example establishing that countries' maximum prison terms for serious cases must be at least four years. Moreover, the PIF Directive includes the involvement of organized crime groups in offenses as an aggravating circumstance. This is frequently the case for the illicit tobacco trade.

The PIF Directive also strengthens sanctions for officials involved in corruption, explicitly adding the acceptance of bribes to the definition of corruption.³⁵ This is relevant for border crossings, where corruption may still be an issue, given the high volume of illicit goods making their way into the territory of the EU. Member States have until July 2019 to adopt laws in line with the Directive.

4. Regulatory Framework: Tobacco Products Directive and Protocol to Eliminate Illicit Trade in Tobacco Products

The EU is now on the threshold of a new phase in its regulatory framework, with some major initiatives specifically aiming to tackle the illicit tobacco trade. Smuggling by its nature is a clandestine activity aimed at evading controls. Nonetheless, tightening loopholes in the regulatory framework has previously had an impact on the illicit tobacco trade, and this remains an area in which regulatory action is required.

³³ COM/2018/338 final.

³⁴ Directive (EU) 2017/1371 of the European Parliament and of the Council. Official Journal of the European Union L 198, 28.7.2017, p. 29–41.

³⁵ Article 4 (2) a. "passive corruption."

4.1 Protocol to Eliminate Illicit Trade in Tobacco Products

The Protocol to Eliminate Illicit Trade in Tobacco Products ("FCTC Protocol"),³⁶ to which the EU is a Party, is the first tailor-made multilateral treaty to specifically tackle the illicit tobacco trade and will enter into force on September 25, 2018.

The Protocol is an international treaty linked to the World Health Organization's Framework Convention on Tobacco Control. The EU played a strong role in negotiating the Protocol. Tackling cross-border smuggling requires cross-border cooperation and, in this respect, the Protocol will facilitate international engagement. The Protocol acts as an additional legal framework for the exchange of operational information in the form of general information sharing,³⁷ enforcement information sharing,³⁸ mutual administrative assistance,³⁹ mutual legal assistance,⁴⁰ and tracking and tracing information.⁴¹

The Protocol offers an excellent framework for international cooperation. However, bilateral engagement with countries remains an important aspect on two levels. Given that low tobacco prices in some of the EU's neighboring countries can drive smuggling activity into the EU, engagement to adjust pricing in order to better protect countries' own fiscal interests can still be harnessed. Bilateral law enforcement cooperation will remain an important facet of international engagement.

In terms of supply chain control, the Protocol offers new substantive provisions. The tracking and tracing provisions⁴² and establishment of a centralized global information-sharing point will allow authorities to monitor the legal supply chain and easily identify products being diverted into the illegal market.

The Protocol also lays down other substantive control mechanisms. For example, it foresees provisions⁴³ to ensure that the movements of tobacco producing machinery will be controlled. This is another area in which regulation may have an impact on the illicit trade. Sanctions can also play a role here, as seizure of a tobacco-producing machine or other manufacturing equipment may be more of a disincentive than simple payment of a fine. This provision, once implemented by Parties to the Protocol, should prevent the diversion of tobacco-producing machinery into the illicit market, or at least make such diversion more difficult, facilitating law enforcement.

³⁶ Council Decision (EU) 2016/1749 Official Journal of the European Union L 268, 1.10.2016, p. 1–5; Council Decision (EU) 2016/1750. Official Journal of the European Union L 268, 1.10.2016, p. 6–9.

³⁷ Article 20, General information sharing.

³⁸ Article 21, Enforcement information sharing.

³⁹ Article 28, Mutual administrative assistance.

⁴⁰ Article 29, Mutual legal assistance.

⁴¹ Article 8 (4.1).

⁴² Article 8.

⁴³ Article 6 and Article 8.

4.2 Tobacco Products Directive

The adoption of the 2014 Tobacco Products Directive (TPD)⁴⁴ marked a pivotal development in tobacco control policy in the EU. The traceability of tobacco products is envisaged under Article 15 of the TPD.⁴⁵ The TPD envisages the traceability of cigarettes and roll-your-own tobacco products as of May 20, 2019, and of all other tobacco products as of May 20, 2024.⁴⁶ It will allow public authorities in the EU to control the whole supply chain of tobacco products. The implementation of the traceability system provided for under TPD Article 15 will also enable the EU and its Member States to fulfil their international obligations under Article 8 of the FCTC Protocol.

4.3 Concept of Traceability

Traceability of finished products can be construed as the ability to track a product forward through specified stages of the supply chain down to the consumer, and simultaneously to retrace the history and locations of the product back to its original production line.⁴⁷

There are two distinct but closely related elements in the concept of traceability. These are tracking and tracing. Tracking is a part of traceability that consists of monitoring the current whereabouts of a product and simultaneously creating a time and location record for all consecutive movements of that product. Tracing is the ability to identify the past locations of a product, which allows for verifying the product's route, all the way back to its origin.

For proper operation, every traceability system must be able to uniquely identify individual products. It is only thanks to unique identification, achieved by marking a product with a unique code (also known as a unique identifier, or UI), that it becomes possible to unambiguously register that product's movements. The basic record of a movement can be reduced to three simple bits of data: the product's unique code, location, and time. Later on, provided it is stored in a single database system, the history of movements can be easily recreated by looking at consecutive locations of a given product, sorted by time.

4.4 Specificity of Tobacco Traceability

Traceability of products is a well-established concept. Multiple traceability systems are used in today's economy, in domains such as pharmaceuticals or food products. The most obvious

⁴⁴ Directive 2014/40/EU of the European Parliament and of the Council. Official Journal of the European Union L 127, 29.4.2014, p. 1–38.

⁴⁵ Article 15 of the TPD required the European Commission to lay down secondary legislation determining technical details for the establishment and operation of the system of traceability, as well as to ensure its interoperability across the EU. See Commission Implementing Regulation (EU) 2018/574 and Commission Delegated Regulation (EU) 2018/573, Official Journal of the European Union, L 96, 16 April 2018.

⁴⁶ In parallel, Article 16 of the TPD requires the establishment of the system of security features for the tobacco products as an additional measure to fight the illicit trade. The relevant technical standards for the operations of such a system are laid down in Commission Implementing Decision (EU) 2018/576, Official Journal of the European Union, L 96, 16 April 2018.

⁴⁷ According to the ISO definition coined for the purpose of standardizing quality management systems.

and best-known examples are provided by parcel services, where each parcel is traceable, and consumers can easily verify the location of their parcels via the service provider's web interface.

It is important to distinguish the different reasons for which traceability systems may be rolled out within a supply chain. For instance, traceability may be introduced for logistical reasons, to improve supply-chain function, as in the case of parcel services; or for product safety reasons, to manage potential product recalls; or finally for regulatory reasons, with goods' being tracked and traced because of their particular characteristics or status.

The traceability of tobacco products is being implemented for the latter reasons. Given the comparatively elevated tobacco excise duties applied in many jurisdictions to discourage consumption, tobacco products are potentially very profitable for illicit traders. Such traders are able to achieve very high margins by offering the non-taxed product at a substantial discount from the official post-tax price. High profitability of illicit trade also creates immediate economic incentives for misusing the traceability system, for example by duplicating identifiers or misreporting logistic events. In addition, the addictive nature of tobacco means that illicit trade may contribute to creating new demand for legal products. Consumers initially prevented by their age or economic status from purchasing legal tobacco products can be initiated with illicit products. But it is also likely that such consumers will eventually turn to legal tobacco products.

For reasons of good governance, the traceability of tobacco products cannot be entrusted to the tobacco industry. Moreover, traceability has to take place at the lowest level of a unit packet of tobacco product, since it is known that, if needed, illicit traders can easily disaggregate any higher level of packaging and distribute the tobacco products in loose unit packets.

4.5 Scope and Basic Description of the EU System of Tobacco Traceability

The EU system of tobacco traceability requires all unit packets of tobacco products manufactured in or imported into the EU to be marked with a unique identifier and their movements to be recorded throughout the supply chain. Information on recorded movements will be stored by third-party data storage providers independent from the tobacco industry. This data will be fully accessible to EU authorities, i.e., the competent authorities of EU Member States and the European Commission, for enforcement purposes.

Under the EU traceability system, the generation of unique identifiers, as well as of all other codes required for pre-registration of economic operators, facilities, and machines, is entrusted to designated "ID issuers," who are also required to be financially and legally independent of the tobacco industry. Their role is vital, as they are in fact the guardians of uniqueness, which is a "must" condition for any traceability system. Each EU Member State is responsible for the appointment of an ID issuer for its territory.

Once appointed, ID issuers will receive, from manufactures and importers of tobacco products, requests to generate the unique identifiers. Manufacturers or importers will have to supply pre-defined information relating to the product and production line. The ID issuers will then generate batches of unique identifiers and deliver them to the ordering manufacturer or importer.

On the production line, manufacturers will complete the unique identifier with a "time stamp" (i.e., a marking indicating the date and time of manufacture of the tobacco product). The unique identifier will then be applied to the unit packet, after being encoded in an authorized data carrier. The unique identifier will take the form of a machine-readable, optical, one- or two-dimensional barcode. Still on the production line, the unique identifier's application must be verified to ensure its readability. An anti-tampering device, capable of creating an unalterable independent record of this verification process, must previously have been installed. This additional record will be accessible to the public authorities for potential investigations and inspections.

Correctly marked unit packets can then be tracked and traced throughout the supply chain. In most cases, these will be aggregated into bigger packages, such as cartons, master cases or pallets, known as "aggregated packaging." Tracking at aggregated packaging level is permitted, provided the unit packets remain traceable. This requires separate aggregated-level unique identifiers, electronically linked to each lower-level unique identifier. Recording product movements at aggregated packaging level is intended to alleviate the operational burden on economic operators (in particular wholesalers and distributors), who would otherwise need to scan each unit packet being handled.

Transportation between different facilities is also subject to a clear set of rules. Each dispatch and arrival must be recorded and reported to the repositories system, up to the point of dispatch to the first retail outlet, i.e., the first place where the products will be made available to consumers.

All recorded information must be submitted to the independent third-party data storage facility. Clear timeframes for the transmission of traceability data to the data storage are laid down: in general, it should take place three hours from the occurrence of a reportable event, and 24 hours prior in the case of dispatch and trans-loading of tobacco products. To ensure the correct transmission of traceability information, the transmission messages have to contain the information pre-defined both in terms of its format and content. For example, the message reporting the arrival of tobacco products at a facility has to contain the "economic operator identifier code" of a submitting party, the "facility identifier code" of that specific facility, the time of arrival in the pre-specified format, and the list of unique identifiers received under the delivery in question.

4.6 Key Characteristics of the EU System

The EU system of tobacco traceability is the first of its kind. It is the first regional system designed to accommodate a range of distribution structures, both concentrated and dispersed supply chains. It is a relatively open system, in which multiple providers can offer competitive technological solutions subject to meeting the set of basic requirements stipulated in the legislation. At the same time, the EU system is characterized by a high level of protection against any attempts at manipulating the data.

The following characteristics of the EU system of tobacco traceability are particularly worth highlighting:

As indicated, the **EU system of tobacco traceability will span the entire supply chain**. The routine reporting obligations cover all the economic operators involved in the manufacture and distribution of tobacco products up to the point of dispatch to the first retail outlet. In practice, this means that the sales of tobacco products at retail outlets will be approximated with the data from the dispatch messages sent by the suppliers of retail outlets.

The public authorities' **control over the EU system is provided by the combination of several measures** that jointly protect this system against any undue interference:

- » Only **independent ID issuers** are allowed to generate the unique identifiers necessary for marking the unit packets. The unique identifiers have two features which will further strengthen the level of control: at the moment of their generation, the unique identifiers have to be related to a specific product presentation and a specific production line, and they have to be preloaded into the repositories system before being delivered to the tobacco industry. This means that the unique identifiers will contain meaningful information from their inception, and the tobacco industry will be constrained in the use of the identifiers to the pre-declared product presentation and production line.
- » All the data will be stored by **independent data storage providers**. The repositories system will include a **central dataset** which will provide for the full overview of all actions occurring in the whole system at any given moment. The authorities will be granted full, uninterrupted, physical and electronic access to the repositories system. The providers of data storage are required not only to store the data, but also to provide several services to the authorities, including a possibility of bulk downloads, executing a full range of searches, automatic alerts, and regular reports. The authorities will be able to configure and subsequently reconfigure all these services, depending on their actual needs. In contrast to the full access by the authorities, the tobacco industry will not be allowed to access the repositories without the authorities' prior permission. Such access will be granted only in duly justified cases.
- » The flow of traceability data is fully structured in terms of its content and format. The legislation contains a **message dictionary** that specifies all key messages that the economic

operators are obliged to send to the repositories system. The repositories system will be based on a common data dictionary.

- » The legislation also contains a set of rules as to when a given message has to be sent. Importantly, **it will not be possible to dispatch or trans-load any tobacco products without prior notification** of such a logistic event. The high density of reporting events, including the transactional operations (e.g., issuing of an invoice), guarantees that each product will have to be reported several times over its life cycle within the supply chain.
- » On the production line, the verification of the marking process will be additionally protected with an **anti-tampering device** which will create an independent, auditable record, which will exist on top of the data stored in the repository system. The EU Member States will have full access to this record.
- » The high quality of data is further strengthened by the obligatory **pre-registration and coding of all economic operators, facilities (including retail outlets), and machines**. These codes, along with the unique identifiers for unit packets, will provide for "seeding" of all further data that are required to be reported in the system. In other words, it will be impossible to successfully report any logistical or transactional operation without making a reference to the obligatory set of codes and identifiers.
- » Last but not least, ID issuers or data storage providers are required by the legislation to be independent from the tobacco industry. The legislation indicates a **set of rules detailing the conditions of independence** in legal, organizational, decision-making, financial, and personal terms. These rules are laid down to assist public authorities in the verification of third-party providers.

Thanks to the structured approach to the management of traceability data, **the EU system will be able to easily export the data to other systems**, be it internally, for example as a means of cross-validation with the Excise Movement and Control System (EMCS),⁴⁸ or externally, via the global information-sharing focal point, which the FCTC Secretariat is supposed to establish under Article 8 of the FCTC Protocol.

As regards the data carriers in which the unique identifiers will be encoded and subsequently marked on the products, the EU system relies on the international standards, and therefore other Parties to the FCTC Protocol will be able to decode the data carriers with any standard equipment, including most modern smartphones.

Finally, it is important to stress an additional fact. Despite the intensity of the design phase, in which the European Commission took the lead to safeguard the system's full compliance with European and international law, and to protect the design process from the influence of vested interests, **the EU system does not overburden public authorities**. On the contrary, it presents them with a new and efficient tool of control. The bulk of the initial investment, as

⁴⁸ EMCS is a computerized system for monitoring the movement of excise goods under duty suspension in the EU.

well as the subsequent operational costs, have been shifted to the tobacco industry, in line with Article 8 of the FCTC Protocol. The European Commission's Impact Assessment, which was carried out for the purpose of preparing the secondary legislation, indicates **multi-billion-euro social and economic benefits** expected from introducing the traceability system. The two main benefits stem from better collection of taxes and at least a partial reduction in the artificially cheap supplies of illegal tobacco products that have been found to affect the uptake and general prevalence of tobacco consumption.⁴⁹

4.7 Examples of Practical Applications

The EU system will enable public authorities to detect several types of fraud, both within and outside the legal supply chain. The following cases can serve as examples:

- » Appearance of duplicated unique identifiers, detectable at the central level of the repositories system, which indicates an inflow of illicit products in one of the two suspected points within the supply chain. Since all the products are tracked, the system can automatically detect when the same unique identifier appears in two distinct locations at the same time. The tracing functionality will further help in establishing which of the two products is original and which is a duplicate;
- » Discovery of a marked product outside the legal supply chain, in which case the traceability system can assist in finding the point of that product's diversion into the illicit market. A unique identifier can be used for constructing a basic query to the repositories system in order to extract all the data relating to that unique identifier, including its last known location, which in this case is likely to be the point of diversion;
- » Abnormal fluctuations in the manufactured or stored quantities of products, detectable at the central level of the repositories system, which can guide the public authorities to potential points of product diversion or other illegal activities. For example, if a given warehouse accumulates a stock of products without forwarding any products to the next destination, such a warehouse may warrant an on-spot inspection to verify the anomaly observed in the traceability data;
- » Abnormal fluctuations in quantities delivered to retail outlets, detectable at the central level of the repositories system, which can guide public authorities to individual retail outlets or to geographic clusters of retail outlets where illicit trade may be taking place. The latter example may be linked to a situation in which illicit traders start distributing their products in a given geographic area, for example suburban town X, which in turn negatively affects the sales of the legal outlets in that area as compared to the historic levels of sales.

⁴⁹ The Impact Assessment can be consulted at: https://ec.europa.eu/health/sites/health/files/tobacco/docs/tt_ia_en.pdf

5. Conclusions

In functional terms, the EU tracking and tracing system is primarily characterized by its broad coverage of the supply chain, including the collection of data on the supplies dispatched to retail outlets. High priority has been given to the overall design of the system, which embeds several elements that together will provide public authorities with full control over the system's operations. In this respect, the key aspects are the independence of the generation of unique identifiers and of the data storage from the tobacco industry, along with the independence criteria and rules on structuring and reporting traceability data.

The EU system represents a scalable example of a system of tobacco traceability that is sufficiently flexible to be implemented both at the regional and the single-country scale. It avoids unnecessary reliance on a single provider, which in the long term may paradoxically reduce public authorities' ability to shape and control the traceability system. It is based on a strong policy case, where substantial social and economic benefits are expected if the system is properly rolled out.⁵⁰

Disclaimer

The information and views set out in this article are those of the authors and do not necessarily reflect the official opinion of the European Union. Neither the European Union institutions and bodies nor any person acting on their behalf may be held responsible for the use which may be made of the information contained therein.

⁵⁰ For further information on the EU system of tobacco traceability and its implementation, see: https://ec.europa.eu/health/tobacco/tracking_tracing_system_en

References

1. European Commission (2013). COM(2013) 324 final of 6 June 2013 - Communication from the Commission to the Council and the European Parliament "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products – A comprehensive EU Strategy." Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2013:0324:FIN> [Accessed 23 September 2018]
2. European Commission (2016). Special Eurobarometer 443: Public perception of illicit tobacco trade, summary, p. 6. Available at: <http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/SPECIAL/search/443/surveyKy/2076> [Accessed 23 September 2018]
3. European Commission (2017). COM(2017) 235 final – Report from the Commission to the Council and the European Parliament Progress report on the implementation of the Commission Communication "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013)." Available at: <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:52017DC0235> [Accessed 23 September 2018]
4. European Commission (2017). Special Eurobarometer 458: Attitudes of Europeans towards tobacco and electronic cigarettes, summary, p. 5. Available at: <http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/instruments/SPECIAL/surveyKy/2146> [Accessed 23 September 2018]
5. European Commission (2017). Report on EU customs enforcement of intellectual property rights, Results at the EU border 2016, Directorate-General for Taxation and Customs Union, p. 10. Available at: <https://publications.europa.eu/en/publication-detail/-/publication/5d6eb531-6b63-11e7-b2f2-01aa75ed71a1> [Accessed 23 September 2018]
6. European Commission (2017). Impact Assessment, SWD(2017) 455 final. Available at: https://ec.europa.eu/health/sites/health/files/tobacco/docs/it_ia_en.pdf [Accessed 23 September 2018]
7. European Commission (2018). Study to identify an approach to measure the illicit market in tobacco products, Supplement to the Official Journal of the European Union, 2018/S 044-095213 Available at: <https://ted.europa.eu/udl?uri=TED:NOTICE:095213-2018:TEXT:EN:HTML> [Accessed 23 September 2018]
8. European Commission (2018). Eurostat: Price convergence in the EU-28 by product groups. Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Price_convergence_in_the_EU-28_by_product_groups,_2007_-_2017.png [Accessed 23 September 2018]
9. European Commission (2018). Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) No 883/2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) as regards cooperation with the European Public Prosecutor's Office and the effectiveness of OLAF investigations - COM/2018/338 final. Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018%3A338%3AFIN> [Accessed 23 September 2018]
10. European Commission (2018). OLAF - Policy - Joint Customs Operations. Available at: https://ec.europa.eu/anti-fraud/policy/joint-customs-operations-jco_en [Accessed 23 September 2018].
11. European Commission. Live, work, travel in the EU - Public Health – Tobacco. Available at: https://ec.europa.eu/health/tobacco/tracking_tracing_system_en [Accessed 23 September 2018]
12. European Anti-Fraud Office (2018). OLAF report 2017. Available at: https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf [Accessed 23 September 2018]
13. European Anti-Fraud Office (2018). OLAF Press release 02/2018. Available at: https://ec.europa.eu/anti-fraud/media-corner/news/27-03-2018/convictions-italy-major-international-contraband-case-uncovered-olaf_en [Accessed 23 September 2018]
14. European Anti-Fraud Office (2017). OLAF Press release 18/2017. Available at: https://ec.europa.eu/anti-fraud/media-corner/news/05-12-2017/joint-customs-operation-magnum-ii-real-time-intelligence-exchange-leads_en [Accessed 23 September 2018]

15. Europol (2013). European Union Serious and Organised Crime Threat Assessment, SOCTA 2013, p. 26. Available at: <https://www.europol.europa.eu/activities-services/main-reports/eu-serious-and-organised-crime-threat-assessment-socta-2013> [Accessed 23 September 2018]
16. Europol and the European Union Intellectual Property Office (2017). "2017 Situation Report on Counterfeiting and Piracy in the European Union," p. 38. Available at: <https://www.europol.europa.eu/publications-documents/2017-situation-report-counterfeiting-and-piracy-in-european-union> [Accessed 23 September 2018]
17. Frontex (2018). Press release "23 smugglers arrested, drugs and cigarettes seized during Frontex-led operation." Available at: <https://frontex.europa.eu/media-centre/news-release/23-smugglers-arrested-drugs-and-cigarettes-seized-during-frontex-led-operation-Plk7rS> [Accessed 23 September 2018]
18. KPMG (2018). Project Sun 2017, Executive summary, Weighted average price of cigarettes in Bulgaria and Ireland, respectively, p.13. Available at: https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2018/08/project_sun_exec_summary.PDF [Accessed 23 September 2018]
19. Office of the Revenue Commissioners (2018). "Revenue and An Garda Siochana dismantle illicit cigarette factory in Jenkinstown, Co. Louth." [Press release] Available at: <https://www.revenue.ie/en/corporate/press-office/press-releases/2018/pr-150318-illegal-cigarette-factory-jenkinstown-louth.aspx> [Accessed 23 September 2018]

Legislation:

1. Regulation (EU, Euratom) 2013/883 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation (Euratom) No 1074/1999, Official Journal of the European Union L 248, 18.9.2013, p. 1–22.
2. Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC of the European Parliament and of the Council, Official Journal of the European Union L 127, 29.4.2014, p. 1–38.
3. Regulation (EU) 2016/794 of the European Parliament and of the Council of 11 May 2016 on the European Union Agency for Law Enforcement Cooperation (Europol) and replacing and repealing Council Decisions 2009/371/JHA, 2009/934/JHA, 2009/935/JHA, 2009/936/JHA and 2009/968/JHA, Official Journal of the European Union L 135, 24.5.2016, p. 53-114.
4. Regulation (EU) 2016/1624 of the European Parliament and of the Council of 14 September 2016 on the European Border and Coast Guard and amending Regulation (EU) 2016/399 of the European Parliament and of the Council and repealing Regulation (EC) No 863/2007 of the European Parliament and of the Council, Council Regulation (EC) No 2007/2004 and Council Decision 2005/267/EC, Official Journal of the European Union L 251, 16.9.2016, p. 1.
5. Council Decision (EU) 2016/1749 of 17 June 2016 on the conclusion, on behalf of the European Union, of the Protocol to Eliminate Illicit Trade in Tobacco Products to the World Health Organisation's Framework Convention on Tobacco Control, with the exception of its provisions falling within the scope of Title V of Part Three of the Treaty on the Functioning of the European Union, Official Journal of the European Union L 268, 1.10.2016, p. 1–5.
6. Council Decision (EU) 2016/1750 of 17 June 2016 on the conclusion, on behalf of the European Union, of the Protocol to Eliminate Illicit Trade in Tobacco Products to the World Health Organisation's Framework Convention on Tobacco Control, as regards its provisions on obligations related to judicial cooperation in criminal matters and the definition of criminal offences, Official Journal of the European Union L 268, 1.10.2016, p. 6–9.
7. Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law of the European Parliament and of the Council. Official Journal of the European Union L 198, 28.7.2017, p. 29–41.
8. Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO'), Official Journal of the European Union L 283, 31.10.2017, p. 1–71.

9. Commission Delegated Regulation (EU) 2018/573 of 15 December 2017 on key elements of data storage contracts to be concluded as part of a traceability system for tobacco products, Official Journal of the European Union, L 96, 16.4.2018, p. 1-6.
10. Commission Implementing Regulation (EU) 2018/574 of 15 December 2017 on technical standards for the establishment and operation of a traceability system for tobacco products, Official Journal of the European Union, L 96, 16.4.2018, p. 7-55.
11. Commission Implementing Decision (EU) 2018/576 of 15 December 2017 on technical standards for security features applied to tobacco products (notified under document C(2017) 8435), Official Journal of the European Union, L 96, 16.4.2018, p. 57 - 63.

⁵⁰ For further information on the EU system of tobacco traceability and its implementation, see: https://ec.europa.eu/health/tobacco/tracking_tracing_system_en

GEOORGIA

5

GEORGIA:

Controlling Illicit Cigarette Trade

Hana Ross and George Bakhturidze¹

Chapter Summary

Georgia represents a success story in the fight against illicit tobacco trade, because it has managed to substantially increase tobacco taxes while reducing the presence of illicit tobacco products in its domestic market. Although the official numbers on illicit trade are incomplete, particularly regarding the border with Russian-controlled areas of Georgia, there are several reliable indicators pointing to limited domestic trade in illicit tobacco products, thanks to vigorous action to strengthen the effectiveness of customs and tax administration.

The major risk of large-scale illicit trade in Georgia is related to export/import business, as Georgia seems to play the role of a transit country for illicit tobacco products, most of them destined for Turkey. Small-scale smuggling is not an issue, since cigarette prices in Georgia are roughly similar to those of its neighbors – except for Turkey, where taxes and prices are far higher. Thus, cross-border shopping does not play a significant role in reducing tobacco tax revenues in Georgia, whether through smuggling (tax evasion) or legal imports (tax avoidance). Tax avoidance, however, is a major problem in Georgia, because tobacco taxes for cigarettes without filters are substantially lower than those for filtered cigarettes,

¹ H. Ross (University of Cape Town, South Africa) and G. Bakhturidze (FCTC Implementation & Monitoring Center, Georgia)

and the tobacco industry exploits this administrative loophole. Another tax avoidance tactic practiced by the industry is forestalling: ordering a larger-than-needed quantity of tax stamps just before a tax increase in order to use these less-expensive stamps after the tax increase comes into effect.

The tobacco industry has, at times successfully, argued against tobacco tax increases on the grounds of illicit trade, pointing to the decline in tobacco tax revenue following a tax increase. However, a closer look at the data shows that the illicit trade story does not hold. In fact, the lower revenue was artificially created by the industry's practice of forestalling. Since it took the market some time to absorb the packs with the old/lower tax stamps, tax revenue receipts immediately after the tax increase were lower, allowing the industry to spread a misleading interpretation of the tax measure's impact on illicit tobacco trade.

Georgia has recently taken a major step toward compliance with the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), which it has signed, by banning tobacco advertising and substantially expanding smoke-free places. Nevertheless, cigarettes in Georgia are still relatively inexpensive, and smoking prevalence, particularly among men, is extremely high.

Georgia's experience supports prior research findings that strengthening the effectiveness of customs and tax administration is by far the most important step to counteract illicit tobacco trade. The concluding section of this chapter offers specific recommendations in line with this result. These recommendations include:

Tackle forestalling. Georgia should adopt measures to prevent firms from buying tax stamps in anticipation of announced tax increases (forestalling). Adopting anti-forestalling measures would lead to gains in tax revenue.

Ratify the Protocol. Georgia should also ratify the Protocol on Illicit Trade, since the additional obligations under the Protocol would be minimal, given that Georgia already uses modern technology to control its cigarette supply chain. Being a party to the Protocol would reinforce the progress made to date in improving the effectiveness of customs and tax administration and allow Georgia to play a role in addressing the transit of illegal cigarettes via its territory.

Rapidly align with the Protocol. The government should analyze the extent to which its current system is compliant with the FCTC Illicit Trade Protocol to be introduced in 2019. The Protocol, for example, requires licensing of economic operators involved in the tobacco product supply chain. Georgia should, therefore, reinstitute its licensing requirement, at least for cigarette manufacturers, importers, and exporters.

Reinforce border protections and product movement control systems. Georgia should enhance the protection of its vulnerable border with Abkhazia and Ossetia by video monitoring of all trucks entering and leaving the country from those territories. Such a surveillance

system could be supported by road cameras and mobile X-rays, and integrated with the e-Transport and the excise marking electronic system.

Reinforce international cooperation. Georgia should consider strengthening cooperation and information exchange with EU Member States, especially with those bordering Russia (e.g., Poland, Estonia, Lithuania), since they are facing similar illicit trade problems, and with its neighbor countries. As in the case of collaboration with the UK Customs office, Georgia can enhance its interaction with Interpol, the European Anti-Fraud Office (OLAF), and other relevant agencies in the fight against illicit tobacco trade.

Bring government-tobacco industry relations in line with international norms.

Government should amend its legislation to comply with Article 5.3 of the FCTC regarding tobacco-industry interference in policy making. The most relevant provisions for controlling the illicit tobacco market are requirements that the tobacco industry and/or its affiliates cannot be involved in discussions related to the ITP ratification or a track-and-trace system.

1. Background

Tobacco production and consumption in Georgia: historical trajectory. As the part of the Soviet Union, the Republic of Georgia was well known for tobacco growing, supplying leaves both for Georgia's own domestic cigarette production and for production in other Soviet territories (Shalutashvili et al. 2007; WB 1996).

The production of raw tobacco and cigarettes collapsed following the fall of the Soviet Union. In 1993–1994, Georgia's tobacco crop was only one-third that of what it had been in 1987 (Ciecierski and Chaloupka 2002). This decline continued until the mid-2000s. During 1991–2005, the size of tobacco fields shrank from 14 thousand hectares to 0.8 thousand hectares, the production of raw tobacco dropped from 23 thousand tons to 1.5 thousand tons, and cigarette output fell from 17 billion to 3 billion cigarettes (State Department of Statistics 2006).

Penetration of transnational firms. This was a great opportunity for transnational tobacco companies to enter Georgia to exploit its extremely high smoking prevalence. In 2001, 53.3 percent of males and 6.3 percent of females smoked. By 2008, the prevalence had risen to 59.8 percent and 14.9 percent among men and women, respectively (Bakhturidze. et al. 2008; Gilmore. et al. 2004). In 2002, 32.6 percent of boys and 12.1 percent of girls aged 13 – 15 reported being current cigarette smokers (GYTS Georgia, 2002).² International evidence shows that roughly half of regular smokers die prematurely as a result of tobacco-related diseases, losing on average two decades of expected life. For the whole population of regular smokers, life expectancy drops by about a decade.³ Thus, Georgia's smoking pandemic is a cause of grave concern for the health and life expectancy of Georgians.

² 2002 Global Youth Tobacco Survey (GYTS), Georgia Report. 2002.

³ Peto and Jha. Global Effects of Smoking, of Quitting, and of Taxing Tobacco. *New England Journal of Medicine*. 2014; 370:60-68; <https://www.nejm.org/doi/full/10.1056/nejmra1308383>

By the early 1990s, three major tobacco companies (Philip Morris, British American Tobacco, Japan Tobacco International) were present in the market, taking advantage of a loose regulatory environment that allowed them to run promotional campaigns encouraging smoking. Only two locally-owned manufacturers out of seven present in 1993 survived the foreign invasion: Tbilisi Tobacco (previously Georgian Tobacco – GTM), and Omega Group Tobacco (OGT) (Shalutashvili et al. 2007).

The Georgian government welcomed the tobacco industry by allowing them to sell tobacco tax-free. Between 1991 and 1997 there was no tax on either locally produced or imported cigarettes. The situation changed in 1997, when imported cigarettes were levied a specific excise and customs tax of 0.25 GEL (about US\$ 0.19) and 0.19 GEL (about US\$ 0.15) per pack of filter and non-filter cigarettes, respectively. Locally produced cigarettes, on the other hand, were levied an excise tax worth 100 percent of their production costs. The following year, both imported and domestic cigarettes were levied a specific excise tax with substantially lower rates for domestic cigarettes. This differential tax treatment of domestic and imported cigarettes persisted till 2010 (Table 1).

Post 2004: new directions in tobacco policy. Between 1998 and 2004 the tax rates remained stable, but their values were eroded by inflation, which hovered around 5 percent most years, with a peak of 19 percent in 1999 (State Department of Statistics 2004). Taking account of annual growth in per capita income of about 6 percent in that period, cigarettes became increasingly affordable, by about 10 percent per year. The new government of Mikheil Saakashvili came into power in 2004 and announced substantial tobacco tax hikes effective January 2005. This measure was motivated essentially by revenue concerns, rather than public health. The tax more than doubled on imported filtered cigarettes and more than tripled for domestic filtered cigarettes (Table 1). As a result, the tax share in the retail price jumped from 36 percent to 54 percent for imported cigarettes, and from 25 percent to 43 percent for domestic cigarettes. However, the tax rate on non-filtered cigarettes remained about one-fourth of that on filtered cigarettes.

Tobacco company “forestalling.” Tobacco companies had six months to prepare for the 2005 tax increase. They pre-purchased tax stamps⁴ at the lower 2004 value for release in 2005, thus realizing tax savings in 2005 (Krasovsky 2013; Shalutashvili et al 2007). This resulted in an unexpected increase in tobacco tax revenue in the second part of 2004 and disappointing revenue in 2005. The tobacco excise tax revenue in 2005 was 72 million GEL, about 4.4 million GEL less compared to 2004, when the revenue was artificially increased by firms’ pre-purchasing the tax stamps (Figure 1). The industry, however, blamed illicit cigarette trade for the revenue shortfall, claiming that the market share of illicit cigarettes went from 10 percent in 2003 to 65 percent after the tax hike (Shalutashvili et al 2007).

⁴ Georgia adopted excise stamps on both domestic and imported cigarettes on February 1, 1999 (Shalutashvili et al. 2007).

A closer analysis reveals that the combined 2004/2005 tobacco excise tax revenue was 65 percent (148 million GEL) higher than the 2002/2003 revenue (90 million GEL) in nominal terms, and 47 percent higher in real terms. This demonstrates that the tax increase did bring significant additional revenue for the government. However, the tobacco industry was able to manipulate the story about the lower 2005 tax revenue, which the industry itself had caused, persuading the government to reduce the tobacco excise tax in 2006, “to decrease smuggling.” This was a sharp blow to Georgia’s tobacco tax policy, and it took the country almost ten years to return to the 2005 rates (Table 1).

Table 1. Evolution of Georgia’s Excise Rates Per Pack of 20 Cigarettes (GEL)

	1991 - 1997	1997	1998	2001	2005	MAY 2006	2010	SEPT 2013	2014	2015	2016	2017	2018
Imported with filter (GEL)	No tax	0.25	0.25	0.4	0.9	0.6	0.6	0.75	0.75	0.9	1.1	1.7	1.7
Imported without filter (GEL)	No tax	0.19	0.19	0.2	0.25	0.15	0.15	0.2	0.2	0.25	0.3	0.6	0.6
Local with filter (GEL)	No tax	100% of production cost	0.15	0.2	0.7	0.4	0.6	0.75	0.75	0.9	1.1	1.7	1.7
Local without filter (GEL)	No tax	100% of production cost	0.05	0.07	0.15	0.1	0.15	0.2	0.2	0.25	0.3	0.6	0.6
Ad valorem rate. %										5 (from July)	10	10	10

Source: Georgian Tax Code 2000, 2004, 2005, 2006, 2009, 2017; Shalutashvili et al. 2007.

2. Recent Evolution of Georgia’s Tobacco Control Policies

Tobacco control measures under the FCTC. In 2006, Georgia ratified the WHO Framework Convention on Tobacco Control (FCTC) and committed itself to carry out a set of measures to decrease the alarmingly high smoking prevalence in the country.

Since one of the most cost-effective measures to curb tobacco use is increasing tobacco taxes,⁵ the government and local NGOs pay particular attention to tobacco tax policy. Following a challenge by British American Tobacco at the World Trade Organization (WTO), the government equalized the excise tax rates for imported and locally manufactured cigarettes in 2010 by raising the rate for domestic cigarettes to the level for imported cigarettes (Table 1). This policy change is in line with the best practice in tobacco taxation. On the

⁵ Tobacco Tax Reform At The Crossroads Of Health And Development. Edited by Patricio Marquez and Blanca Moreno-Dodson. World Bank. October 2017

other hand, the persistent gap between the tax rates on filtered and non-filtered cigarettes goes against WHO recommendations on tobacco tax policy⁶ and encourages downward substitution instead of reduction in smoking.

In addition to its tobacco tax policy, Georgia has implemented other tobacco control measures following the ratification of the FCTC. The 2008 Tobacco Control Law banned smoking in educational, medical, sport, and cultural facilities, while other indoor facilities had to have designated smoking areas. As a result, bars and restaurants allowed smoking in up to 50 percent of their premises. The law also prohibited the sale of cigarettes to/by minors and the sale of cigarettes in places where toys or children's clothing were sold. The legislation banned cigarette sales within 50 meters of schools. Tobacco advertisement was banned on TV/radio and within 100 meters of schools and bridges. Since 2009, it is prohibited to accept sponsorship from the tobacco industry (Law on Advertisement of Georgia 2009).

In 2010, the law introduced new packaging regulations requiring health warnings to cover 30 percent of the pack. However, the enforcement of these tobacco control laws was weak, also due to frequent court challenges against the legislation. In addition, no proof of age was required to purchase tobacco products (Bakhturidze et al. 2016). As a result, a 2014 survey showed that 77 percent of Georgian adolescents had no difficulty in buying tobacco products at points of sale.⁷

Association with the European Union: implications for tobacco control. In 2014, Georgia signed an association agreement with the European Union (EU-Georgia Association Agreement 2014). According to the Agreement, Georgia is obliged to harmonize its tax policy, including tobacco tax policy, with that of the EU. As a result, Georgia adopted a mixed tobacco tax system in 2015 by adding an ad valorem component to the excise duty. The base for calculating the ad valorem tax is retail prices set each year by order of the Ministry of Finance (MoF 2017). In addition, substantial tax increases took place in 2015, 2016, and 2017 with the goal of reaching the current EU tax level (1.8 Euro per pack, or about 5.2 GEL) within about seven or eight years following the Association Agreement. These tax increases resulted in a higher share of tax in the retail price and in additional tax revenue. (Figure 1)

As of January 1, 2018, filter cigarettes incur a specific excise tax of GEL 1.70 (0.70 USD) per 20 cigarettes, and non-filter cigarettes a specific tax of GEL 0.60 (0.25 USD) per 20 cigarettes, independent of their origin. In addition, each pack is also levied 10 percent ad valorem excise (Tax Code 2018). Excise taxes are also levied on pipe/loose tobacco at GEL 35 (14.5 USD) per kilogram. This translates to GEL 0.50 (0.20 USD) per pack, assuming 0.7 g of tobacco per cigarette, a rate lower than non-filtered cigarettes.⁸ Only about 2.5 percent of smokers in Georgia use roll-your-own tobacco (ISSA 2016). All tobacco products are also subject to 18 percent VAT.

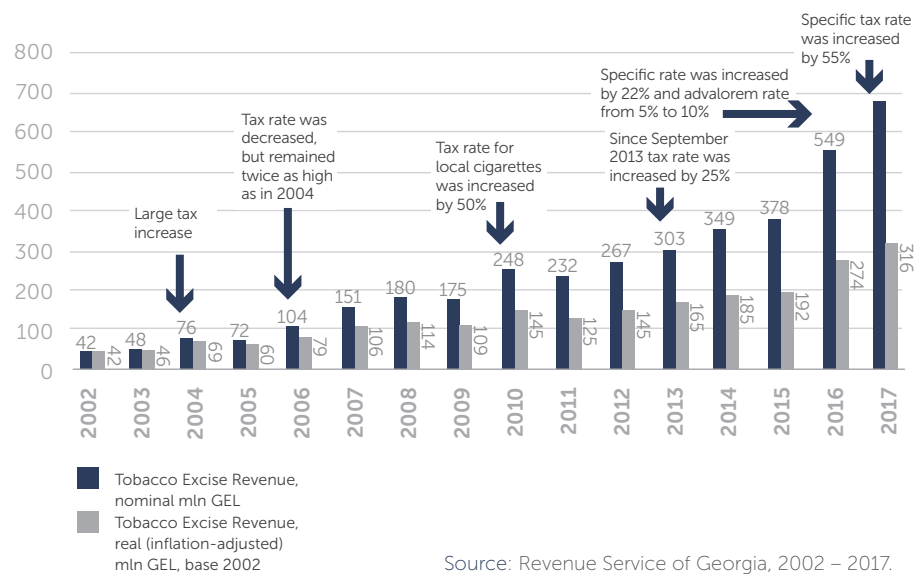
⁶ Guidelines for implementation of Article 6, WHO FCTC, 2014.

⁷ Global Youth Tobacco Survey, Georgia, 2014

⁸ Hana Ross, Report on Technical Assistance Visit to Georgia, 4 - 12 September, 2017.

Starting on August 1, 2017, Georgia began to tax e-cigarettes (0.2 Gel, or 0.08 USD, per 1 mg of liquid) as well as cartridge and iQOS devices (GEL 1.7, or 0.7 USD per piece) (Tax Code 2018).

Figure 1. Tobacco Excise Revenue in Georgia 2002–2017, Nominal and Real (Million GEL)

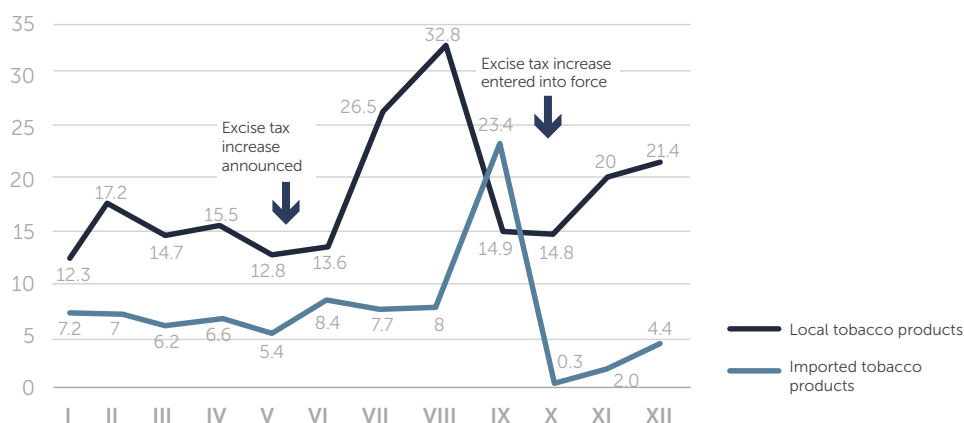


Forestalling continues. The tobacco industry is still engaged in forestalling. Figure 2 demonstrates this behavior in 2013. A tax increase was announced in June 2013, effective September 1, 2013. The excise revenue from local cigarettes reached 23.4 million GEL in September 2013, three times more than the previous month, reflecting tax stamp purchases just before the tax increase. The tax receipts for the rest of the year amounted to only 63 million GEL. Despite industry tax avoidance, total excise tax revenues reached 303 million GEL in 2013, 13 percent more than in 2012.

Similar behavior was recorded in 2017, when the industry requested 14.6 percent fewer excise tax stamps compared to 2016 (Table 2). Despite this pattern, 2017 excise revenue increased by 123 million GEL compared to 2016, thanks to the higher tax rate (Figure 1).

Maneuvers by the industry makes it challenging to study the reaction of the market to recent tax increases. As noted, rather substantial tax increases occurred in September 2013 and then each January in 2015, 2016, and 2017. The tobacco industry responded to the 2013 tax increase by an overproduction/over-importation of cigarettes (Figure 2) before the tax increase. Therefore, a drop in the size of the market was expected in 2014. The demand for tax stamps declined in 2014, but the size of the market actually increased in that year, based on official statistics concerning local production, import, and export (Table 2). The 2015 tax increase kept the demand for tax stamps almost constant, but the size of the market shrank. Comparing the size of the market and the demand for tax stamps in 2013 with 2016, we

Figure 2. Monthly Excise Tax Revenue in 2013, Nominal, Million GEL



Source: Revenue Service of Georgia, 2014.

observe a decline in both statistics, signaling that the decline in the number of cigarette sold after the 2013 tax increase was real. However, the size of the cigarette market in 2017 was almost identical to its size in 2013 (Table 2). This is likely related to the affordability of cigarettes, explored below.

The cigarette re-export phenomenon. In 2017, the gap between the market size and the number of cigarettes based on the excise marks sold increased dramatically. This is likely related to cigarettes for re-export, a phenomenon that began in 2014. These cigarettes, imported to Georgia to be re-exported to a third country, are not featured in the import/export statistics, but are recorded in a separate line (Table 2). The import for re-export is not taxed, but it incurs a service fee for processing, bringing additional revenue to Georgia. Re-exported cigarettes are likely to escape excise taxation in the destination country, thus supplying the black market.⁹ The primary destination for the re-export used to be Turkey, where cigarettes are more expensive compared to Georgia. However, the recent collaborative agreement between Georgia and Turkey, adopted in 2017, successfully blocked this pathway.¹⁰ Therefore, the top destinations for re-export in 2017 were Azerbaijan (1,218.5 million sticks), Kazakhstan (1,146.4 million), and Singapore (249.4 million) (National Statistics Office of Georgia 2018).

Another interesting development was a massive decline in domestic production and an increase in imports during 2010 - 2017. Domestic production represented about 33 percent of the total market in 2013, but its share had dropped to about 18 percent by 2017. Legal exports tend to fluctuate but do not represent a significant portion of the market (Table 2).

⁹ Interview with the former head of Georgia Customs Service and a representative of the Georgia Revenue Service.

¹⁰ Interview with a representative of Georgia Customs Service conducted March 18, 2018.

Table 2. The Cigarette Market in Georgia, 2010–2017, Million Sticks

MILLION PIECES/ YEARS	2010	2011	2012	2013	2014	2015	2016	2017
A: Domestic production	5,002.0	4,429.0	3,813.0	3,463.7	3,128.1	1,888.3	1,670.6	1,857.4
B: Export	21.0	0	1.0	10.1	151.9	352.8	68.5	149.2
C: Import	4,492.0	5,261.0	5,991.0	6,953.4	8,242.2	7,968.5	8,441.1	9,206.0
Market Size (=A-B+C)	9,473.0	9,690.0	9,803.0	10,407.0	11,218.4	9,504.0	10,043.2	10,914.2
Re-export	0	0	0	0	27.4	402.3	704.8	2,764.2
Number of cigarettes based on the excise marks sold	NA	NA	NA	9,898.4	9,717.9	9,745.7	9,296.9	7,943.3

Source: National Statistics Office of Georgia 2018 and the Revenue Service 2018.

Evolution of the domestic cigarette market: unexpected directions. Given the tobacco excise tax increases in recent years and the declining size of the population,¹¹ one would expect the Georgian market to shrink. However, Table 2 shows otherwise. To investigate the issue, Table 3 presents the estimates of affordability of three different types of cigarettes sold in Georgia. We have used a standard method to measure affordability, calculating it as the share of per capita GDP needed to purchase 100 cigarette packs in one year.¹² Results show that the affordability is increasing, with a declining percentage of per capita GDP needed to purchase 100 cigarette packs.

The affordability of all cigarette types increased between 2000 and 2017. It took 6.48 percent of per capita GDP to buy 100 imported cigarette packs in 2000, but only 3.77 percent of per capita GDP to do so in 2017, for example. This is not a positive development from a public health perspective, since the affordability of products, which captures the impact of both prices and income, is an important driver of consumption. The affordability trend explains the limited impact of higher taxes on the size of the market in Georgia. On a positive note, the affordability of cigarettes declined in 2017 compared to the previous year, though this trend is likely not to be sustained since no tax increase took place in 2018.

A quick market observation in September 2017 revealed that the cheapest (non-filtered) cigarettes cost GEL 1.25 per pack (about \$0.50), while the prevailing price of a non-filtered cigarette pack was GEL 1.30 per (about \$0.54). Premium cigarettes were sold for about GEL 4 per pack (\$1.65). The substantial tax increases in recent years, together with the persistence of the price difference between filtered and non-filtered cigarettes due to the two-tiered tax system, motivated some consumers to switch to the cheaper non-filtered

¹¹ United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2017 Revision.

¹² Blecher, C and P van Walbeek. International analysis of cigarette affordability. *Tobacco Control* 2004;13:339–346. doi: 10.1136/tc.2003.006726

Table 3. Cigarette Affordability in Georgia, RIP, 2000–2017

YEAR	AFFORDABILITY LOCAL WITHOUT FILTER	AFFORDABILITY LOCAL WITH FILTER	AFFORDABILITY IMPORTED WITH FILTER
2000	1.84%	3.30%	6.48%
2001	1.54%	4.81%	6.64%
2002	1.29%	4.75%	5.77%
2003	1.06%	3.86%	4.77%
2004	1.13%	3.77%	4.51%
2005	1.31%	5.00%	5.51%
2006	1.15%	3.34%	5.31%
2007	0.90%	3.43%	4.25%
2008	0.79%	2.73%	3.70%
2009	0.84%	2.74%	3.86%
2010	0.89%	2.50%	3.46%
2011	0.87%	2.31%	3.08%
2012	0.82%	1.97%	3.39%
2013	0.85%	2.11%	3.52%
2014	0.86%	2.13%	3.19%
2015	0.92%	2.25%	3.20%
2016	0.99%	2.38%	3.13%
2017	1.21%	2.98%	3.77%

Source: Authors' calculation based on data from the Statistical Office of Georgia. RIP = relative income price

cigarettes. According to the Revenue Service of the Ministry of Finance, the sales of excise tax stamps for non-filtered cigarettes doubled in 2017.

A 25-gram bag of loose tobacco sold for GEL 3, a pack-equivalent of GEL 1.7 (\$0.71).¹³ This is slightly more compared to non-filtered cigarettes, despite lower tax rates on loose tobacco. Nevertheless, only 2.5 percent of smokers roll their own cigarettes. Cheap devices for rolling cigarettes costing GEL 3 (about \$1.25) are available on the market (ISSA 2016).¹⁴

Getting around the regulations: enforcement falls short. Despite a ban, sale of single cigarettes is easily observed on the streets of Tbilisi. The prices range from 7.5 to 10 tetri (about

¹³ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017

¹⁴ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

3 – 4 US cents), a pack-equivalent of 1.5 – 2 GEL, which means that there is a premium charged for selling single cigarettes.¹⁵ The possibility of acquiring a cigarette so inexpensively reduces the economic barrier to smoking initiation, even though the premium should reduce the number of cigarettes smoked per day. The Code of Administrative Offenses effective since May 1, 2018, allows the revenue authority to issue a penalty on the spot in the amount of GEL150 (\$61) for single cigarette sales (Law on Tobacco Control 2018, Law on Advertisement 2018). Implementation and enforcement of the law are still low priorities.

Even though tobacco advertising has been banned since 2009, tobacco companies have found ways to advertise new brands through banners, sponsorship programs, and displays at checkouts. As recently as September 2017, the Georgian capital was flooded with billboards promoting cigarettes. This changed on May 1, 2018, when Georgia amended its tobacco control legislation to cover all tobacco products including e-cigarettes and hookahs, for example. The new law bans smoking in public places (with only a few exceptions, such as casinos, cigar bars, and private taxis) as well as all forms of advertising and promotions. (Outdoor displays will be banned from September 1, 2018, while indoor displays will be banned from January 1, 2021.) Pictorial health warnings covering 65 percent of the front of the pack will become obligatory from September 1, 2018, and plain packaging will enter into force from December 31, 2022. Proof of age is now required to purchase tobacco products (Law on Tobacco Control 2018).

Stubbornly high prevalence rates and tobacco-related mortality. As result of the high affordability of cigarettes and the fact that major tobacco control policy advances have for the most part occurred recently, the effort to reduce smoking prevalence has had only moderate success. In 2016, 57 percent of men and 7 percent of women reported current smoking, while a cotinine test suggests that close to 12.2 percent of women smoke (STEPS 2016). The majority of smokers (90.5 percent) are daily smokers. About 16.5 percent of boys and 7.8 percent of girls aged 13–15 years consume tobacco products.¹⁶ These statistics put Georgia on the list of countries with the highest smoking prevalence, both in Europe and worldwide.

The death toll from tobacco use in Georgia is correspondently large – about 11,400 deaths or 22 percent of all deaths in the country are attributable to smoking every year. Tobacco use imposes a substantial economic burden on society, amounting to about 825 million GEL (345 million USD) per year, equivalent to 2.4 percent of GDP. Out of this amount, 327 million GEL (135 million USD) are related to healthcare. This represents 13 percent of Georgia’s total public healthcare expenditures (UNDP 2018).

¹⁵ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

¹⁶ Global Youth Tobacco Survey. Georgia. 2014.

3. Tax Avoidance and Tax Evasion

The transition period toward democracy after the collapse of the Soviet Union was characterized by several conflicts with Russia that resulted in the separation of regions of Abkhazia and South Ossetia from Georgia. High levels of corruption also marked this period.

Conflict, corruption, and illicit trade. This situation created fertile soil for illicit trade in tobacco products. Smugglers took advantage of the vulnerable borders between Georgia, Abkhazia, and South Ossetia. Domestic manufacturers evaded paying taxes by declaring cigarettes for export while selling them tax-free in Georgia. The authorities regularly detected false excise tax stamps and noticed excise tax stamps being used just on cartons instead of on individual packs. Illegal cigarettes, mostly with Russian excise tax stamps and/or Russian health warnings, were easily found (Shalutashvili et al. 2007).

A 2002 survey revealed that only two-thirds of the cigarettes on the market had the correct excise mark, with only one-third of imported cigarettes falling into that category. The majority of non-compliant imported cigarettes had a Russian tax stamp.¹⁷ In addition, about 62.5 percent of the domestic cigarettes on the market were produced in non-registered facilities.¹⁸

A survey conducted one year later, in 2003, reported that only 32.5 percent of the cigarette brands sold in Georgia were legal. About 31 percent of brands were sold without an excise stamp or with an excise stamp from a foreign country, while the remaining 36 percent of brands were sold both legally (with the proper excise stamp) and illegally (without the excise stamp or with an excise stamp from another country) (Kobeshavidze et al. 2003). One study estimated that, from 1997 to 2003, illicit cigarettes represented 50 percent and 30 percent of the cigarette market in rural and urban areas, respectively (Shalutashvili et al. 2007). Euromonitor reported similar figures (Table 4).

Post-2004 reforms: reining in illicit tobacco. The reforms initiated in 2004 by the new government focused on economic revival while addressing corruption and widespread tax evasion. Large-scale changes at the Ministry of Finance and the Georgia Customs Services (which falls under the Ministry of Finance) improved tax administration so that, by 2005, the number of registered cigarette manufacturers doubled compared to 1995, as formerly unregistered entities were forced to enter the ranks of registered companies (Shalutashvili et al. 2007). Georgia's ranking in the Corruption Perceptions Index by Transparency International improved strikingly, from rank 133 in 2004 to 67 in 2008 and further to 51 in 2012, surpassing several EU countries. The economy began to grow, and the state budget increased by 300 percent between 2004 and 2007.¹⁹ A doubling of tobacco excise tax revenue contributed to this progress, thanks to a higher tobacco tax rate and improved tobacco tax administration (Figure 1). The World Bank named Georgia as the leading economic

¹⁷ Supply and Use of Tobacco Goods in Georgia. State Department for Statistics of Georgia. Tbilisi, 2002.

¹⁸ Supply and Use of Tobacco Goods in Georgia. State Department for Statistics of Georgia. Tbilisi, 2002.

¹⁹ Mikheil Saakashvili. Wikipedia. https://en.wikipedia.org/wiki/Mikheil_Saakashvili Accessed June 6, 2018.

Table 4. Illicit Trade Market Share in Georgia

YEAR	SHARE OF ILLICIT % (2016)	SHARE OF ILLICIT % (2017)
2001	40.60	NA
2002	40.30	51.63
2003	36.70	47.84
2004	34.40	45.41
2005	36.90	48.08
2006	12.20	18.06
2007	7.20	10.98
2008	4.20	6.53
2009	1.50	2.41
2010	0.80	1.34
2011	0.60	0.88
2012	0.60	0.88
2013	0.30	0.42
2014	0.30	0.40
2015	0.30	0.42
2016	NA	0.44

Source: Euromonitor 2016 and 2017.

Note: The reliability of Euromonitor data has been questioned,²⁰ and the data for Georgia are not consistent between 2016 and 2017 reports. However, the trend reported by Euromonitor has been corroborated by other reports.

reformer in the world and noted that "Georgia's transformation since 2003 has been remarkable. The lights are on, the streets are safe, and public services are corruption-free."²¹

Because of these changes, the illicit trade in cigarettes declined dramatically, despite the increasing tax and even though cigarette prices in Georgia became for some period of time higher compared to neighboring countries (Krasovsky 2013). According to Euromonitor, the largest drop in the illicit cigarette market occurred between 2006 and 2009 (Table 3). By 2017, the Head of the Healthcare Committee of the Georgian Parliament reported that the illicit cigarette market share was less than 3 percent of total consumption (Commersant 2017-1), a truly remarkable reduction from the high levels discussed above and shown in Table 4.

²⁰ Evan Blecher, Alex Liber, Hana Ross, Jo Birckmayer. Euromonitor data on the illicit trade in cigarettes. *Tobacco Control* 2015. 24:100-101

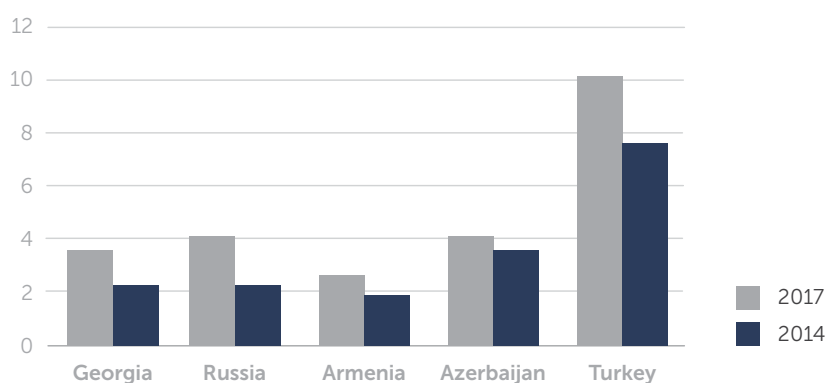
²¹ Mikheil Saakashvili. Wikipedia. https://en.wikipedia.org/wiki/Mikheil_Saakashvili Accessed June 6, 2018.

Table 5. Nominal Prices (GEL) for Selected Cigarette Brands, 2014 and 2017

BRAND	GEORGIA		RUSSIA		ARMENIA		AZERBAIJAN		TURKEY	
	2014	2017	2014	2017	2014	2017	2014	2017	2014	2017
Marlboro	3	4	2.8	4.5	2.3	3.2	4	5	9.5	11
Winston	2.2	3.5	2.2	4	1.8	2.6	3	4	7.5	10
Pall Mall	2	3	1.8	3.5	1.6	2.2	2.8	3.5	7	9

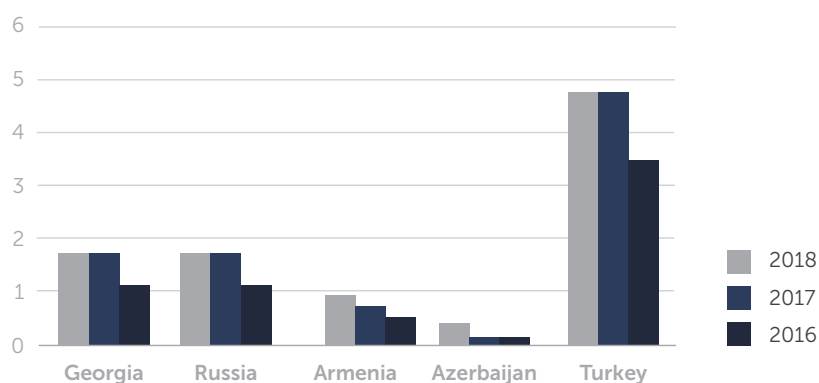
Source: <https://worldcigaretteprices.com>; MPOWER 2015; WHO Global Tobacco Control Report, 2017; tabacum.ru

Figure 3. Prices of Winston Brand Cigarettes in Georgia and Its Neighbors, 2014 and 2017



Note: Winston is the most popular imported brand in Georgia and Turkey.

Figure 4. Cigarette Excise Tax Rates in Georgia and Neighboring Countries, 2016–2018, in GEL



Source: Tax Laws of Georgia, Russia, Turkey, Armenia, and Azerbaijan. Data in GEL provided by Konstantin Krasovsky.

Note: Minimum specific excise tax rates are shown; tax in Georgia does not include the ad valorem component.

This would be in line with the estimates of the MoF (about 2 percent of the total market in 2017²²) and Euromonitor (Table 4).

Cross-border dynamics. The motivation for cross-border shopping varies from country to country, but the recent excise tax increases in Georgia made this activity less profitable (Table 5, Figure 3, and Figure 4). Georgia has four land neighbors: Turkey, Russia, Armenia, and Azerbaijan. Cigarette prices in Turkey are about three times higher than in Georgia, due to substantially higher excise taxes. As a result, Turkey does not pose a threat to the Georgian domestic cigarette market, but cigarettes seem to be smuggled from Georgia to Turkey. There are some reports that the proceeds from this business are funding the Kurdistan Workers' Party (PKK), recognized as a terrorist organization by Turkey, the EU, and the United States (Daily Sabah 2015; Eurasianet 2014; Hurriyet Daily News 2015; Panorama 2015). To address the issue, Georgia, in collaboration with Turkey, adopted strengthened control measures in 2017, preventing organized crime groups from smuggling cigarettes from Georgia to Turkey and other countries surrounding the Black Sea.²³

Russian excise tax rates are similar to those in Georgia, but cigarette prices are higher in Russia.²⁴ However, the Georgian territories Abkhazia and South Ossetia, controlled by Russia, could potentially be a source of illicit tobacco products (discussed below).

Cigarettes in Armenia are the most tempting for cross-border shopping (which could be either legal or illegal, depending on the quantity), because cigarette prices in Armenia are about 20 – 25 percent lower than in Georgia. The price difference stems from the difference in excise taxes – the Armenian excise is around 50 percent lower than that applied in Georgia.

Authorities' current concerns. Officials of the Georgia Revenue Service, which includes the Customs Service, have stated that the main issues that currently worry them are (a) small-scale cigarette smuggling related to other criminal activities and (b) transit of illicit cigarettes through Georgia.²⁵ Small-scale cigarette smuggling usually involves small trucks or cars and takes the form of bootlegging or "ant smuggling" (frequent cross-border movement of small amounts of cigarettes). This is considered a comparatively minor problem. The movement of illegal cigarettes from Russia, Armenia, Azerbaijan, or Ukraine via Georgian territory to third-country destinations (often Turkey) is of greater concern.

The tax-avoidance challenge. Even though tax evasion is a minor issue in Georgia, the country has a problem with tax avoidance. In addition to forestalling, tobacco companies are taking advantage of the tax differential between filtered and non-filtered cigarettes. In 2015, in response to the growing gap between filtered and non-filtered cigarettes, local manufacturers began to manufacture non-filtered cigarettes with an elongated empty end suitable for

²² Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

²³ An interview with a representative of Georgia Customs Service conducted March 18, 2018.

²⁴ Federal Tax Service of Russia. <http://service.nalog.ru/tabak.do>

²⁵ Customs Service presentation during the Georgia mission of the European Network for Smoking and Tobacco Prevention (ENSP), December 2017.

inserting filters. The filters are offered separately at the point of sale free of charge. This tax avoidance saves a company 1.1 GEL (USD 0.45) on a pack of cigarettes (based on 2018 tax rates) and encourages downward substitution that increases the affordability of cigarettes. This industry behavior would explain the doubling of non-filtered cigarette sales in 2017.

4. Measures to Control Tax Avoidance and Tax Evasion

Tax stamps. All tobacco products sold in Georgia are subject to taxation and must bear an excise tax stamp, except for pipe tobacco. Excise tax stamps were first introduced in 1999 as a tax-collection instrument, meaning that manufacturers and importers pay taxes by purchasing these fiscal stamps. The security features on the stamps were initially minimal, making them vulnerable to counterfeiting. The authorities also reported multiple uses of single tax stamps.²⁶ Since their introduction, tax stamps have evolved substantially, making them much more secure, as described below in the section on the tracking and tracing system.

Excise duties and VAT are payable when the goods are supplied to the final consumer or upon removal from the warehouse facility for sale. Importers pay these taxes at the time of import (Revenue Service of Georgia 2018; Tax Code of Georgia 2018).

The Department of Standards, in charge of the content of tobacco products, was dissolved in 2005. In the same year, raw tobacco was excluded from the Ministry of Agriculture's regulatory jurisdiction (Petriashvili et al. 2016). Raw tobacco intended for manufacturing tobacco products is exempt from excise taxes.

Shifts in the approach to licensing. Georgia introduced licensing of tobacco manufacturing and packaging in 1999 (Law on Licensing of Production of Food and Tobacco Products 2010). Unfortunately, the law was suspended towards the end of 2005 (Law on Licensing and Permissions 2005) and abolished by 2009 (Law on Licensing of Production of Food and Tobacco Products 2010). Therefore, no license is currently required to import, export, or distribute tobacco products in Georgia.

Duty-free shops selling tobacco products must have a license issued by the Revenue Service of Georgia and are obligated to assist Customs in executing their control authority (Revenue Service of Georgia 2012). The retail sale of tobacco products via Internet or mail is prohibited since May 1, 2018 (Law on Tobacco Control 2018).

Customs Service enforcement activities. The Georgia Customs Service has already implemented several measures to control illicit trade in tobacco products. For example, it runs a risk analysis and assessment system to select suspicious trucks for inspection. It uses X-ray

²⁶ Alexander Shalutashvili, Hana Ross, Judith Watt, Stephanie Hilborn, George Bakhturidze, Gela Kobeshavidze, Zaza Grigalashvili. Tobacco Economic Study in Georgia since the Fall of the Soviet Union. Editor: George Magradze. Open Society Institute. Tbilisi, Georgia, November 2007.

scanners at all border crossings and at the postal sorting center²⁷ to detect suspicious cargos and packages. It employs trained dogs that can recognize nicotine. However, only about 2 percent of containers with imported excisable goods are being randomly inspected. If a container has cigarettes, 2 percent of cartons are chosen, and then 2 percent of packs from those cartons are selected for inspection.²⁸

As of January 2018, international travelers can bring either 200 cigarettes (reduced from the previous 400 cigarettes) or 50 cigars or 50 cigarillos or 250 grams of other tobacco products or 10 capsules for e-cigarettes to Georgia tax free (Tax Code of Georgia 2018). For those using a land border, this limit applies for a period of 30 calendar days to prevent “ant” tax avoidance.²⁹

There are penalties for selling illegal cigarettes. The first offense calls for a fine ranging from 1000 to 2000 GEL (USD 400 to 800). The second offense within the same year is subject to a penalty of 10,000 GEL, or USD 4,000.³⁰

Implementing an integrated control system. In November 2011, the Georgia Revenue Service launched a competitive bid for an “Integrated System of Movement and Registration of Products.” Seven companies submitted proposals, and in the end the contract was awarded to SICPA, a company based in Switzerland.³¹ The system, which became operational in March 2013, requires all packs intended for the domestic market to carry a paper-based fiscal stamp with a high level of security features (overt, semi-covert, and covert). These stamps are unique, secure, and non-removable. Each stamp contains information stored in a serialized code intended for tracking and tracing and for a data management system. This information includes the name of producer or importer, product name, time and place of production, and volume. The data management system is located at the Georgia Revenue Service, and the information sent to the data center is transmitted in near real time. A web application allows domestic producers and importers to order, forecast, pay, and activate the fiscal stamps. This electronic system of excise marking imposes an immediate control by identifying the producer, the product, and how the product entered the market.

Even though the system is capable of both tracking and tracing, it is currently used only for tracing. The Georgia Revenue Service is currently satisfied with its performance. Revenue Service field officers carry hand-held inspection devices allowing them to authenticate products in retail distribution.

²⁷ X-rays at post offices are not a high priority due to the low prevalence of tax evasion via those channels.

²⁸ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

²⁹ “Ant” tax avoidance is defined as making frequent journeys across the border with the legally allowed amounts of tobacco products for the purpose of making profit.

³⁰ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

³¹ Information provided by a SICPA representative on 25 January 2017.

Packs intended for export carry a bar code indicating the destination country.³² An additional benefit of strengthening tobacco tax administration was spillover to tax administration of other products. In 2012, the SICPA system was expanded to cover alcohol and beer, then further extended to non-alcoholic beverages in 2016. The cost of the system (5 Euro/1000 stamps) is just a bit more than the previous simple tax stamp system. These expenses are initially covered by the government, but starting in 2018 the industry must cover the costs.³³

International collaboration. Regarding international collaboration, Georgia is a member of the World Trade Organization, and its Ministry of Finance has a memorandum of understanding with the UK Customs office to share intelligence regarding large-scale smuggling operations.³⁴ Even though Georgia was involved in the negotiations related to the FCTC's Protocol to Eliminate Illicit Trade in Tobacco Products, which was adopted by the Conference of Parties in 2012 (WHO 2012), unfortunately it has yet to ratify the Protocol.

Recent seizures of illicit cigarettes. The Investigative Services unit of the Ministry of Finance seized 61,419 and 557,685 packs of illegal cigarettes in 2016 and 2017, respectively. Simultaneously, the Customs Service of Georgia reported 96,896 and 228,071 cigarette packs that were not declared in those two years, respectively, even though only a portion of them were intended for sale in Georgia (Ministry of Finance of Georgia, 2018³⁵). For example, in October 2017, Customs seized 113,600 packs of Armenian cigarettes destined for Russia (Sputnik – Georgia, 2017). Based on the health warnings, these cigarettes were produced in Armenia for export to Iraq, but “got lost” on their way.³⁶ The growing number of seizures can be linked to the growing re-export business, which makes the country vulnerable to leaks from trade volumes not intended for the domestic market. The seized cigarettes are destroyed, but the Ministry of Environment and National Resources Protection has yet to establish an environmentally friendly method to dispose of these products.

Given the number of cases of seizure and the revenue loss estimated at 950,000 GEL in 2017 (tobacco excise revenue reached 672 million GEL in that year), the Ministry of Finance does not suspect any systematic violation of the tobacco excise tax law, except for the situation near the uncontrolled territories (Abkhazia and South Ossetia) and near the border with Armenia (Ministry of Finance of Georgia, 2018). The Georgian Ministry of Interior Affairs (MIA) reported only five criminal cases related to illicit tobacco trade in 2016, while it investigated seven such cases in 2017 (MIA of Georgia 2018). The MIA Border Police reported no criminal violations during the period 2013–2017 (Border Police of Georgia, 2018).

³² Tobacco Products Taxation Policy, National Diseases Control Center. 2016.

³³ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

³⁴ Hana Ross. Report on Technical Assistance Visit to Georgia. 4 - 12 September. 2017.

³⁵ Despite the Rise of Smuggling, Cigarette Sales Did Not Fall. *Commerzant*, April 2018; <https://commerzant.ge/en/post/despite-the-rise-of-smuggling-cigarette-sales-not-fell>

³⁶ A resident of Georgia found almost 30 thousand packs of contraband cigarettes in the attic. *Black Sea Press*, 16 May 2017. <https://www.newsgeorgia.ge/u-zhitelya-gruzii-obnaruzhili-na-cherdake-pochti-30-tysyach-pachek-kontrabandnyh-sigaret/>

Misinformation on seizures and illicit tobacco flows. Despite the remarkable record of Georgia's authorities in controlling illicit trade, the tobacco industry and associated groups persist in drawing attention to illicit cigarette trade. Industry spokespersons commented, for example, on the higher number of seizures in 2017, erroneously claiming that illicit trade in cigarettes increased 18-fold (Commersant 2017-II). In this context, it is important to note that seizures are not the best indicator of the level of illicit trade activity, since they are also a function of the intensity and the level of law enforcement.

The industry's multipronged strategy. The tobacco industry continues to interfere with Georgia's excise tax policy. It organizes seminars for both high- and mid-level MoF officials, particularly focusing on the Central Administration, Revenue Service, and Investigation Units (Academy of MoF, 2013). Even though since 2009 it is prohibited to receive sponsorship from the tobacco industry (Law on Advertisement of Georgia 2009), the transnational tobacco companies provide funding to various public agencies (e.g., Rondeli Foundation, the Police Academy), as well as several universities (e.g., Caucasus School of Business, Tbilisi State University, Sokhumi State University, Free University).

5. Conclusions

Georgia is an example of a country that successfully brought the illicit market in tobacco products under control, thanks to progressive economic reforms targeting, among other institutions, its Revenue and Customs services. In a relatively short period of time, Georgia managed to reduce corruption, set up effective tax administration and enforcement, and institute strong border control as key components of its strategy to control illicit trade in tobacco products. As a result, Georgia has managed to substantially decrease tax avoidance through various administrative measures, while pursuing a policy of regularly increasing cigarette excise taxes.

The data reveal the highest level of tax evasion during 1997 – 2003, when excise tax rates were about four- and eight-times lower on imported and domestic cigarettes, respectively, than in 2017. Yet the illicit cigarette market in 2017 is reported to be negligible. This confirms the empirical evidence from other countries pointing to the relatively small role of cigarette taxes as drivers of illicit cigarette trade. Georgia's experience adds to the growing body of evidence that tobacco tax increases can boost revenue even as vigorous enforcement keeps the illicit tobacco trade under control.³⁷

The remaining issues for the Georgian authorities to address are related to weak administrative borders with Abkhazia and South Ossetia, occupied by Russia, cross-border activities

³⁷ The Economics of Tobacco and Tobacco Control. National Cancer Institute Tobacco Control Monograph 21. NIH Publication No. 16-CA-8029A. Bethesda, MD: U.S. Department of Health and Human Services. National Institutes of Health. National Cancer Institute; and Geneva: World Health Organization; 2016. <https://cancercontrol.cancer.gov/brp/tcrb/monographs/21>

along the Armenian border, and possible movement of illegal goods across Georgian territory to other countries. Ratifying the Illicit Trade Protocol would provide Georgia with more tools to address these loopholes in its system.

Only the substantial excise tax increase in 2017 achieved the policy “win-win”: revenue increased, and the affordability of cigarettes was reduced. The moderate tax increases in previous years were beneficial from the revenue perspective but had less impact on public health. However, the excise tax on tobacco products, and especially on non-filtered cigarettes, is still low compared to Georgia’s neighbor, Turkey, or to the EU. The excise tax was supposed to increase in January 2018, but the government planned to adopt a strong tobacco control bill in May of that year and decided to postpone the tax increase. It is also possible that the tobacco industry played a role in this decision, as it continues to influence government agencies and their officials. Further tax increases are urgently needed, since the affordability of the largest cigarette market segment increased from 2010 to 2017.

The recent changes in the tobacco control law are in line with Georgia’s commitments under the FCTC and under the 2014 Association Agreement calling for a gradual approximation of Georgia’s national legislation with the tobacco control legislation of the European Union (2014). Four main tobacco control measures hold greatest promise for Georgia: regular tax increases, smoke-free policy, advertising bans, and labeling/packaging rules. If Georgia implements these measures aggressively and durably, the country could avoid 3.6 billion GEL (1.5 billion USD) in economic losses caused by tobacco use over the next 15 years, obtaining a return on investment of 357 GEL (143 USD) for every 1 GEL invested (UNDP, 2018). The tobacco industry in Georgia is engaging in at least two forms of tax avoidance: forestalling and exploiting the tax difference between filtered and non-filtered cigarettes. This can be addressed by changing the tax law according to the international best practice (e.g., taxing existing inventories at the new tax rate once it becomes applicable) and by equalizing the tax rate for filtered and non-filtered cigarettes.

Recommendations

Tackle forestalling. There are many ways to deal with forestalling by industry. Many countries apply the new tax rate on all existing inventory by, for example, applying an additional tax stamp. Other countries prevent sale of cigarettes with old tax stamps within days after a tax increase. In the UK, for example, the tobacco companies cannot order tax stamps in excess of their average sales prior to a tax increase. Adopting anti-forestalling measures would lead to gains in tax revenue.

Rapidly align with the Illicit Trade Protocol. The government should analyze the extent to which its current system is compliant with the ITP. The ITP, for example, requires licensing of economic operators involved in the tobacco product supply chain. Georgia should, therefore, reinstitute the licensing requirement, at least for cigarette manufacturers, importers,

and exporters. Licensing requiring background checks would further aid enforcement. The ITP also requires marking of all tobacco products, including those intended for export. This, together with regular exchange of enforcement data with other countries, would enhance Georgia's contribution to the global effort to control international illicit trade in tobacco products. In this regard, Georgia should ratify the ITP. The effort needed to comply with the ITP would be minimal, since Georgia already meets most of the ITP requirements.

Reinforce international cooperation. Georgia should consider strengthening cooperation and information exchange with EU Member States, especially with those bordering Russia (e.g., Poland, Estonia, Lithuania), since they are facing similar illicit trade problems, and with its neighboring countries. Georgia can enhance its interaction with Interpol, the European Anti-Fraud Office (OLAF), and other relevant agencies in the fight against illicit tobacco trade.

Reinforce border protections and product movement control systems. Georgia should enhance the protection of its vulnerable border with Abkhazia and Ossetia by video monitoring of all trucks entering and leaving the country from those territories. Such a surveillance system could be supported by road cameras and mobile X-rays, and integrated with the e-Transport and the excise marking electronic system. Further, a system resembling the EU's Excise Movement and Control System (EMCS) or the Monitoring System for the Road Carriage of Goods (MSRCG) implemented recently in Poland should be considered, given the trade flows and the Agreement with the EU. These systems assist risk assessment and information exchange across relevant stakeholders. The MSRCG, for example, requires that all parties to a transaction involving transport of "sensitive goods" such as fuels, alcohol, and tobacco products (i.e., the sending entity, the receiving entity, the carrier and the driver) notify the Customs service authorities in advance about the movement of the goods.

Ensure that legislation adequately supports enforcement actions. To enhance compliance, Georgia should revisit its anticorruption laws, the criminal code, the codes of conduct, and the conflict of interest regulations so that they support the enforcement efforts of the Georgia Customs Services and the National Revenue Agency.

Accelerate plain packaging. The implementation of plain packaging, planned for December 31, 2022, could be speeded up. Even though the industry is pointing to a threat of illicit trade, there is no research evidence to justify such concerns (Evans and Reeves, 2015; Joossens, 2012; Scollo et al., 2014). Plain packaging could help to reduce the high smoking prevalence and in fact make identification of illicit cigarettes from other countries easier (Brennan et al., 2015; Durkin et al., 2015; Scollo et al., 2015; Wakefield et al., 2015).

Bring government-tobacco industry relations in line with international norms.

Government should amend its legislation to comply with Article 5.3 of the FCTC regarding tobacco-industry interference in policy making. The most relevant provisions for controlling the illicit tobacco market are requirements that the tobacco industry and/or its affiliates cannot be involved in discussions related to the ITP ratification or a track-and-trace system.

The administrative effort to control illicit trade in tobacco products should be supported by enhanced monitoring, a comprehensive surveillance system, and data analysis, so that policy making is backed up by solid research evidence and does not have to rely on data generated by the tobacco industry.

References:

- Academy of the Ministry of Finance. 2013. Retrieved from: <http://mofacademy.ge/News/2278>
- Bakhturidze GB, Ross H. What J, et al. 2008. Population survey on tobacco economy and policy in Georgia. FCTC Implementation and Monitoring Center in Georgia. 4-22.
- Bakhturidze G, Peikrshvili N, Mittelmark M. 2016. The influence of public opinion on tobacco control policy-making in Georgia: Perspectives of governmental and non-governmental stakeholders. *Tob. Prev. Cessation*; 2(January):1 DOI: www.dx.doi.org/10.18332/tpc/61580
- Border Police of Georgia, letter dated February 7, 2017, N MIA 2 18 00303660
- Brennan E, Durkin S, Coomber K. 2015. Are quitting-related cognitions and behaviours predicted by proximal responses to plain packaging with larger health warnings? Findings from a national cohort study with Australian adult smokers. *Tob Control*. 24. suppl 2.
- Ciecierski C, Chaloupka F. 2002. Data for Economic Analysis. World Bank.
- Commersant 2017 – I: http://commersant.ge/?view=post&id=133241&lang_id=en
- Commersant 2017-II: http://commersant.ge/?view=post&id=136599&lang_id=en
- Departments of Statistics of the Ministry of Economic Development of Georgia. 2006. Import-Export of Raw Tobacco in 2000-2004.
- Daily Sabah, Sep 25, 2015. Cigarette smuggling biggest source of income for PKK. Retrieved from: <https://www.dailysabah.com/investigations/2015/09/26/cigarette-smuggling-biggest-source-of-income-for-pkk>
- Durkin S, Brennan E, Coomber K, et al. 2015. Short-term changes in quitting-related cognitions and behaviours after the implementation of plain packaging with larger health warnings: findings from a national cohort study with Australian adult smokers. *Tob Control*. 24. suppl 2.
- EU-Georgia association Agreement 2014: Information is available at: <http://www.parliament.ge/ge/ajax/downloadFile/34753/AA> Or <https://www.matsne.gov.ge/ka/document/download/2496959/0/ge/pdf>
- Eurasianet, Apr 11, 2014. Georgia Feeds Turkey's Jones for Tobacco. By Nicholas Alan Clayton. Retrieved from: <https://eurasianet.org/node/68264>
- Euromonitor International. Cigarettes – Georgia. 2009, 2011, and 2017.

Evans-Reeves KA. Hatchard JL and Gilmore AB. 2015. 'It will harm business and increase illicit trade': an evaluation of the relevance, quality and transparency of evidence submitted by transnational tobacco companies to the UK consultation on standardised packaging 2012. *Tob Control*. 24(e2): e168-e177. doi: 10.1136/tobaccocontrol-2014-051930

Georgian Law on Tobacco Control, different versions incorporated in one. Retrieved in 2018 from: <https://matsne.gov.ge/ka/document/view/1160150>

Georgian Law on advertisement, different changes incorporated in one. Retrieved from: <https://matsne.gov.ge/ka/document/view/31840>

Georgian Tax Code, 2018. Changes made during 2000-2017. Edition 1997-2004 retrieved from: <https://matsne.gov.ge/ka/document/view/31690>

Edition 2004-2010 Retrieved from: <https://matsne.gov.ge/ka/document/view/32842>

Edition after 2010. retrieved from: <https://matsne.gov.ge/ka/document/view/1043717>

Geostat – National Statistics Office of Georgia, letters dated: January 25, 2018, N 5-182; March 9, 2018, N 10-638; April 12, 2018, N 5-1021.

Gilmore A., Pomerleau J., McKee M., Rose R., Haerpfer C., Rotman D., Tumanov S. et al. 2004. Prevalence of Smoking in 8 Countries of the Former Soviet Union: Results from the Living Conditions, Lifestyles and Health Study. *American Journal of Public Health*. 94(12). 2177-87.

Hurriyetarynews May 14, 2015. Cigarettes smuggled from Georgia, Northern Iraq, Bulgaria. Retrieved from: <http://www.hurriyetarynews.com/cigarettes-smuggled-from-georgia-northern-iraq-bulgaria-82431>

Institute of Social Studies and Analysis (ISSA). 2016. Public Attitudes regarding tobacco control policy in Georgia. Retrieved from: <http://issa-georgia.com/ge/non-entrepreneurial-non-commercial-legal-entity/tabaqos-kontrolis-charcho-konventsiiis-implementatsiisa-da-monitoringis-tsentri/10>

Investigation Service of Ministry of Finance of Georgia, letter dated February 5, 2018; N 924/15-02

Joossens L. 2012. Smuggling the tobacco industry and plain packs. *Cancer Research UK*. https://www.cancerresearchuk.org/sites/default/files/smuggling_fullreport.pdf

Kobeshavidze, Meskhishvili, Bakhturidze, Grigalashvili. 2003. Cigarette smuggling and illicit trade problems in Georgia. Georgian National Counter Tobacco Center. Tbilisi.

Krasovskiy. KS. 2013. The impact of changes in excise rates on the cigarette market and budget revenues in Georgia (unpublished manuscript in Russian).

Law on Advertisement of Georgia. 2009. Retrieved from: <https://matsne.gov.ge/ka/document/view/31840>

Law on food and tobacco. 2010. Retrieved from: <https://matsne.gov.ge/ka/document/view/11938>

Law on Licensing and Permissions 2005. Retrieved from: <https://matsne.gov.ge/ka/document/view/26824>

Ministry of Interior Affairs, letter dated January 23, 2018, N MIA 1 18 00172449

Ministry of Finance 2017 See the prices respectively for 2017 and 2018 at <https://mof.ge/images/File/sajaro.../410/gamosaqveynebeli.xlsx>
<https://mof.ge/images/File/kanonmdebloba/brz-277-danarti.xlsx>

Ministry of Finance 2018, web site: <https://mof.ge/en/>

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

- National Statistics Office of Georgia. Statistical Yearbooks of Georgia. 2005-2017.
- Omega group tobacco (OGT): <https://ogt.ge/en/invention-cigarette-mouthpiece/>
- Panorama, Aug 5, 2015. Turkey seizes 3.5 million packets of cigarettes smuggled from Georgia. Retrieved from: <https://www.panorama.am/en/news/2015/08/05/turkey-georgia/1212>
- Eurasianet 2014: <https://eurasianet.org/node/68264>
- Revenue service of Georgia, MoF web site info updated in June 5. 2012: http://rs.ge/Default.aspx?sec_id=4816&lang=2
- Revenue service of Georgia, MoF web site info updated in March 11. 2015: www.rs.ge/en/5253
- Revenue service of Georgia, MoF web site info updated in 2018: http://www.rs.ge/Default.aspx?sec_id=5405&lang=2&catid=69
- Scollo M, Bayly M and Wakefield M. 2014. Availability of illicit tobacco in small retail outlets before and after the implementation of Australian plain packaging. *BMJ* Vol. 24.e1.
- Scollo M., Zacher M., Coomber K., Wakefield M. 2015. Use of illicit tobacco following introduction of standardised packaging of tobacco products in Australia: results from a national cross-sectional survey. *Tob Control*. 24. suppl 2.
- Shalutashvili A, Ross H, Watt J, Hilborn S, Bakhturidze G, Kobeshavidze G, Grigalashvili Z. 2007. Tobacco Economic Study in Georgia since the fall of the Soviet Union. FCTC Implementation and Monitoring Center in Georgia.
- SICPA web site: <https://www.sicpa.com/offices/georgia-tbilisi>
- Sputnik-Georgia 2017. Retrieved from: <https://sputnik-georgia.ru/incidents/20171031/237985553/Sigarety-vmesto-kamnej-i-cvetovgrazhdane-Armenii-popalis-v-Gruzii.html>
- State Department of Statistics. 2004. Retrieved from: <http://www.geostat.ge/index.php?action=search&lang=eng>
- STEPS Survey for Georgia. 2016. Retrieved from: http://ncdc.ge/AttachedFiles/STEPS%20report%20full-final_51403d9f-eda5-4789-93e0-3466d2711e17.pdf
- Petraishvili V, Shamugia N, Bakhturidze G, Gvinianidze K, Goginashvi K, Archvadze I, Moroshkina N, Maglakelidze N, Tesche J, Wood L. 2016. Tobacco Products Taxation Policy (Georgia). National Center for Disease Control on Georgia. Ministry of Labor, Health and Social Affairs of Georgia.
- UNDP, National Center for Diseases Control and Public Health of Georgia (NCDC); RTI International, WHO FCTC Secretariat. 2018. The case for investing in WHO FCTC implementation in Georgia. See report at: <http://www.ncdc.ge/Pages/User/News.aspx?ID=5aada9ce-57aa-4ec5-9d81-915d43c388e9>
- Wakefield M, Coomber K, Zacher M, et al. 2015. Australian adult smokers' responses to plain packaging with larger graphic health warnings 1 year after implementation: results from a national cross-sectional tracking survey. *Tob Control*. 24. suppl 2.
- WHO (World Health Organization). 2012. The Protocol to Eliminate Illicit Trade in Tobacco Products. <http://www.who.int/fctc/protocol/en/>
- WHO (World Health Organization). 2015. MPOWER: See information at: http://www.who.int/tobacco/global_report/2015/en/

WHO (World Health Organization). Framework Convention on Tobacco Control (FCTC) text: retrieved from: [www.fctc.org.ge](http://www.fctc.org/ge)

WHO Global Tobacco Control Report. 2017. Monitoring tobacco use and prevention. Retrieved from: <http://apps.who.int/iris/bitstream/handle/10665/255874/9789241512824-eng.pdf;jsessionid=3CDB6F426A1DD0F8BBF0E05359E200F1?sequence=1>

World Bank. 1996. "Reforms in Food and Agriculture in Georgia". Washington, DC: World Bank.

IRELAND

6

IRELAND:

Addressing the Illicit Flow of Tobacco Products

Alan Cummins, Oliver Gainford, and Peadar O'Lamhna¹

Chapter Summary

Ireland is committed to a policy of high tobacco taxation to encourage people to quit smoking. A high rate of tobacco excise, and the consequent high price of tobacco products, make Ireland attractive to those involved in the illicit tobacco trade. The supply of cheap illicit tobacco lessens the effectiveness of demand reduction strategies, including by enabling greater youth smoking uptake and continued tobacco use by price-sensitive consumers. However, Ireland's comprehensive and effective system of customs and tax enforcement, alongside strong regulatory control of the tobacco market, has contained the illicit flow of tobacco products onto the Irish market.

This chapter sets out the context of tobacco consumption within Ireland and details the operational and specific processes followed by Ireland in addressing the challenge of illicit tobacco, with particular focus on tax administration reforms. The chapter addresses the legal, institutional, and enforcement mechanisms which control legal supply chains and the marketing of tobacco products, as well as measures to identify and disrupt the supply of illicit products.

¹ General Excise and Tobacco, Indirect Taxes Policy and Legislation Division, Office of the Revenue Commissioners, Ireland

The chapter illustrates the fact that illicit tobacco trade remains a complicated phenomenon, and that even the estimation of its size is methodologically challenging. Effective action to inhibit the illicit tobacco trade requires a multi-pronged approach by agencies within a country, along with international cooperation.

1. Situation Description

1.1 Overview

Tobacco consumption is a recognized danger to human health, and tobacco policy in Ireland is informed by public health policy. Smokers lose an average of ten years of life compared with otherwise similar non-smokers.² Department of Health research indicates that smoking remains the leading cause of preventable death in Ireland, accounting for nearly 19 percent of the country's preventable deaths annually.³ Health inequalities are also associated with smoking, with prevalence higher in lower socio-economic groups,⁴ contributing to marked differences in mortality rates by socio-economic group. In March 2013, the *Healthy Ireland* framework⁵ outlined national public-health objectives, including reducing the country's smoking prevalence to 5 percent by 2025. This target was reconfirmed in *Tobacco Free Ireland: Report of the Tobacco Policy Review Group*, published by the Department of Health in October 2013.⁶ Government policy is to reduce harm through reducing tobacco consumption and smoking prevalence in Ireland.

The World Health Organization (WHO) advocates raising tobacco prices through increased taxation as an effective approach to control the spread of tobacco use.⁷ Tobacco tax is recognized as a key policy instrument in reducing tobacco consumption in Ireland.⁸ The WHO considers that higher prices prevent initiation of tobacco use, induce cessation, and reduce relapse among those who have quit. Ireland currently imposes the highest duty rates in the European Union on tobacco products, including on cigarettes and roll-your-own tobacco,⁹ resulting in relatively high retail prices for tobacco products.

² Jha et al, 2018, <https://www.bmj.com/content/361/bmj.k1162>

³ Howell F R, Shelley E, *Mortality attributable to tobacco use in Ireland. The Faculty of Public Health Medicine RCPI Winter meeting*; Dublin (2011).

⁴ Hickey, P., Evans, D.S., *Smoking in Ireland 2014: Synopsis of Key Patterns, 2015*, National Tobacco Control Office.

⁵ Healthy Ireland: <https://health.gov.ie/wp-content/uploads/2014/03/HealthyIrelandBrochureWA2.pdf>

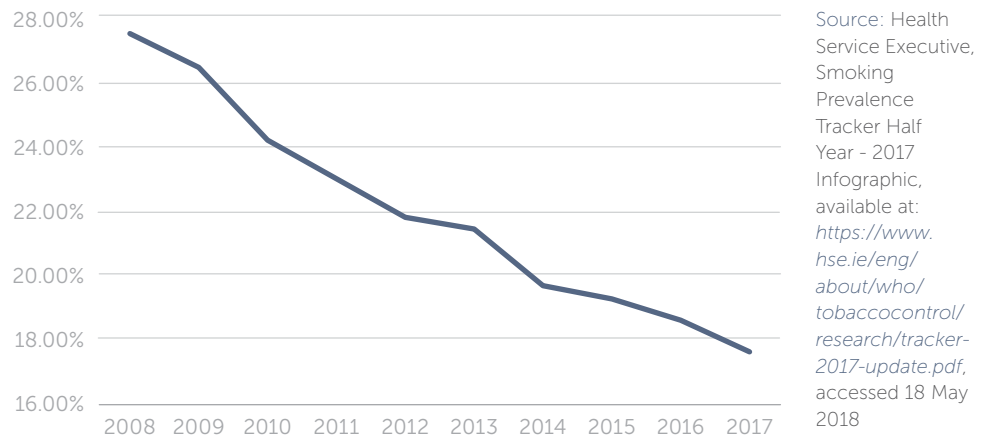
⁶ Tobacco Free: <https://health.gov.ie/wp-content/uploads/2014/03/TobaccoFreeIreland.pdf>

⁷ WHO: Tobacco Free Initiative (TFI): Taxation, <http://www.who.int/tobacco/economics/taxation/en/>, accessed 05 February 2018

⁸ Joint Committee on Health and Children, *Report on Hearings in relation to the General Scheme of the Public Health (Standardised Packaging of Tobacco) Bill*, Volume 1, April 2014, p 63

⁹ European Commission, Excise Duty Tables, Part III – Manufactured Tobacco, 2018. https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf

Figure 1. Smoking Prevalence in Ireland, 2007 to 2017



A sustained increase in excise taxation has coincided with and contributed to reductions in smoking prevalence in Ireland (Figure 1). Tax on tobacco products has been increased in nine of the last ten years. Analysis by the World Bank suggests that overall elasticity of demand lies between 0.3 and 0.8, meaning that a 10 percent increase in cigarette prices should lead to a 3 to 8 percent decline in consumption.¹⁰ Over the period from 2007 to 2017, the Irish Consumer Price Index rose by 2.4 percent. During that period, the tax-inclusive price of cigarettes in the Most Popular Price Category (MPPC) has increased by 60.8 percent, an increase in real terms of 57.1 percent.

Figure 2 shows the decrease in affordability between 2006 and 2016, taking account of two key determinants: inflation and growth in per capita income, both in current market prices. The Relative Income Price (RIP) is the percentage of per capita income required to purchase 100 packs of cigarettes. Affordability is expressed as a percentage, where higher percentages indicate less affordable cigarettes as a greater proportion of income is required to purchase the same quantity of cigarettes. Blecher¹¹ used per capita GDP as measure of income, however this chapter adopts per capita modified gross national income (GNI*) as more appropriate to the measurement of domestic economic activity for Ireland.¹²

The tax content (excise plus Value-Added Tax (VAT)) of the cigarette retail price has increased by 62.6 percent, a real increase of 58.8 percent, while the non-tax element of retail price has risen by 54.6 percent, an increase of 51 percent in real terms. The tobacco industry has applied price increases in addition to tax increases. The total tax as a percentage of the retail price increased marginally from 77.5 percent in 2007 to 78.3 percent in October 2017.¹³ At

¹⁰ World Bank, *Tobacco Tax Reform: At the Crossroads of Health and Development*, 2017, p 35.

¹¹ Blecher, E., *Targeting the affordability of cigarettes: a new benchmarking for taxation policy in low-income and-middle-income countries*, 2010.

¹² Report of the Economic Statistics Review Group, Central Statistics Office, 2016.

¹³ Calculations based on a current price of a pack of 20 cigarettes of €11.50.

Figure 2. Affordability (Relative Income Price) of Cigarettes, 2006 to 2016



the same time, smoking prevalence in Ireland has fallen by 9.66 percentage points since 2007, from 27.26 percent¹⁴ to 17.6 percent (as of June 2017).¹⁵ Fewer people are smoking than ten years ago, and those that smoke are smoking less.

Economic theory suggests that the quantity demanded of a product depends on multiple factors including its price, the price of related goods, incomes and unemployment.¹⁶ The nature of tobacco products introduces other demand variables. The addictive nature of tobacco products implies that current consumption levels depend upon past consumption, and potentially upon an idea of future prices and other determinants of demand.¹⁷ Setting expectations of continuing substantial increases in taxes is an important demand suppressant tool, particularly so for lower-income smokers and for young people who have not yet become confirmed tobacco addicts.¹⁸ In addition, tobacco consumption is influenced by tobacco control policies,¹⁹ including the mandatory presence of warning labels, bans on tobacco marketing practices, and access to cessation treatments and services.²⁰ Moreover, traditional variable-demand relationships have changed over time. Previously, increases in income would have been expected to give rise to increases in tobacco consumption; more recently, however, as knowledge about the health consequences of smoking has increased, this relationship has either disappeared or been reversed.²¹

¹⁴ Smoking Trend Data 2003-2013, available at: https://www.drugsandalcohol.ie/22499/1/Smoking%20Trend_Data_2003%20-%202013.pdf, accessed 18 May 2018.

¹⁵ Health Service Executive, Smoking Prevalence Tracker Half Year - 2017 Infographic, available at: <https://www.hse.ie/eng/about/who/tobaccocontrol/research/tracker-2017-update.pdf>, accessed 18 May 2018.

¹⁶ Walsh et al, *Economics of Tobacco: An Analysis of Cigarette Demand in Ireland*, 2015, p 13.

¹⁷ Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 8

¹⁸ World Bank, *Tobacco Tax at the Crossroads of Health and Development: A Multisectoral Perspective*, 2017, p 86

¹⁹ Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 13

²⁰ *Ibid.*

²¹ Jha P, Chaloupka FJ (1999). *Curbing the Epidemic: Governments and the Economics of Tobacco Control*. Washington D.C.: The International Bank for Reconstruction and Development/The World Bank.

Opportunities for tax avoidance are also relevant variables.²² Such opportunities include consumers purchasing tobacco products in non-EU countries from duty free shops or in other EU countries at prices that include local taxes but are well below prices in Ireland. Other examples involve distributors and retailers stockpiling cigarettes to avoid an anticipated tax increase. Such practices are affecting the demand for Irish duty-paid tobacco products by permitting substitution by non-Irish duty-paid (NIDP) products.²³

Differences in the relative prices of tobacco products tend to lead to some substitution among products by consumers.²⁴ This has prompted the World Bank to recommend maximum use of uniform specific excise taxes, in preference to ad valorem taxes or specific excises for different price tiers.²⁵ Alternatives to cigarettes may include cigars, roll-your-own (RYO) fine-cut tobacco for the rolling of cigarettes, other smoking tobacco and, more recently, electronic cigarettes,²⁶ all of which have lower incidence of taxation.²⁷ Finally, substitution of illicit for licit tobacco products affects demand for Irish duty-paid tobacco products.

Whereas, at first glance, there appears to be a correlation between tax increases and reduced consumption, the causal factors behind any reduction require careful analysis. In addition, due to the nature of the illicit tobacco market and the difficulty in deriving an agreed figure for the size of the illicit market, the nearest measure of total consumption available is based on Irish duty-paid sales. Furthermore, these figures are themselves a proxy and not actual consumption.²⁸ As these figures reflect the payments of excise taxes at the wholesale level,²⁹ they do not include non-Irish duty-paid tobacco products, whether legally acquired or illicit, and are distorted, relative to actual consumption, by the operational choices made by tobacco companies as to the timing of inventory releases. Data on actual tobacco product consumption simply does not exist for the Irish market.³⁰

The illicit tobacco trade avoids State regulation and taxation and jeopardizes tobacco control policies. Simultaneously, the illicit tobacco trade enables greater consumption by lowering the effective cost of tobacco products. It also shrinks tax-financed public funding available to the health care system,³¹ including monies collected in respect of tobacco-product taxes and earmarked for the Ministry for Health.³² While the illicit trade in tobacco is a global problem, it is particularly so for countries, including Ireland, that pursue a policy of

²² Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 13

²³ Walsh et al, *Economics of Tobacco: Modelling the Market for Cigarettes in Ireland*, 2011, p iii.

²⁴ Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 6

²⁵ World Bank, *Tobacco Tax at the Crossroads of Health and Development: A Multisectoral Perspective*, 2017, p 14

²⁶ Walsh et al, *Economics of Tobacco: An Analysis of Cigarette Demand in Ireland*, 2015, p 8

²⁷ Tobacco Products Tax is not applied to electronic cigarettes

²⁸ Walsh, *Economics of Tobacco: An Analysis of Cigarette Demand in Ireland*, 2015, p 14

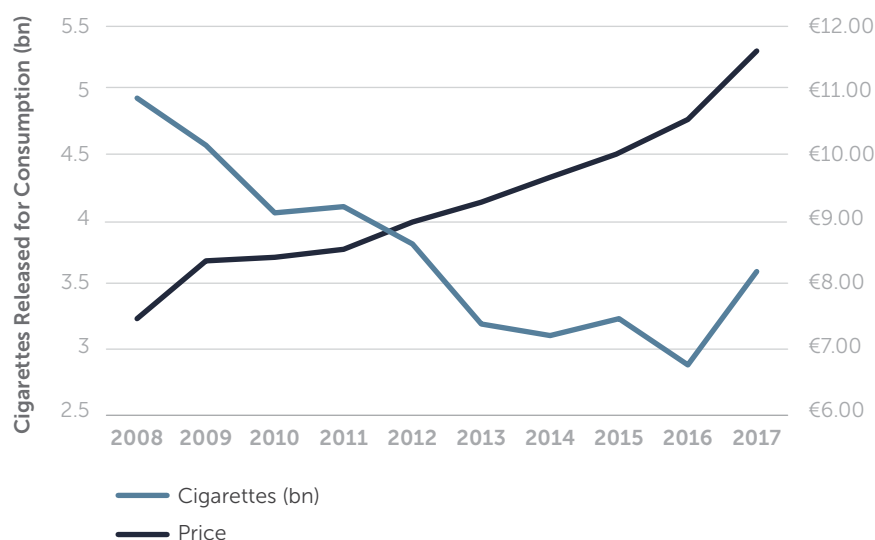
²⁹ Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 11

³⁰ Chaloupka, FJ and Tauras, JA, *The Demand for Cigarettes in Ireland*, 2011, p 11

³¹ Calderoni, F, Rotondi, M, Favarin, S, *The Factbook on the Illicit Trade in Tobacco Products Issue 3: Ireland, Transcrime*, 2013, p 61

³² Section 3 of the Appropriation Act, 1999

Figure 3. Cigarette Consumption and the Price of Cigarettes in the Most Popular Price Category (MPPC) in Ireland, Expressed in Current Market Prices



high tobacco taxes.³³ However, the most recent survey results show that, while trend data for illicit cigarette use show an increase in the most recent year, the general trend over the period 2007 to 2017 in the prevalence of the illicit trade has been downward.³⁴ This has occurred even as the price of cigarettes has risen, suggesting that, while the illicit trade has not been eliminated, Revenue’s extensive program of enforcement³⁵ has contained it. This would be consistent with the general finding from the World Bank (2017), suggesting that the main driver of illicit flows is not relative levels of price or taxation but the effectiveness of customs and tax enforcement.³⁶ The most recent survey evidence suggests that 13 percent of cigarette consumption in Ireland is illicit.³⁷

³³ Joint Committee on Health and Children, *Report on Hearings in relation to the General Scheme of the Public Health (Standardised Packaging of Tobacco) Bill*, Volume 1, April 2014, p 63

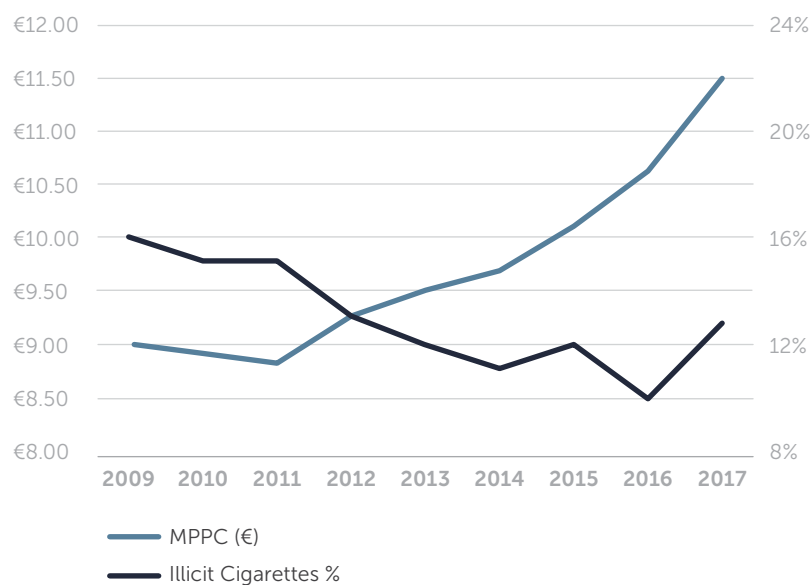
³⁴ Revenue, *Illegal Tobacco Products Research Surveys 2017*, available at: <https://www.revenue.ie/en/corporate/documents/research/illegal-tobacco-survey-2017.pdf>

³⁵ Revenue, *Annual Report 2017*, available at: <https://www.revenue.ie/en/corporate/press-office/annual-report/2017/ar-2017.pdf>, p 29

³⁶ World Bank, *Tobacco Tax at the Crossroads of Health and Development: A Multisectoral Perspective*, 2017, p 18

³⁷ IPSOS MRBI, *Illegal Cigarette Research 2017*, April 20188

Figure 4. Illicit Cigarettes and the Price of Cigarettes in the Most Popular Price Category (MPPC) in Ireland



There are three main types of illicit tobacco of most concern to the Irish authorities:³⁸

- CONTRABAND:** genuine tobacco which has been smuggled or diverted due to discrepancies in price between jurisdictions;
- COUNTERFEIT:** tobacco products which have been manufactured covertly and smuggled into the country;
- CHEAP WHITES:** tobacco products which are produced independently of the International Tobacco Manufacturers and then smuggled into the country avoiding tax.

1.2 Context of Tobacco Control

In the context of public health policy, tobacco control and regulation in Ireland are governed primarily by the Public Health (Tobacco) Acts 2002 to 2013. These Acts include provisions which prohibit tobacco advertising and sponsorship and restrict the marketing and sale of tobacco products.

³⁸ Joint Committee on Health and Children, *Report on Hearings in relation to the General Scheme of the Public Health (Standardised Packaging of Tobacco) Bill*, Volume 1, April 2014, p 64

Some of the key legislative measures introduced in recent years include the workplace smoking ban, the ban on the sale of cigarettes in packs containing less than 20 cigarettes, the ban on point-of-sale advertising, the introduction of graphic warnings on tobacco packaging, the introduction of standardized packaging, and the ban on smoking in cars carrying a child.

The illicit trade presents a number of different challenges to government policies, and the fight against the illicit trade is a priority for several reasons:

1. The availability of illicit tobacco products undermines public health policies, including demand-reduction strategies regarding tobacco. As illicit tobacco is available outside the normal regulatory framework, it may fail to comply with regulations regarding, availability, advertising, appearance and the presence of appropriate health warnings. Such regulations aim to reduce the appeal of cigarettes and smoking, enhance the salience of health warnings on packs, and address the use of packaging elements that mislead smokers about product harm. Illicit tobacco products that fail to comply with such regulations undermine policy initiatives aimed at reducing consumption by vulnerable persons, including low-income groups and minors. In addition, illicit tobacco may fail to comply with regulations regarding the reporting of ingredients and emissions and may contain additional harmful substances, including “asbestos, mold, dust, dead flies, rat droppings, and even human excrement.”³⁹
2. The illicit trade in tobacco results in losses to national finances through uncollected tax.
3. The illicit trade damages compliant taxpayers, including retailers and distributors, when the legitimate product they deal in is substituted by cheaper illicit tobacco products.
4. Finally, criminal groups, and in some cases terrorist groups, are financial beneficiaries of the illicit trade,⁴⁰ and the profits they acquire may be used to fund further activities harmful to society.

Since 2004, cigarette manufacturers and the European Union have cooperated in comprehensive initiatives, including traceability operations, aimed at limiting illicit activity. These agreements have been criticized for lacking transparency, serving the interests of tobacco companies, failing to align with the requirements of Article 5.3 of the WHO’s Framework Convention on Tobacco Control (FCTC), having inadequate penalties, and for generally

³⁹ Gabe Jagger, *The Times*, Illegal tobacco tainted by asbestos and rats, 16 May 2017

⁴⁰ UK Parliament, Northern Ireland Affairs Committee, *Third Report: Fuel laundering and smuggling in Northern Ireland*, 20 March 2012, para 28; Transcrime, *The Factbook on The Illicit Trade in Tobacco Products: Issue 3 Ireland*, 2013, p 88; Independent Monitoring Commission, *Twenty-fifth Report of the Independent Monitoring Commission: Presented to the Government of the United Kingdom and the Government of Ireland under Articles 4 and 7 of the International Agreement establishing the Independent Monitoring Commission*, October 2010, p 12, p 17

threatening progress in tobacco control.⁴¹ However, they have coincided with a drastic reduction in the smuggling of major brands.⁴²

Better control of the major cigarette supply chain appears to have changed the nature of the illicit market. Whereas previously the illicit trade mainly involved large-scale container smuggling of well-known brands of cigarettes, recent years have seen a relative decline of such activities, replaced by counterfeiting, illegal production, and cheap whites.⁴³ However, the majority of the illicit cigarette market in Europe still comprises tobacco industry product and well-known brands.⁴⁴

SECURITY SITUATION

The illicit trade in tobacco is, by its nature, a criminal undertaking, and quantifying a clandestine activity is inherently difficult. However, the trade appears to be dominated by organized crime groups (OCGs) operating across borders.⁴⁵

OCGs operating within the EU are highly diverse and range from large, "traditional" OCGs to smaller groups and loose networks supported by individual criminals, who are hired and collaborate in an *ad hoc* manner. More than 5,000 OCGs operating on an international level are currently under investigation in the EU, involved in many areas of criminality.

In 2012, the then Garda Commissioner (highest ranking officer in the Irish police force) indicated that there were approximately 25 organized crime groups operating throughout the State and that, while most were domestically orientated, five had a significant international dimension.⁴⁶ The Netherlands, Spain, and the UK were described as the main locations for such links.⁴⁷ The OCGs operating in Ireland tend to be Irish, but there is also evidence of Chinese and Eastern European groups.⁴⁸ Not all OCGs are involved in the illicit tobacco

⁴¹ Luk Joossens, Anna Gilmore, Michal Stoklosa and Hana Ross. An assessment of European Union's agreements with the four major Transnational Tobacco Companies to address the illicit cigarette trade. *Tobacco Control* 2016; 25:254–260

⁴² European Commission, *Technical Assessment of the experience made with the Anti-Contraband and Anti-Counterfeit Agreement and General Release of 9 July 2004 among Philip Morris International and affiliates, the Union and its Member States*, Brussels, 24.2.2016 SWD(2016) 44 final, pp 19–22

⁴³ European Commission, *Communication from the Commission to the Council and the European Parliament: Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products – A comprehensive EU Strategy*, 06 June 2013, COM(2013) 324 final, p 4

⁴⁴ Gilmore AB, Rowell A, Gallus S, et al., Towards a greater understanding of the illicit tobacco trade in Europe: a review of the PMI funded 'Project Star' report, *Tobacco Control* 2014;23:e51-e61; Gilmore AB, Gallagher AWA, Rowell A, Tobacco industry's elaborate attempts to control a global track and trace system and fundamentally undermine the Illicit Trade Protocol *Tobacco Control* Published Online First: 13 June 2018. doi:10.1136/tobaccocontrol-2017-054191

⁴⁵ European Commission, *Communication from the Commission to the Council and the European Parliament: Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products – A comprehensive EU Strategy*, 06 June 2013, COM(2013) 324 final, p 4

⁴⁶ Commissioner Martin Callinan, *Joint Committee on Justice, Defence and Equality*, 21 November 2012

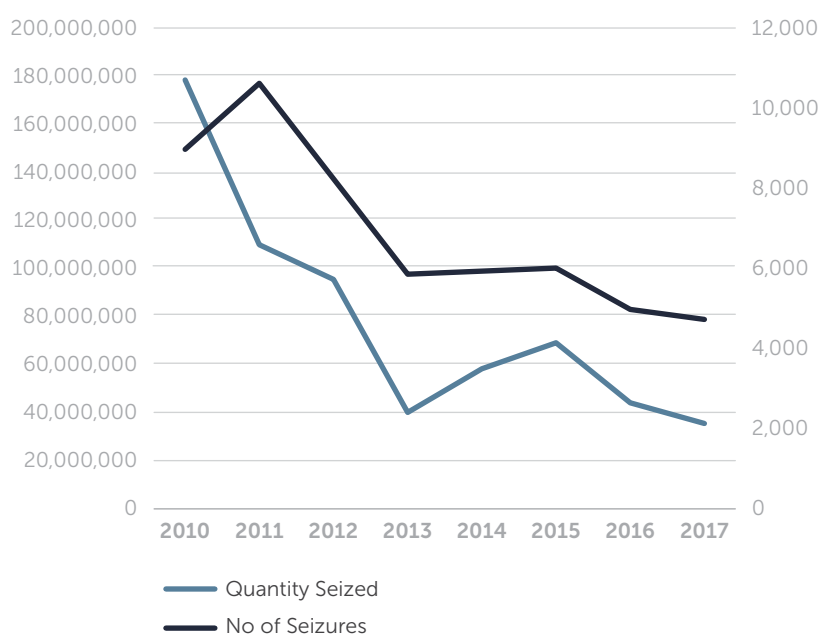
⁴⁷ *Ibid.*

⁴⁸ Transcrime, *The Factbook on The Illicit Trade in Tobacco Products: Issue 3 Ireland*, 2013, p 87

trade, but they feature prominently and often have extensive networks on both sides of the border with Northern Ireland which allow them to partake in numerous illegal ventures, often working in partnership with each other.⁴⁹

In 2017, 34.2 million cigarettes were seized in Ireland by Revenue, compared to 44.6 million in 2016 and 67.9 million in 2015.⁵⁰ Seizures of illicit tobacco in any given year can be affected by a range of factors, including the disproportionate impact of one or more particularly large seizures and the adaptation by smugglers to successful enforcement measures. Revenue is aware that smugglers are constantly looking for new ways to avoid detection, and that it needs to be agile and adaptable in responding to emerging threats. Revenue is continuously reviewing the ways in which it acts against the illicit trade and carefully monitors trends and patterns so that its response can be adjusted accordingly.

Figure 5. Cigarette Seizures in Ireland, 2009 – 2017



⁴⁹ British-Irish Parliamentary Assembly, *Report from Committee A (Sovereign Matters) on Cross-border Police Cooperation and Illicit Trade*, 2015, p 6

⁵⁰ Revenue, *Annual Report 2017*, Table 20: Excisable Products Seized, p 63, available at: <https://www.revenue.ie/en/corporate/press-office/annual-report/2017/ar-2017.pdf>; Revenue, *Annual Report 2016*, Table 23: Excisable Products Seized 2016, p 102, available at: <https://www.revenue.ie/en/corporate/press-office/annual-report/2016/ar-2016.pdf>; Revenue, *Annual Report 2015*, Table 20: Excisable Products Seized in 2015, p 79, available at: <https://www.revenue.ie/en/corporate/documents/statistics/annual-report-2015.pdf>.

In 2017, 88 people were convicted for illicit tobacco offenses, and Irish courts imposed custodial sentences in 18 cases. Of these, three people were sentenced to an average sentence of three months for smuggling offenses and six months for selling offenses, while 15 had their sentences suspended. A suspended sentence involves the judge imposing a prison sentence but suspending some or all of it on certain conditions. If the convicted person breaks any of the conditions set during the period for which the sentence is suspended, they will have to serve the term of imprisonment originally suspended. Average fines of €2,580 were imposed in 69 cases.

Figure 6. Convictions and Sentences Imposed for Illicit Tobacco Offenses in Ireland, 2009 – 2017

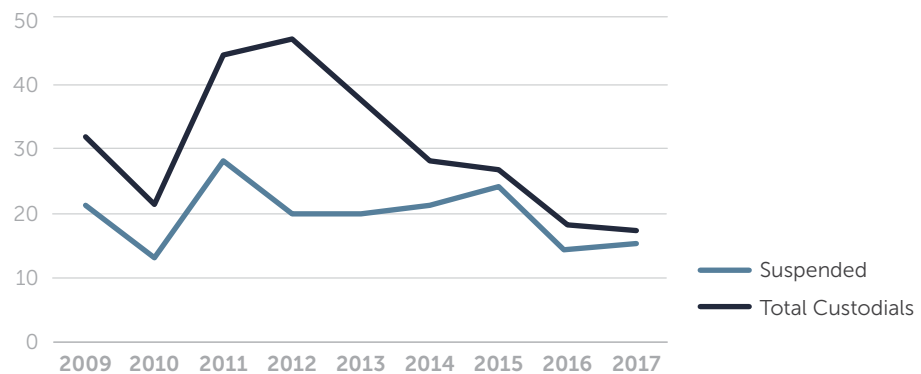
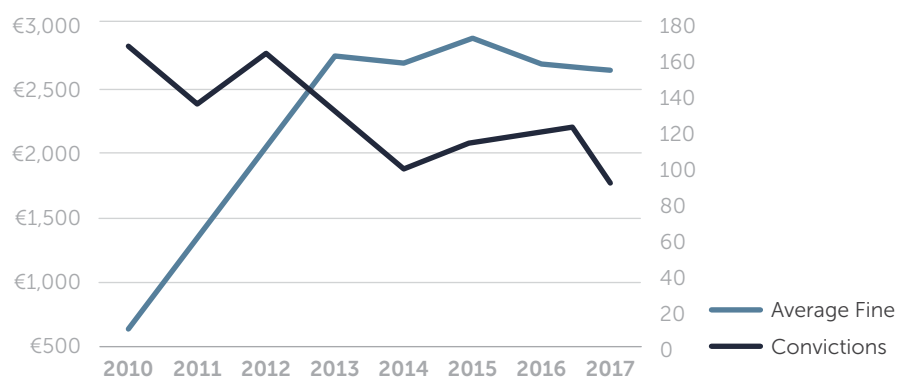


Figure 7. Convictions and Fines for Illicit Tobacco Offenses in Ireland, 2009 – 2017

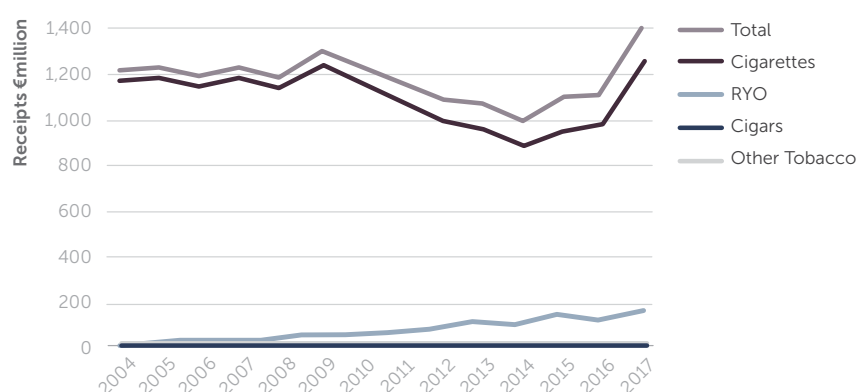


RATES OF FISCAL REVENUE

Despite a decline in Ireland's cigarette consumption, Tobacco Product Tax receipts rose in nominal terms from €568 million in 1994 to peak at €1,217 million in 2009. By 2016, receipts had slipped to €1,098 million. However, provisional figures show that receipts for 2017 rose to €1,397.4 million, exceeding the 2016 yield by €299.7 million. As these figures reflect the

payments of excise taxes, they are distorted, relative to actual consumption of legitimate tobacco products, by the operational choices made by tobacco companies as to the timing of inventory releases.

Figure 8. Receipts of Tobacco Products Tax in Ireland Since 2004, Expressed in Current Market Prices



RELEVANT INSTITUTIONS

The Office of the Revenue Commissioners (Revenue), the Department of Health, and the Department of Finance are the main institutional actors in the regulatory field, controlling the supply and sale of tobacco products in Ireland.

Revenue is responsible for the administration and collection of tobacco products tax and has, additionally, prioritized combating the illegal tobacco trade. Revenue’s strategy as regards the illicit trade includes a range of measures to identify and target the supply of illicit tobacco products, with a view to seizing illicit products and prosecuting those responsible. In this role, Revenue cooperates with An Garda Síochána (Irish police force) and with the other relevant agencies in the State.

The Department of Health is responsible for tobacco control legislation in Ireland in the context of public health. These laws include restrictions on the sale of tobacco products to minors, restrictions on the advertising and marketing of tobacco products, restrictions on point-of-sale displays, and the prohibition of smoking of tobacco products in workplaces. They also encompass measures controlling the appearance of cigarette packages, including text and photographic warnings (in line with EU Directives), and standardized packaging. The Health Service Executive enforces most of the tobacco control legislation in the context of public health.

The Department of Finance is responsible for fiscal policy advice to Government in relation to tobacco products.

POLITICAL SITUATION

Ireland is a multiparty parliamentary democracy with an executive branch headed by a prime minister (An Taoiseach), a bicameral parliament (the Dáil and Seanad), and a directly elected president. Political support for regulating the control and supply of tobacco products in Ireland is evidenced by a number of key legislative measures introduced in recent years:

- » The enclosed workplace smoking ban (2004), which means that pubs and restaurants, shops, and public transport, as well as other workplaces, are smoke-free;
- » The ban on the sale of cigarettes in packs of less than 20 (2007);
- » The ban on point-of-sale advertising (2009);
- » The introduction of graphic warnings on tobacco packaging (2013);
- » The introduction of standardized packaging (2017); and
- » The ban on smoking in cars carrying a child (2016).

INTERNATIONAL COOPERATION

Ireland is a Member State of the European Union. The current rates and structures of excise duty on tobacco products are harmonized across the European Union through Directive 2011/64/EU (Tobacco Products Tax Directive). Directive 2014/40/EU (Tobacco Products Directive) seeks to approximate the laws, regulations, and administrative provisions of Member States concerning the manufacture, presentation, and sale of tobacco and related products.

Ireland is a party to the WHO Framework Convention on Tobacco Control (FCTC) and a signatory to the Protocol to Eliminate Illicit Trade in Tobacco Products (FCTC Protocol). The FCTC was developed in response to the globalization of the tobacco epidemic, and it places an obligation on Parties to “develop, implement, update and review comprehensive multi-sectoral national tobacco control strategies, plans and programmes.”⁵¹ The FCTC Protocol requires Parties to adopt effective measures to control and regulate the supply chain of tobacco products in order to prevent, deter, detect, and prosecute the illicit trade in such products. The European Union is a party to both the FCTC and the FCTC Protocol.

Ireland pursues extensive cooperation with other tax administrations and with the European Anti-Fraud Office (OLAF) and the European Multiagency Platform Against Criminal Threats (EMPACT).

⁵¹ Article 5(1), WHO Framework Convention on Tobacco Control

2. Tobacco Tax Policy

2.1 Overview of the Legal Framework

Ireland classifies tobacco products for fiscal purposes as follows:

- » Cigarettes
- » Cigars or cigarillos
- » Fine-cut tobacco for the rolling of cigarettes (commonly known as “roll your own” or RYO tobacco)
- » Other smoking tobacco (for products containing smoking tobacco that do not fall into the above categories) ⁵²

Section 72 of the Finance Act 2005 provides for the charging of excise duty on tobacco products. The rates of duty are set down in Schedule 2 of the Finance Act 2005. The current rates of Tobacco Products Tax, in force from 10 October 2018, are as follows:

DESCRIPTION OF PRODUCT	RATE OF TAX
	Rate of tax at-
Cigarettes	<p>a. except where paragraph (b) applies, €327.10 per thousand together with an amount equal to 9.04 per cent of the price at which the cigarettes are sold by retail, or</p> <p>b. €376.82 per thousand in respect of cigarettes sold by retail where the rate of tax would be less than that rate had the rate been calculated in accordance with paragraph (a).</p>
Cigars	Rate of tax at €375.058 per kilogram.
Fine-cut tobacco for the rolling of cigarettes	Rate of tax at €360.827 per kilogram.
Other smoking tobacco	Rate of tax at €260.199 per kilogram.

The manner in which Tobacco Products Tax is calculated for each type of tobacco product is outlined below.

CIGARETTES

Tobacco Products Tax on cigarettes consists of two separate elements:

- i. An *ad valorem* element, which is a percentage of the retail selling price.; plus
- ii. A specific amount of tax calculated per 1,000 cigarettes.

⁵² Section 71 Finance Act 2005

EXAMPLE: 20 PACK CIGARETTES WITH A RETAIL PRICE OF €12.00

Specific Duty ($€327.10 \div 1000$) x 20	=	€6.542
Ad Valorem Duty $€12.00 \times 9.04\%$	=	€1.0848
Total Tobacco Products Tax due	=	€7.63

CIGARS OR CIGARILLOS

Tax is to be charged on the net weight of taxable product in kilograms per case, with some allowance for rounding.

EXAMPLE: A CASE OF CIGARS WEIGHING 5.60KGS

Tobacco Products tax payable: $5.60\text{kg} \times €375.058 = €2,100$

FINE-CUT ROLL-YOUR-OWN TOBACCO

Tobacco Products Tax is to be charged on the total net weight per case.

EXAMPLE: A POUCH OF ROLL-YOUR-OWN TOBACCO WEIGHING 30G

Tobacco Products Tax payable: $0.03\text{kg} \times €360.827 = €10.82$

OTHER SMOKING TOBACCO

Tobacco Products Tax is to be charged on the total net weight per case.

A 20KG BOX OF TOBACCO NOT FALLING WITHIN ANY OF THE ABOVE CLASSIFICATIONS

Tobacco Products Tax payable: $20\text{kg} \times €260.199 = € 5,203.98$

VALUE-ADDED TAX (VAT)

VAT at the standard rate, currently 23 percent, is applied to all tobacco products, on the excise-inclusive price. To ensure the VAT charged remains proportional to the pre-VAT price, an adjustment is required in its calculation, as such the 23 percent standard rate is reported as 18.7 percent.⁵³

⁵³ $23/(123 \times 100) = 18.7$

EXAMPLE: 20-CIGARETTE PACK WITH A RETAIL PRICE OF €12.00

Specific Duty ($€327.10 \div 1000$) x 20	=	€6.542
<i>Ad Valorem</i> Duty ($€12.00 \times 9.04\%$)	=	€1.0848
VAT ($€12.00 \times 18.7$)	=	<u>€2.2439</u>
Total Tax due	=	€9.87

UNMANUFACTURED TOBACCO

Unmanufactured tobacco is not liable to Tobacco Products Tax but it is subject to control. Any unmanufactured tobacco found in the state must comply with the requirements of Section 78A of the Finance Act 2005, which requires that unmanufactured tobacco can only be kept, under a specified customs procedure, for use as a raw material either for the production of tobacco products in a tax warehouse or for the production of something other than a tobacco product, and not for any other reason. Any unmanufactured tobacco found in the State contrary to Section 78A would be prohibited goods and liable to seizure. As unmanufactured tobacco is not a harmonized excisable product, its movement is not controlled under the EU-wide Excise Movement and Control System (EMCS).

TOBACCO GROWING

A license is required to grow, cure, or re-handle tobacco.⁵⁴ In addition, the area which may be planted with tobacco in any one year in Ireland is regulated. In 2017, the maximum number of hectares permissible to plant with tobacco was set at 5 hectares, while the maximum by any one person was set at 0.5 hectares.⁵⁵

EXEMPTIONS: WITHIN THE EU

As a Member State of the European Union, Ireland is bound by Article 32 of Directive 2008/118/EC,⁵⁶ which allows a private individual to acquire tobacco for his or her own use in one Member State and to transport that tobacco to another Member State. In order to determine whether the excise goods are intended for the own use of a private individual, Member States are allowed to set indicative levels. Article 32(3) sets a lower bound on all of the levels.

Irish law has transposed these EU principles and sets out a range of circumstances to be considered when determining whether quantities of tobacco are to be considered as being for the personal use of individuals travelling within the EU, including the frequency with which the person brings tobacco products into the State. The following indicative levels are applied:

⁵⁴ Regulation 1, Statutory Instrument. (S.I.) No. 3/1933 - The Tobacco Growing Regulations, 1933

⁵⁵ Regulation 2, S.I. No. 41/2017 - Tobacco (Areas for 2017) Order 2017

⁵⁶ Council Directive 2008/118/EC concerning the general arrangement for excise duty repealing Directive 92/12/EEC

- » 800 cigarettes;
- » 400 cigarillos;
- » 200 cigars;
- » 1 kg smoking tobacco.⁵⁷

Where it is determined that the tobacco products in question are for the personal use of the individual, no further Irish duty is payable. Where it is determined that the tobacco products were brought into Ireland for commercial purposes, then Irish duty at the appropriate rate must be paid.

EXEMPTIONS: OUTSIDE THE EU

For individuals arriving in Ireland from outside the European Union, the following personal allowances of tobacco apply:

- » 200 cigarettes;
- » 100 cigarillos;
- » 50 cigars; or
- » 250g smoking tobacco.⁵⁸

An individual may split his or her allowance on a fractional basis, for example: 100 cigarettes and 50 cigarillos.

DISTANCE SALES

Retailers established in Ireland who intend to engage in cross-border distance sales of tobacco products or electronic cigarettes to consumers located in the European Union, and retailers established in another Member State who intend to engage in cross-border distance sales of tobacco products or electronic cigarettes to actual or potential consumers located in Ireland, must register with the Health Service Executive (HSE).⁵⁹

In the case of tobacco products sold to consumers located in Ireland, the retailer in question must appoint a tax representative, established in Ireland, who is liable for the payment of Excise Duty and Value-Added Tax.⁶⁰

⁵⁷ Regulation 25 of S.I. No. 146/2010 - Control of Excisable Products Regulations 2010

⁵⁸ Regulation 5(1) of I. No. 480/2008 - European Communities (Tax Exemption for Certain Non-Commercial Goods Imported in the Personal Luggage of Travellers from Third Countries) Regulations 2008; Article 8(1) of Council Directive 2007/74/EC of 20 December 2007 on the exemption from value added tax and excise duty of goods imported by persons travelling from third countries

⁵⁹ Regulations 23 and 25 (3) of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016 (S.I. No. 271 of 2016) as amended by the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) (Amendment) Regulations 2017 (S.I. No. 252 of 2017).

⁶⁰ Section 109U, (1) Finance Act, 2001

USE OF TAX STAMPS

Ireland uses tax stamps for fiscal purposes and to identify tax-paid tobacco products. A tax stamp must be affixed to all packets of cigarettes and roll-your-own tobacco. The tobacco tax stamp has a range of sophisticated security features to minimize the risk of counterfeiting. In addition, a newly designed tax stamp is held in reserve by Revenue should security be breached on the current stamp.

It is an offense to sell cigarettes and roll-your-own tobacco which do not carry an Irish tax stamp. The penalties currently available in Ireland on conviction for these offenses were increased in 2010.

In Ireland, offenses may be dealt with by a judge of a lower court (the District Court) sitting alone without a jury, and in such cases the offense is referred to as a summary offense. Where the offense is tried before a judge and jury, it is an indictable offense.

On conviction following summary prosecution for tobacco tax stamp offenses, a court may impose a fine of €5,000, or a term of imprisonment not exceeding 12 months, or both a fine and imprisonment. A fine of up to €126,970, or a term of imprisonment not exceeding five years, or both a fine and imprisonment, may be imposed on conviction following a prosecution on indictment.

COMBINED HEALTH WARNINGS

Combined health warnings are required on all packages⁶¹ of tobacco products placed on the market. The tar, nicotine, and carbon monoxide yields of cigarettes must be printed on one side of the cigarette packet in both the Irish and English languages. A general warning as to the adverse health effects of tobacco must be printed. In addition, a combined text and photo warning is required.

STANDARDIZED/PLAIN-PACK CIGARETTES

All tobacco products for sale in Ireland from 30 September 2017 must be presented in standardized retail packaging.⁶² There is a wash-through period so that any products placed on the market before that date will be permitted to be sold for a 12-month period, i.e., until September 30, 2018.

Standardized packaging will mean that all forms of branding, including trademarks, logos, colors, and graphics, are no longer present on tobacco packs. The brand and variant names are to be presented in a uniform typeface, and the packs are to be in one plain neutral color. The aim of standardized packaging is to decrease the attractiveness of tobacco packs to consumers, increase the effectiveness of health warnings, and prevent packaging from misleading consumers as to the harmful effects of smoking.

⁶¹ Public Health (Tobacco) (General and Combined Warnings) Regulations 2011 (S.I. No. 656/2011)

⁶² Public Health (Standardised Packaging of Tobacco) Act 2015

2.2 Overview of the Institutional Framework

Revenue is responsible for the administration and collection of tobacco products tax⁶³ on tobacco products. In addition, tackling the illicit tobacco trade remains a high priority for the agency.⁶⁴

As Revenue is a fully integrated tax and customs administration, it is not possible to disaggregate resources deployed exclusively at any given time on regulation of the tobacco trade, including action against smuggling and other illicit tobacco-trade activities. Revenue currently has approximately 2,000 staff engaged on activities that are dedicated to targeting and confronting non-compliance. These frontline activities include anti-smuggling and anti-evasion, investigation and prosecution, audit, assurance checks, anti-avoidance, returns compliance, and debt collection.

The legislation governing excisable products, and offenses regarding same, is consolidated in the Finance Act 2001. Sections 133–144 set out the powers of officers with regard to excisable products. In addition, tobacco products are subject to the provisions contained in Chapter 3 of Part 2 of the Finance Act 2005. Section 1078 of the Taxes Consolidation Act 1997 is also relevant, insofar as it creates offenses in relation to duties of excise.

Revenue Officers, authorized by a Commissioner, have powers to stop,⁶⁵ examine, search, and take samples from vehicles.⁶⁶ However, such powers are exercisable only to the extent necessary to control excisable products. For instance, Officers have the power to search a vehicle,⁶⁷ but only in order to establish: (a) whether the vehicle contains anything liable to forfeiture under excise law;⁶⁸ (b) that excisable products are being transported in compliance with the rules on intra-EU movement of goods under a suspension arrangement or the intra-EU movement of duty-paid excisable products;⁶⁹ or (c) that the vehicle itself is goods registered for Vehicle Registration Tax.⁷⁰

For all excisable products including tobacco, Section 136 of the Finance Act 2001 provides that an authorized officer may, at all reasonable times, enter a premises (with the exception of a dwelling) in which excisable products are being processed, held, stored, kept, imported, purchased, packaged, offered for sale, sold, or disposed of,⁷¹ and may there carry out a search and investigation, take samples without the need for payment, inspect and copy records, question persons present, and detain or seize vehicles or goods.⁷² Powers to search dwellings derive from powers conferred on Revenue Officers through search warrants issued by the Courts.

⁶³ Chapter 3 of Part 2 of the Finance Act 2005

⁶⁴ Revenue Commissioners, Annual Report 2016, p 37

⁶⁵ Section 134(1), Finance Act 2001

⁶⁶ Section 135(1), Finance Act 2001

⁶⁷ Section 135(1)(b), Finance Act 2001

⁶⁸ Section 135(1)(b)(i), Finance Act 2001

⁶⁹ Section 135(1)(b)(ii), Finance Act 2001

⁷⁰ Section 135(1)(b)(iii), Finance Act 2001

⁷¹ Section 136(1)(a), Finance Act 2001

⁷² Section 136(3), Finance Act 2001

In relation to offenses connected with the operation of the tobacco tax stamp system, as provided for under Section 78 of the Finance Act 2005, an Authorized Officer has the power to question and require information from persons.⁷³ Furthermore, an Authorized Officer has the power to arrest without warrant a person reasonably suspected of evading or attempting to evade excise duty⁷⁴ or committing an offense connected to the operation of the tobacco tax stamp system.⁷⁵

Separate provisions also apply to Customs Officers, and these include:

- » The power to stop vehicles where there is a belief smuggled goods are being transported;⁷⁶
- » The power to search stopped vehicles for smuggled goods.⁷⁷

The Department of Health oversees the implementation of Ireland's tobacco control policy, *Tobacco-Free Ireland* under the *Healthy Ireland* framework.⁷⁸

The Department of Health is responsible for introducing a number of measures in recent years in the area of tobacco control. These include prohibiting the sale of tobacco products to minors,⁷⁹ setting a minimum pack size of 20 for cigarettes,⁸⁰ the mandatory registration of retail outlets to sell tobacco,⁸¹ restrictions on the advertising of tobacco products⁸², bans on displays of tobacco products in shops,⁸³ restrictions on certain types of promotional activities,⁸⁴ restricting smoking in workplaces (the smoking ban),⁸⁵ and introducing standardized packaging for tobacco products.⁸⁶

In line with Directive 2014/40/EU concerning the manufacture, presentation, and sale of tobacco and related products ("the Directive"), the Department of Health introduced legislation providing for the setting of technical standards in relation to the content of tobacco products,⁸⁷ reporting of ingredients and emissions by tobacco manufacturers,⁸⁸ a minimum

⁷³ Section 138(1), Finance Act 2001

⁷⁴ Section 139(1)(a), Finance Act 2001

⁷⁵ Section 139(2)(a), Finance Act 2001

⁷⁶ Section 26, Customs Act 2015

⁷⁷ Section 27 (3), Customs Act 2015

⁷⁸ <http://health.gov.ie/wp-content/uploads/2014/03/TobaccoFreeIreland.pdf>

⁷⁹ Section 45 of the Public Health (Tobacco) Act 2002

⁸⁰ Section 38 of the Public Health (Tobacco) Act 2002, as inserted by section 9 of the Public Health (Tobacco) Act 2004

⁸¹ Section 37 of the Public Health (Tobacco) Act 2002, as inserted by section 8 of the Public Health (Tobacco) (Amendment) Act 2004; Public Health (Tobacco) (Registration) Regulations 2009 (S.I. No. 41 of 2009)

⁸² Section 33 of the of the Public Health (Tobacco) Act 2002, as amended by Section 5 of the Public Health (Tobacco) (Amendment) Act 2004

⁸³ Section 33A of the of the Public Health (Tobacco) Act 2002, as inserted by Section 5 of the Public Health (Tobacco) (Amendment) Act 2004

⁸⁴ Public Health (Tobacco)(Control of Sales Promotion) Regulations 2013 (S.I. No. 530/2013)

⁸⁵ Section 47 of the Public Health (Tobacco) Act 2002, as inserted by section 16 of the Public Health (Tobacco) Act 2004

⁸⁶ Part 2 of the Public Health (Standardised Packaging of Tobacco) Act 2015

⁸⁷ Regulation 4 of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016

⁸⁸ Regulation 4 of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016

weight of 30g for roll-your-own tobacco packs,⁸⁹ combined health warnings on packages,⁹⁰ and traceability and security features systems for tobacco products.⁹¹

The Health Service Executive is the enforcement authority for the public health provisions of tobacco control legislation. Section 48(4) of the Public Health (Tobacco) Act 2002⁹² provides that authorized officers, appointed by the Health Service Executive⁹³, have the power to:

- » Enter a specified premises or place;
- » Inspect and take copies of any books, records, other documents or extracts;
- » Remove any such books, records, or documents and detain for a reasonable period;
- » Carry out, or have carried out, such examinations, tests, inspections, and checks of the premises, any tobacco product, or any article or substance, and any equipment, machinery, or plant at the premises as may be reasonably necessary;
- » Require any person at the premises to give assistance and information as may be reasonably required;
- » Take samples;
- » Direct that such tobacco products are not to be sold, distributed, or moved from the premises, without consent;
- » Secure for later inspection any premises or part of any premises for such period as may reasonably be necessary;
- » Take possession of and remove from the premises for examination and analysis any tobacco product, or any substance or article, and detain them for such a period as is reasonably necessary

Section 48(7) of the Public Health (Tobacco) Act 2002 provides that a judge of the District Court may issue a warrant to an authorized officer to enter a dwelling and perform the functions listed under Section 48(4) of the Public Health (Tobacco) Act 2002. The Environmental Health Officer (EHO) may be accompanied by members of An Garda Síochána or Revenue officers, as necessary.

Section 48(9) of the Public Health (Tobacco) Act 2002 provides that, where an authorized officer has reasonable grounds to believe that a person has committed an offense under

⁸⁹ Regulation 13(1) of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016

⁹⁰ Regulation 14 of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016

⁹¹ Regulations 20 and 21 of the European Union (Manufacture, Presentation and Sale of Tobacco and Related Products) Regulations 2016

⁹² Section 48 of the Public Health (Tobacco) Act 2002, as inserted by section 23 of the Public Health (Standardised Packaging of Tobacco) Act 2015

⁹³ Section 48(1) of the Public Health (Tobacco) Act 2002

this Act, the authorized officer may require that person to provide his or her name and the address at which he or she ordinarily resides.

As part of their enforcement operations, EHOs carry out test purchases in retail stores.⁹⁴

STATUS OF ADMINISTRATIVE MECHANISMS

Licit

With regard to interactions with tobacco companies as taxpayers, Revenue ensure that such interactions respect the Framework Convention on Tobacco Control (FCTC) and the Guidelines for implementation of Article 5.3 of the FCTC on the protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry.

Control Officers employed by Revenue have specific responsibility for interacting with individual tobacco companies, and their role includes oversight of the reporting and payment of tobacco products tax, the taxation of new tobacco products, supervising delivery of Irish tax stamps from the tax stamp manufacturer to tobacco company stores, conducting stock checks of those stores, and supervising any destruction of Irish tax stamps and damaged or waste tobacco products. Revenue also interact with individual tobacco companies and the wider tobacco industry in order to source information in relation to trends and developments in the illicit tobacco trade.

Under EU legislation, excise duties are paid on alcohol, tobacco, and energy products at the final point of consumption. While in transit to their final destination, these goods are in duty suspension, i.e., no excise duty has yet been paid on them. Member States use an electronic system, the Excise Management and Control System (EMCS), to monitor the movement of these goods in real time, in order to ensure that the duties are properly levied at the final destination.⁹⁵ As there are no tobacco manufacturing facilities in Ireland, the movements of tobacco products into Ireland through the legitimate supply chain are controlled, as excisable goods, under EMCS and under cover of the appropriate excise Administrative Document (eAD). Interventions are based on a risk-profiling assessment, or may be intelligence led.

EMCS. Under EMCS, a movement of excise goods is documented at every stage through an electronic Administrative Document (eAD).

- » The eAD is issued by the original consignor, containing information on the consignment and the planned movement within the EU.

⁹⁴ 465 tobacco sales to minors test purchases were carried out in 2016: HSE Annual Report and Financial Statements 2016, p 106 <http://www.hse.ie/eng/services/publications/corporate/hse-annual-report-and-financial-statements-2016.html>

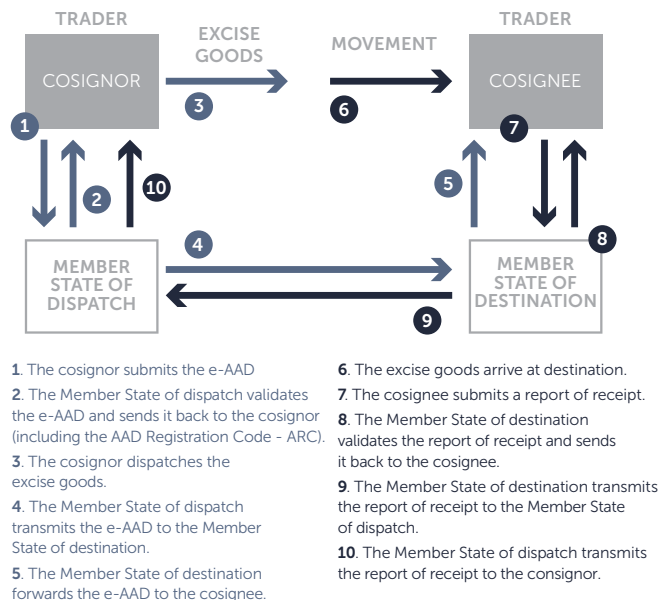
⁹⁵ The legal framework for the Excise Movement Control System (EMCS) is laid down by Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC

- » The eAD is validated in the Member State of dispatch. A European register of operators (SEED) is used to check the excise numbers of the consignor and consignee.
- » The eAD is electronically transmitted by the Member State of dispatch to the Member State of destination.
- » The Member State of destination forwards the eAD to the consignee.
- » The consignee submits a "report of receipt" once he/she has received the excise goods. This report should mention any anomalies, such as shortages or excesses in the consignment.
- » The report of receipt is sent to the consignor, who can then discharge the movement and recover the financial guarantees they had to make for the excise products.

Illicit

Revenue strategy towards combatting the illicit trade includes a range of measures designed to complement each other in identifying and targeting the supply of illicit tobacco products, with a view to disrupting the supply chain, seizing the illicit products and prosecuting those responsible. Key elements of Revenue's strategy include:

Figure 9. EMCS System



Source: European Commission, EMCS: How it Works, available at: https://ec.europa.eu/taxation_customs/business/excise-duties-alcohol-tobacco-energy/excise-movement-control-system/emcs-how-it-works_en, accessed 14 May 2018

- » Using risk analysis and profiling to screen cargo, vehicles, baggage, and postal packages to intercept the supply of illicit tobacco products;
- » Post-importation intelligence-based operations and random checks at retail outlets, markets, and private and commercial premises; and
- » Extensive cooperation between Revenue and An Garda Síochána, other relevant State agencies, and counterparts in Northern Ireland, as well as cooperation with other tax administrations and with the European Anti-Fraud Office (OLAF) in ongoing international programs of action to tackle the illicit trade.

Revenue works closely with EU partners to identify source countries, share intelligence on illicit shipments of tobacco products into Ireland, and monitor shipping and passenger traffic. Revenue also deploys scanning equipment and sniffer dogs and conduct regular street-level exercises to tackle illicit cigarette sales.

In March 2018, a commercial illicit cigarette production plant was discovered, along with 40 tonnes of tobacco, all the pre-cursor components for the manufacture of cigarettes, and approximately 25 million cigarettes. This was the first time a commercial illicit cigarette production plant was discovered in the State. The factory was closed down by Revenue officials and members of An Garda Síochána, and eleven men were arrested at the site. Investigations are ongoing, nationally and internationally.⁹⁶

Offenses

Persons contravening tobacco control regulations may face prosecution under tax and excise law and under health legislation. They may also face prosecution under other criminal legislation. Prosecution Guidelines require that the prosecutor not “over-charge,” that is prefer charges more serious than are justified by the evidence, and that the prosecutor should avoid pursuing too many charges arising out of the same set of facts.⁹⁷ As such, not all potential charges will be brought in response to a particular set of facts.

Persons involved in the smuggling and sale of illicit tobacco will generally be prosecuted for offenses under tax and excise law, including the evasion of excise duty,⁹⁸ the keeping for sale or delivery of tobacco products without a tax stamp,⁹⁹ or for dealing in counterfeit tax stamps.¹⁰⁰ Where OCGs are involved, offenses related to organized crime¹⁰¹ and money laundering¹⁰² may also be relevant. Furthermore, a body of health legislation supports the

⁹⁶ Revenue, Revenue and An Garda Síochána dismantle illicit cigarette factory in Jenkinstown, Co. Louth, 15 March 2018, <https://www.revenue.ie/en/corporate/press-office/press-releases/2018/pr-150318-illegal-cigarette-factory-jenkinstown-louth.aspx>

⁹⁷ Director of Public Prosecutions, *Guidelines for Prosecutors*, 4th Edition, 2016, p 23

⁹⁸ Section 119 of the Finance Act 2001

⁹⁹ Section 78(3) of the Finance Act 2005

¹⁰⁰ Section 78(3) of the Finance Act 2005

¹⁰¹ Criminal Justice Act 2006

¹⁰² Criminal Justice (Money Laundering and Terrorist Financing) Act 2010

maintenance of controls over the wider regulatory environment, including the display, sale, and regulation of tobacco products in the State.

TOBACCO COMPANY AGREEMENTS

As a method of addressing the illicit tobacco trade, the European Union signed cooperation agreements with four major transnational tobacco companies.

Agreements were signed with Philip Morris (PM) in 2004, with Japan Tobacco International (JTI) in 2007, and with both British American Tobacco (BAT) and Imperial Tobacco Limited (ITL) in 2010.¹⁰³

The agreements set out obligations for the tobacco companies, including in respect of:

- » Their manufacturing, sales, distribution, storage and shipment practices;
- » The marking and the “tracking and tracing” of their products;
- » Providing information to the Commission and Member States; and
- » Cooperation in the event of significant seizures of products bearing their trademarks in order to determine whether the products were genuine or counterfeit.¹⁰⁴

Each of the agreements provided for two types of payments: annual payments totaling US\$1.9 billion over 20 years and supplementary payments equivalent to the taxes evaded in the event that genuine product was seized.¹⁰⁵ In 2016, the European Commission decided not to renew its agreement with Philip Morris. The agreements with JTI and BAT do not have to be renewed until at least 2022.¹⁰⁶

PROCESSES

Supply chain controls

The EU-wide Excise Movement and Control System (EMCS) is a computerized, paperless system that is used by businesses when moving duty-suspended excise goods (alcohol, tobacco, and certain mineral oils) between EU Member States as part of their commercial activities. Its purpose is to combat fiscal fraud by providing tax authorities and the traders involved with real-time information and checks on individual consignments of excise goods along the supply chain. As a standardized, electronic system for the whole EU, it also simplifies procedures and reduces administrative costs for businesses and tax authorities.

¹⁰³ Joosens, L, Gilmore, AB, Stoklosa, M, Ross, H, Assessment of the European Union’s illicit trade agreement with the four major Transnational Tobacco Companies, *Tob Control*, 2016; 25:254–260, p 254

¹⁰⁴ Heyward, M. Legal Analysis of the agreements between the European Union, Member States, and multinational tobacco companies, New York, 2010

¹⁰⁵ Joosens, L, Gilmore, AB, Stoklosa, M, Ross, H, Assessment of the European Union’s illicit trade agreement with the four major Transnational Tobacco Companies, *Tob Control*, 2016; 25:254–260, p 254

¹⁰⁶ Robinson, D, Financial Times, EU to end anti-tobacco smuggling deal with Philip Morris, 05 July 2018, available at: <https://www.ft.com/content/1724b620-42b9-11e6-b22f-79eb4891c97d>, accessed 21 May 2018

Revenue has a number of staff appointed as Control Officers to help control the supply chain of tobacco within the State. Tobacco Traders must inform their designated Control Officer in advance of certain processes taking place, and Revenue Control Officers have the power to enter premises where tobacco is stored at any time to carry out spot checks on the amount of tobacco being kept in storage. Revenue Control Officers must also witness the destruction of tobacco products as required by European Union legislation.

Revenue officers may enter premises where tobacco is being sold within the State to check that products have the correct tax stamp affixed. Stamps may be checked during scheduled compliance visits or random audits of businesses. Revenue Officers are empowered to conduct random checks in retailers and may seize products where tax is deemed not to have been paid.¹⁰⁷ Revenue Officers have also been active in seizing tobacco products on sale illegally, including at street markets within the State.¹⁰⁸

National public-health legislation concerning the sale and use of tobacco is enforced by Environmental Health Officers employed by the Health Service Executive. The laws include the mandatory registration of retailers selling tobacco products, the restriction of advertising and marketing of tobacco products, restrictions on the point of sale, and the prohibition of the smoking of tobacco products in certain places. Environmental Health Officers carry out random test purchases to make sure that retail outlets are abiding by tobacco control legislation, including the prohibition on selling tobacco products to minors.

International cooperation

Revenue works very closely with OLAF, EUROPOL, and with the authorities of other countries to tackle the problem of illicit tobacco entering Ireland. Regular development and exchange of intelligence and joint operations are the norm. There is an ongoing review of operational action in the light of emerging trends, new detection technologies, and identification of best practice. As a result of Revenue's cooperation with other countries and agencies, seizures of illicit tobacco occur not only in Ireland but also in other jurisdictions.

In June 2014, over 32 million cigarettes and 4,500 kg of water pipe tobacco were seized at Drogheda Port, as was the cargo vessel MV Shingle, following dedicated work and international cooperation involving Revenue and authorities across several jurisdictions, including Slovenia, Portugal, and Ireland.¹⁰⁹ The seized cigarettes and tobacco represented a potential loss to the Exchequer of nearly €13 million. Cooperation between authorities regularly takes place across both sides of the border with Northern Ireland.¹¹⁰

¹⁰⁷ Revenue, Revenue seizes tobacco products, alcohol, prohibited drugs and cash, 08 January 2018, available at: <https://www.revenue.ie/en/corporate/press-office/press-releases/2018/pr-080118-tobacco-products-alcohol-prohibited-drugs-and-cash.aspx>, accessed 18 May 2018

¹⁰⁸ Revenue, Revenue seizes over 11,000 cigarettes on Moore Street, 03 July 2017, available at: <https://www.revenue.ie/en/corporate/press-office/press-releases/2016/pr-121216-cigarettes.aspx>, accessed 18 May 2018

¹⁰⁹ Revenue, Revenue seizes over 32m cigarettes in Drogheda Port, the largest seizure in Europe to date this year, 24 June 2014, available at: <https://www.revenue.ie/en/corporate/press-office/press-releases/2014/pr-240614-cigarettes.aspx>

¹¹⁰ The Guardian, 2m cigarettes seized in Northern Ireland raids, 04 February 2015, available at: <https://www.theguardian.com/uk-news/2015/feb/04/cigarettes-seized-northern-ireland-raids>

A key factor in the successful cooperation between agencies and states has been the legislation enacted by the EU, such as the Convention on Mutual Assistance and Cooperation between Customs Administrations (Naples II), which ensures that Member States of the EU have a legal basis when providing assistance and information through formal mutual assistance requests.

As a Member State of the EU, Ireland works very closely with its EU partners to tackle source countries and apply the maximum pressure on the governments concerned. This includes working with other Member State law enforcement agencies, including OLAF and EUROPOL, with which Revenue has a very close relationship. Revenue currently has five officers assigned abroad who are directly involved with the international exchange of information and intelligence. These officers work with Revenue's Customs Division and the Investigations and Prosecutions Division. Two officers are assigned to Ireland's permanent Representation to the EU in Brussels, one officer is assigned to the Irish Embassy in London, one officer is assigned to Europol headquarters in The Hague, and one is assigned to the Maritime Analysis Operations Centre (Narcotics) in Lisbon.

The land frontier continues to feature as a focal point for those involved in smuggling of tobacco products into both jurisdictions. Revenue has traditionally worked very closely with Her Majesty's Revenue and Customs (HMRC), the United Kingdom's tax, payments, and customs authority, and continues to do so on specific projects. For example, in July 2015, a joint operation involving Revenue, HMRC, and the Police Service of Northern Ireland seized more than four million cigarettes along with a suspected mobile fuel laundering plant in County Tyrone.¹¹¹

Investment in systems

Revenue continually invests in its resources for tackling the illicit tobacco trade in the State. A number of resources are used, including scanning equipment at ports and airports within the State. A state-of-the-art mobile x-ray scanner was acquired in 2017, partly funded by the EU Hercule III program administered by OLAF.¹¹² Revenue also has a team of highly trained sniffer dogs that can be deployed nationwide in uncovering consignments of tobacco in properties, vehicles, and boats.

Intelligence-led interventions

Revenue conducts risk analysis to profile cargo, vehicles, baggage, postal packets, and passengers entering the State. These risk analyses are constantly monitored, updated, and refined to ensure that Revenue is consistently on top of any threat to the legitimate tobacco market in the State.

¹¹¹ <https://www.revenue.ie/en/corporate/press-office/press-releases/2015/pr-280515-cigarettes.aspx>

¹¹² <https://revenue.ie/en/corporate/press-office/press-releases/2017/pr-150617-scanner.aspx>

Tobacco stamp

A tobacco tax stamp for cigarettes and roll-your-own tobacco products was introduced in 1994 and must be affixed to products for retail sale in Ireland. The stamp serves as proof to both Revenue and consumers that tax has been paid on the product. In the majority of cases, tobacco products not bearing a tax stamp are seized by Revenue officers and sellers prosecuted in the Courts. In certain cases, such as duty-free shops and diplomatic sales, products may be sold without a tax stamp, as tax will not have been paid on these products.

Offenses

Revenue benefits from a comprehensive legislative framework to support its work against those who sell or smuggle excisable products. It is an offense to evade tax on, that is to smuggle, excisable products, and it is an offense to sell cigarettes and roll-your-own tobacco products which do not carry an Irish tobacco tax stamp.

The specific penalty to be applied in any particular case is entirely a matter for the courts and, where a fine is imposed, the amount is at the judges' discretion and may be mitigated. In addition, the Court may choose to impose a term of imprisonment, a suspended sentence, or a community service order in lieu of a fine. Revenue, on an ongoing basis, monitors closely the outcome of cases prosecuted and the severity of the sanctions and penalties imposed upon conviction.

3. Enforcement Solutions

3.1 Tobacco Tax Stamp

Tax stamps are labels issued by Revenue under Section 73 Finance Act 2005 for the purpose of collecting the Tobacco Products Tax on cigarettes and fine-cut tobacco for the rolling of cigarettes. They are applied directly to cigarette packs beneath the cellophane wrapper. Each stamp measures 19.05 mm x 44.45 mm. Tax stamps are supplied in sequentially numbered batches containing 30,000 numbered stamps.

Tobacco Products Tax on cigarettes and fine cut tobacco for the rolling of cigarettes (RYO) – described as “specified tobacco products” in section 71 Finance Act 2005 - shall be payable by means of tax stamps issued by Revenue. Each pack of cigarettes or RYO, intended for sale, delivery, or consumption in the State, must have a tax stamp affixed to it in respect of which the appropriate duty has been paid. Revenue shall issue tax stamps only on payment of an amount equivalent to the duty represented by such stamps, although the operation of the systems allows for deferred payment, usually for a period of two months. This amount is known as the tobacco tax stamp charge.

The Irish tobacco tax stamp is highly sophisticated with a number of overt, semi-covert, and covert layered security features. Revenue has a role in preventing the contamination of the supply chain with illicit tobacco products and counterfeited tax stamps, and Revenue control

officers and enforcement officers are trained to carry out checks on tobacco products to detect counterfeit stamps. Each stamp has a unique printed code which correlates to the brand and price point of product to which it is affixed. The code on the stamp is an overt security feature and is used by Enforcement officers as a means of identifying the trader, quantity of cigarettes/rolling tobacco, retail selling price, when the product was released, and the production specifics of the stamp itself. Revenue owns the code. Revenue officers are trained to identify the overt security features of the stamp and have handheld verification tools to identify the semi-covert security features. There are contingency plans in place such that, should a counterfeit stamp be found, the current stamp can be replaced by a backup design which is ready to go into production immediately.

Tobacco traders may purchase tax stamps and hold stocks of stamps subject to strict Revenue control. Anti-forestalling measures may be imposed including by placing restrictions on the release of tobacco tax stamps in the three-month period prior to a Budget, where the quantity of cigarettes or tobacco involved exceeds the expected requirements for the period.¹¹³ The granting of permission to purchase and store stamps will be subject to the acceptance by the trader of any conditions, including security, as set out in legislation or laid down by Revenue.

Deliveries of the tobacco tax stamps are made using door-to-door delivery by secure Cash-in-Transit¹¹⁴ from the printers' premises to the tobacco traders' secure premises. Revenue officers attend at deliveries of tax stamps to secure stores. On delivery of stamps, an official of the authorized trader and a Revenue Officer will compare the number and details of stamps received with the details contained in the delivery docket. Batches found to be incomplete or damaged are to be returned to the printing contractor and the delivery docket endorsed. Delivery dockets are to be signed by an authorized company official and the Revenue Officer.

Tobacco traders must provide a secure store for stamps, which must be capable of being placed under Revenue lock. Responsibility for the security of stamps delivered to a trader's premises rests solely with the trader. Traders must notify their designated Revenue Officer if stamps are discovered to be damaged or unusable after receipt.

Stamps are to be affixed directly to tobacco packs beneath the cellophane wrapper and in a position on the pack that does not obscure or interfere with health warnings or other markings required by law. Physically affixing the tobacco tax stamps is for the tobacco manufacturer or importer, and mainly this takes place at the manufacturing plant.

It is important that each stamp be affixed solidly to a pack so that it cannot be removed without damage to the stamp itself or to the packaging material which contains the tobacco products.

¹¹³ Section 18 of the Finance Act 1939 (as amended)

¹¹⁴ National Standards Authority of Ireland, Cash-in-transit Services, I.S. 998:2006

Revenue staff will carry out a stocktake of tax stamps in the secure store in conjunction with the tobacco trader each month. This allows for any discrepancies to be managed appropriately by Revenue.

Tax stamps damaged or otherwise rendered unusable during the packaging process are to be made available for inspection by the Revenue Officer. Suitable arrangements are made for the destruction of the stamps in the presence of the Revenue Officer, where required. Stamps destroyed under supervision will qualify for a refund of excise paid.

DESIGN

The design of the tax stamps is governed by Regulation 21 of The Tobacco Products Tax Regulations 2006 (S.I. 261/2006), which provides that the tax stamp shall include:

- » A continuous background printing of the words "The Revenue Commissioners" and "Na Coimisinéirí Ioncaim";
- » A representation of the (Official) Irish Harp containing 12 strings in a vertical plane encircled by a ring on which are printed the words "Ireland," "Éire," "Excise Duty," and "Dleacht Mháil";
- » Three lines of encoding printed in black containing such combination of characters as Revenue have authorized for the tobacco products to which the stamp relates; and
- » Such security or other features as Revenue may from time to time direct.

Figure 10. The Current Irish Tobacco Tax Stamp Design



The paper specification currently utilized is an ungummed coated security paper to the following specification:

Coated Substance	72±5 gm ²
Base stock	62±3 gm ²
Coat weight	10±1 gm ²
Caliper (microns)	80±5
Parker Roughness (microns)	2.5 max
Gloss %	30 ± 5
I.G.T. cm/sec LVO	135 min
Ink Absorption (K+N units)	15 ± 5
Brightness (%)	80 (min)
Security fibers	Yes - (not for disclosure)

CONTRACT

Within the framework of Regulation 21, Revenue outsources the design, production, printing, and delivery of the tobacco tax stamp. Currently (July 2018), the tobacco tax stamp contract is held by the DLRS Group.¹¹⁵ In order to select a third-party supplier, the Office of Government Procurement, on behalf of Revenue, conducts a competitive tendering processing comprised of two stages:

- i. Stage 1 - Short-listing (invites responses and short-lists all the prospective suppliers that are compliant and meet selection criteria); and
- ii. Stage 2 - Tendering and Award.

The purpose of the first stage is to obtain sufficient information from candidates to enable Revenue to evaluate suppliers based on their economic and financial standing and their technical and professional ability. Revenue apply a pre-defined list of selection criteria to the responses received during the first stage in order to arrive at a short-list of candidates to proceed to the second stage. At the second stage, those suppliers who were successfully short-listed will be invited to submit tenders for the work involved.

The two-stage process allows Revenue to limit the availability of the full details of the specifications, requirements, and other contractual provisions to the second stage of the contract award process, and so protect the confidential nature of the tobacco tax stamp.

The final contract will cover the design, supply of all materials, and printing of high-security tobacco tax stamps, and the secure delivery of those stamps on behalf of Revenue. The

¹¹⁵ <https://dlrsgroup.com/>

three-year contract is extendable by periods of one year, with a maximum of three such extensions. The estimated quantity of stamps required in a year is between 150 and 200 million.

To ensure continuity, successful suppliers are required to supply, on an interim basis, quantities of the tobacco tax stamp in its current design for a transition period of no more than six months, before supplying a new tobacco tax stamp incorporating new and/or additional features and enhancements as designed by the supplier. The supplier is also required to provide a second design along with a quantity of such stamps – sufficient to meet immediate requirements – to act as an emergency back-up stamp in case of a force majeure event or a breach of security compromising their new stamp design. Where no force majeure or breach occurs, the second design will become the tobacco tax stamp after the elapse of three years, at the discretion of Revenue, and a third design will be required to act as an emergency back-up to that stamp.

Each enhancement must provide added multi-layered security and enhanced features to its predecessor while remaining within the terms set for the design of tax stamps as governed by Regulation 21 of The Tobacco Products Tax Regulations 2006 (S.I. 261/2006) and the contractual requirements as set by Revenue. This process of ongoing enhancement ensures that the tobacco tax stamp remains cutting-edge.

There are limitations to the design of such enhancements. For instance, Revenue requires that the specification for the existing paper substrate, or its exact equivalent, must be retained for reasons of functionality on cigarette packaging machinery. There are limitations to the inclusion of certain features to the surface of the tobacco tax stamps imposed by the functional characteristics and mechanical restrictions of the tobacco tax stamp applicators on cigarette packaging equipment. The application of overt surface security measures that are applied to only part of the surface of the tobacco tax stamp and/or have a partially raised profile will not be appropriate due to irregular or uneven pilling of tobacco tax stamps in the cigarette packaging equipment applicators. Watermarks are not considered practical due to the weight of the paper, totality of ink coverage, and practicality of application. Similarly, intaglio printing is also not suitable, since it cannot be read under cellophane.

However, Revenue will consider solutions if the supplier can provide evidential proof that the suggested proposal is currently in mainstream tobacco production and utilizes the same process and packaging machinery as currently utilized by the tobacco manufacturers who supply the Irish market.

TRACEABILITY AND SECURITY FEATURES

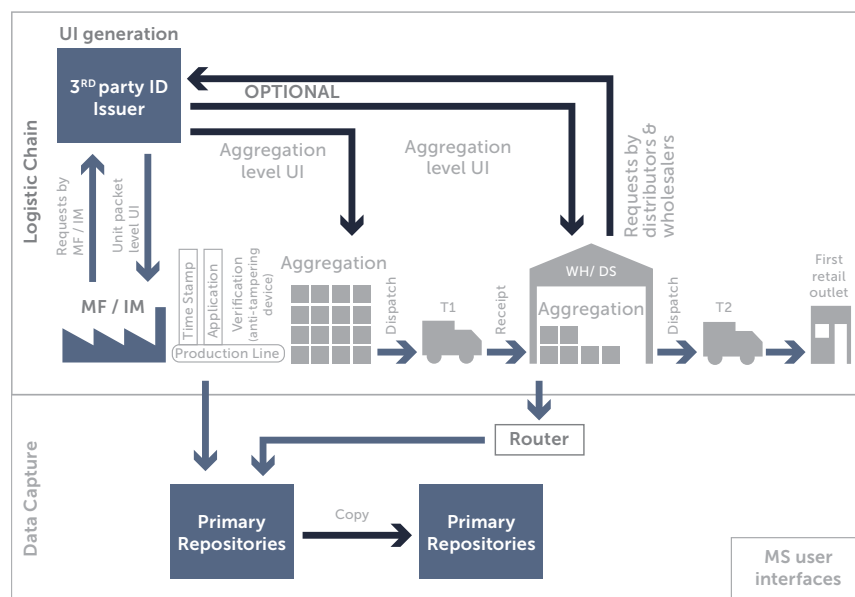
The revised Tobacco Products Directive 2014/40/EU concerning the manufacture, presentation, and sale of tobacco and related products (TPD) provides for, amongst other measures, the introduction of mandatory traceability and security feature systems for tobacco products. Implementing and delegated acts to lay down the technical details necessary for the systems of traceability and security features for tobacco products were adopted by the

European Commission on December 15, 2017, and published in the Official Journal of the EU on April 16, 2018.¹¹⁶

The proposed system involves the marking of individual packs of tobacco products with a "Unique Identifier" which allows for individual packs and aggregated packages to be recorded in a "Primary Repository," exclusive to the manufacturer or importer concerned. This data is then copied to a "Secondary Repository" which allows for surveillance by competent authorities as packs move through the supply chain.

The governance model aims to ensure the required level of integrity by ensuring the systems operate independently of the tobacco industry, as envisaged by the Protocol and the TPD.

Figure 11. Traceability – Operational System Structure



Source: European Commission, EU systems for traceability and security features of tobacco products, Presentation: Regional Workshop No. 1 Stockholm, 25 January 2018, available at: https://ec.europa.eu/health/sites/health/files/tobacco/docs/ev_201801252_ag_en.pdf

Enhanced supply-chain controls, alongside traceability and authentication systems that could operate globally and include source and transit countries, have real potential to assist in the control of the illicit tobacco market. An impact assessment prepared by the EU anticipates that implementation would increase collected taxes (i.e., VAT and excise duties) by €2 billion per year throughout the EU.¹¹⁶ However, this estimate is generic in that it is based on

¹¹⁶ European Commission, Impact Assessment accompanying Commission Implementing Regulation (EU) 2018/574 on technical standards for the establishment and operation of a traceability system for tobacco products and Commission Implementing Decision (EU) 2018/576 on technical standards for security features applied to tobacco products, Brussels, 15 December 2017, SWD(2017) 455 final, p 35

the EU-wide tobacco market and does not take into account the particularities of the Irish tobacco market. As Ireland currently operates a robust tax stamp system and controls the movement of legitimate tobacco arriving in Ireland, a more specific study would be needed to measure the exact effects on the illicit tobacco market in Ireland of the proposed system.

Revenue and the Department of Health are working together to devise the best method of implementing the envisaged traceability and security feature systems in Ireland, so that they may be incorporated into the existing regulatory framework for the distribution and sale of tobacco in Ireland. A competent authority for the implementation of the traceability and security feature systems in Ireland will be designated by the Government.

4. Results

Measuring the illicit tobacco trade is methodologically challenging for a number of reasons, and similar challenges are faced when measuring the success, or otherwise, of control measures intended to inhibit the illicit tobacco trade. As an illegal activity, participants are unlikely to record their activities in a manner that provides easy proof of their criminality. Where authorities have data on the activities of those involved in the illicit tobacco trade, they may prefer not to share this data for security reasons. In addition, all methods to estimate the illicit tobacco trade have limitations.

The three most commonly used methods to measure the illicit trade are:

- » Comparison of tax-paid sales and individually reported consumption measures;
- » Survey of tobacco users' purchase behaviors; and
- » Observational data collection.

Overall smoking prevalence, including the smoking of licit and illicit tobacco, has declined in Ireland from 27.6 percent in 2007 to 17.6 percent in 2017. Over the same period, excise receipts from tobacco products has remained relatively stable between €1 billion and €1.4 billion per year.

The quantity of tobacco demanded depends on multiple factors, economic and societal, but is also influenced by the interaction of the dual licit and illicit tobacco markets. Estimating the percentage of overall tobacco consumption captured by the illicit market is fraught with difficulties. Both smoking prevalence and the size of the licit market are important indicators, and certainly trends within the licit market which may indicate that consumers are seeking cost-effective alternatives are particularly relevant. However, such figures must be considered within the broader context.

In 2017, 34.2 million cigarettes were seized, compared to 44.6 million in 2016 and 67.9 million in 2015. These figures continue to show a decline, especially considered against the 178.3 million cigarettes seized in 2010. These figures reflect a response by OCGs to enforcement activities and successful interception of larger consignments, resulting in a move away

from very large consignments in favor of smaller volumes. Where possible, those involved in smuggling, distributing, or selling illicit cigarettes are prosecuted. In 2017, 88 people were convicted for illicit tobacco offenses, and Irish courts imposed custodial sentences in 18 cases and average fines of €2,580 in 69 cases where fines were imposed.

Seizure figures may be distorted by the seizure of a small number of atypically large consignments, while figures for convictions, sentencing, and the imposition of fines may be affected by judicial processes not directly relevant to the illicit tobacco trade. As such, survey results indicating the penetration of the illicit market are considered an important measure of the incidence of illicit consumption,¹¹⁷ and therefore an important gauge of the success, or otherwise, of measures to control the illicit tobacco trade.

The KPMG Project Sun report, produced on behalf of the Royal United Services Institute for Defense and Security Studies (RUSI) in the UK, estimated that Ireland had the third-highest rate of illicit tobacco consumption in the EU at 17.5 percent.¹¹⁸ The KPMG methodology is principally based on a calculation of legal domestic sales (from which outflows of legal sales to other countries are subtracted and inflows from other countries are then added back in) to give an estimate for the total consumption, combined with data from an Empty Pack Survey (EPS) to provide a measurement of the share of non-domestic packs.¹¹⁹ The EPS method relies upon the random collection of empty packs of any brand and market variant from streets and easy access bins. The following should be noted in relation to EPS survey data:

- » They assess non-domestic products, which include legitimately purchased cigarettes;
- » Figures are based on packs of cigarettes and exclude other products, such as RYO or cigars;
- » They do not identify domestic contraband cigarettes; and
- » The sample is collected at the street level and does not consider homes and workplaces.¹²⁰

While all estimation methodologies have their limitations, in Ireland the best estimate of the scale of the illicit tobacco problem comes from the IPSOS-MRBI surveys conducted for Revenue and the National Tobacco Control Office.¹²¹ In addition, the consistency of the methodology allows for changes in illicit consumption levels to be tracked over time. The most recent survey, conducted in late 2017, found that 13 percent of cigarette consumption was illicit. This compares to a figure of 10 percent in the comparable survey for 2016. The

¹¹⁷ Moran, G. Revenue Commissioners, evidence to the Oireachtas Joint Committee on Health and Children, 23 January, 2014

¹¹⁸ KPMG, Project Sun: A study of the illicit cigarette market in the European Union, Norway and Switzerland, 2016 Results, p 80

¹¹⁹ KPMG, Project Sun: A study of the illicit cigarette market in the European Union, Norway and Switzerland, 2016 Results, p 174

¹²⁰ Transcrime, The Factbook on The Illicit Trade in Tobacco Products: Issue 3 Ireland, 2013, footnote 15, p 64

¹²¹ Moran, G. Revenue Commissioners, evidence to the Oireachtas Joint Committee on Health and Children, 23 January, 2014

2017 survey also found that a further 9 percent of consumption was accounted for by cigarettes purchased abroad and brought into Ireland legitimately for personal consumption.

5. Methodology

The purpose of this case study is to describe the illicit flow of tobacco products in Ireland and the counter-measures taken to halt that illicit trade. It is important to state that all data relied upon in the compilation of this case study are publicly available.

The primary assumption underlying the case study is that there are dual licit and illicit tobacco markets in Ireland, the former closely regulated and controlled, and the latter operating at the margins, or entirely outside, such controls.

The existence of a separate illicit market, outside the controlled licit market, gives rise to difficulties in estimating the size of shadow economy activities. In addition, criminal actors in the illicit tobacco trade are found to be dynamic and responsive, and this demands a similar attitude on the part of the authorities, necessitating a multi-pronged approach to the control of the illicit tobacco trade.

As such, two related evidential problems arise in relation to the illicit tobacco trade: (i) estimating the illicit tobacco share of overall tobacco consumption, particularly given the influence of other variables on tobacco consumption; and (ii) disaggregating the effect of particular control measures on the illicit tobacco trade, as can be seen by attempts to estimate the future effects of EU-wide traceability and security feature systems on the illicit tobacco trade in Ireland.

Literature exists concerning the multiple influences on demand for illicit tobacco, however the authors discovered less literature addressing the impact of specific control measures on the illicit trade in Ireland.

In deciding upon the selection of data concerning these dual markets and their interactions, the authors prioritized data which were: (i) publicly available, (ii) acknowledged as reliable, and (iii) capable of being tracked over time.

The authors' purpose was to gain an understanding of the existence of the illicit tobacco trade in Ireland and to describe the responses of the Irish authorities. It is hoped that the case study will both provide insights into the problem and help to develop ideas or hypotheses for potential additional research.

6. Recommendations

The illicit tobacco trade is a complicated phenomenon and requires a multi-pronged approach for its control and suppression. As outlined, the authorities in Ireland devote considerable resources to the control of the licit tobacco market and supply chain. In addition,

substantial resources are also deployed to suppress the activities of the illicit tobacco trade, the scale of which has been successfully contained.

The case study makes the following recommendations:

1. Additional research should be conducted in the area of tobacco generally and illicit tobacco specifically. Areas of special interest would be:
 - › The overall tobacco market;
 - › Drivers of illicit trade; and
 - › Optimal taxation point for tobacco products.
2. Ireland's comprehensive and effective system of customs and tax enforcement, and the resultant relatively low rate of illicit flows, suggest that Ireland retains the opportunity to further increase real and affordability-corrected taxes on tobacco. Appropriate tax increases and improved structure can continue to help drive down tobacco consumption and save Irish people from disease and premature death.
3. There should be continued efforts to improve tax and customs enforcement, building on strong progress and good results to date.
4. Consideration should be given, at an EU-wide level, to greater controls over unmanufactured tobacco, a potential ingredient of illicit tobacco products, which is not currently controlled under the Excise Movement Control System (EMCS) or other EU-wide control mechanism.
5. An assessment should be undertaken of the impact of EU-wide traceability and security feature systems, post-introduction in May 2019.

Annex

Tax and Excise Legislation

Section 119 Finance Act, 2001 provides for an offense of evading excise duty by taking possession, custody, transporting or concealing excisable products with intent to defraud the State of Excise Duty.

Persons found guilty of an offense under this section are liable on summary conviction to a fine of €5,000 or a term of imprisonment of 12 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine of €126,970 or where the value of the excisable goods concerned, including any duties or taxes chargeable on them is greater than €250,000, the maximum penalty is three times the value of those products. The Courts have discretion in imposing a prison sentence of up to five years.

Section 121 Finance Act, 2001 provides for an offense of failing to comply with the rules and regulations relating to the production, processing and holding of excisable products.

Section 122 Finance Act, 2001 provides for an offense of submitting a fraudulent claim, return, statement or accounts or to furnish any incorrect information.

Section 123 Finance Act, 2001 provides that any person who resists, obstructs or impedes an officer of Revenue in the exercise of these powers shall be guilty of an offense. The penalty for an offense committed under Sections 121–123 on summary conviction is €5,000.

Section 124A Finance Act, 2001 provides that any authorized ware housekeeper who contravenes or fails to comply with any condition or requirement imposed on him by legislation is liable to a penalty of €1,500 for each contravention or failure.

Section 125 Finance Act, 2001 provides that any excisable products in respect of which an offense has been committed (or any goods packed with and/or vehicles used in concealing the excisable products in question) are liable to forfeiture.

Section 136 Finance Act, 2001 provides that an authorized officer of Revenue may at all reasonable times enter premises on which the manufacture of tobacco products is reasonably believed by the officer to be carried on, and may there make such search and investigation and take such samples of materials, tobacco products and partially manufactured tobacco products as the officer shall think proper, and may inspect and take copies of or extracts from any books or other documents there found and reasonably believed by the officer to relate to the manufacture of tobacco products.

Section 78(3) Finance Act, 2005 provides that any person who in the State offers for sale or delivery, other than under a duty-suspension arrangement, cigarettes otherwise than in a pack or packs to which a tax stamp, on which Tobacco Products Tax at the appropriate amount has been paid, is affixed in the prescribed manner, is guilty of an offense and shall be liable on summary conviction to a fine of €5,000 and/or a maximum of twelve months imprisonment, or on conviction on indictment to fine of up to €126,970 and/or a maximum of five years imprisonment. The cigarettes in respect of which an offense has been committed and any goods packed with or used to conceal the said cigarettes and any vehicle or conveyance in which the said cigarettes are found in, on, or in any manner attached to, are also liable to forfeiture.

Section 78(4) Finance Act, 2005 provides that any person who counterfeits, alters or otherwise makes fraudulent use of, or who is knowingly concerned in holding, selling or dealing in counterfeited or altered tax stamps is guilty of an offense and shall be liable on summary conviction to a fine of €5,000 and/or a maximum of twelve months imprisonment, or on conviction on indictment to fine of up to €126,970 and/or a maximum of five years imprisonment.

Section 79 Finance Act, 2005 provides that any person who offers to treat, offers for sale or sells by retail any packet of cigarettes at a price higher than, in the case of cigarettes sold or to be sold by means of a coin-operated vending machine, the nearest multiple of five cent to the price, or in all other cases, the retail price, shall be guilty of an offense and shall be liable on conviction to an excise penalty of €60 in respect of each such offense.

Section 78A Finance Act, 2005 provides that any person who produces or possesses any illicit tobacco product or attempts to produce or process is guilty of an offense. An illicit tobacco is defined as a tobacco product that has not been produced or processed in the State in a tax warehouse contrary to section 108A Finance Act 2001. It is also an offense to knowingly deal in any illicit tobacco product, to keep prohibited goods on any premises or other land or on any vehicle or to deliver or to be in the process of delivering, any illicit tobacco product or prohibited goods. Penalties for these offenses can be up to a maximum of €5,000 or 12 months imprisonment on summary conviction or €126,970 or 5 years in prison on indictment. Illicit tobacco products are liable to forfeiture and if they are found within a vehicle, the vehicle is also liable to forfeiture. Where any unmanufactured tobacco is found in the State and where that unmanufactured tobacco is not shown to the satisfaction of Revenue to be kept or in the course of delivery under a customs procedure, for use as raw material for the production of tobacco products in a tax warehouse, for use as raw material for the production of any product or thing other than a tobacco product or for any other use that is not contrary to the legislation, it shall be presumed until the contrary is proved that the unmanufactured tobacco is prohibited goods.

Health Legislation

Section 33 Public Health (Tobacco) Act, 2002 provides that a person who advertises, or causes the advertisement of, a tobacco product in contravention of the Directive of 2003 shall be guilty of an offense and shall be liable on summary conviction to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 or two years imprisonment or both.

Section 33A Public Health (Tobacco) Act, 2002 provides that the advertisement of tobacco products in premises in which the business of selling tobacco products by retail is carried on in whole or in part is prohibited. A person found guilty on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 36 Public Health (Tobacco) Act, 2002 provides that a person who engages in sponsorship in contravention of the Directive of 2003 shall be guilty of an offense and shall be liable on summary conviction to a fine not exceeding €3,000 on summary conviction, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 37 (13) Public Health (Tobacco) Act, 2002 provides that a person who, knowingly or recklessly provides information or a particular [when registering] that is false or misleading in a material respect, or who believes any such information or particular provided by him or her, not to be true, shall be guilty of an offense. A person found guilty on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both.

Section 37 (14) Public Health (Tobacco) Act, 2002 provides that it shall be an offense for a person to sell a tobacco product, or cause a tobacco product to be sold, by retail unless the person is registered. A person found guilty on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 38 Public Health (Tobacco) Act, 2002 provides that it shall be an offense to sell cigarettes in packs less than 20, to manufacture, import, supply, sell or offer for sale an oral smokeless tobacco product, to sell confectioneries that resemble in appearance a type of tobacco product, to import, sell, or supply tobacco products which does not conform to the standardised packaging legislation to import, sell or supply tobacco products which do not contain a batch number to ascertain date and place of manufacture, to supply tobacco products free of charge to promote consumption of tobacco products, to supply or sell vouchers or coupons to the Public to pay or exchange for a tobacco product, or to sell a

tobacco product where consideration is a gift, token, stamp, coupon or other thing that may be exchanged for or used as part payment for the goods. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 39 Public Health (Tobacco) Act, 2002 provides that it shall be an offense to fail to comply with regulations regarding standards and requirements relating to their manufacture, importation, distribution and sale. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 40 Public Health (Tobacco) Act, 2002 provides that it shall be an offense to fail to abide by requirements to provide information to the HSE relating to tobacco products when required to by the HSE including information relating to composition and properties and sale and/or marketing, to fail to carry out tests specified by the HSE, to fail to allow an official to attend the tests, to fail to provide notice of the results to the HSE within 14 days of the results of the test. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 42 Public Health (Tobacco) Act, 2002 provides that where the packaging or any printed material attached to a tobacco product bears an assertion that smoking does not cause life-threatening illnesses, smoking a particular brand is less harmful than another, that smoking of tobacco products is not addictive, that filters or other additives or ingredients render the product less harmful than others, then the manufacturer, importer, distributor, and if the tobacco product is sold by retail, the retailer, shall be guilty of an offense. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Section 43 Public Health (Tobacco) Act, 2002 provides that it is an offense to sell or to make available for sale tobacco products by way of self service, other than in conformity with regulations made by the Minister. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both.

Section 45 Public Health (Tobacco) Act, 2002 provides that it is an offense to sell tobacco to a person under 18 years of age. A person found guilty of an offense under this section

on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both.

Section 46 Public Health (Tobacco) Act, 2002 provides that it is an offense to fail to display a sign in a premises to which the public have access identifying the parts of the premises in which smoking is permitted or prohibited. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both.

Section 47 Public Health (Tobacco) Act, 2002 provides that it is an offense to smoke a tobacco product in a specified place, being a workplace, a school, college, public building, or other building listed in the section. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000.

Section 48(8) Public Health (Tobacco) Act, 2002 provides that it is an offense to obstruct, or interfering with an authorised officer, a member of An Garda Síochána, or Revenue officers when they are exercising a power under the Act. The section also provides that it is an offense for a person to falsely represent themselves as an authorised officer of the HSE. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both.

Section 53 Public Health (Tobacco) Act, 2002 provides that it is an offense to forge documents or to have forged documents, or to aid or abet in the commission of a forgery. A person found guilty of an offense under this section on summary conviction shall be liable to a fine not exceeding €3,000, imprisonment of 3 months or both. On indictment, a person found guilty of an offense under this section is liable to a fine not exceeding €125,000 if convicted on indictment or 2 years imprisonment or both.

Other relevant criminal offenses

Organised crime offenses (Part 7 of the Criminal Justice Act 2006, as amended by the Criminal Justice (Amendment) Act 2009). These offenses comprise conspiracy to commit a serious crime (s.71), direction of a criminal organisation (s.71A), participation in, or contribution to, certain activities (s.72) and commission of an offense for a criminal organisation (s.73). The penalties range between life imprisonment for the direction of a criminal organisation to a maximum of 15 years of imprisonment for participation in and commission of an offense for a criminal organisation.

Conspiracy is agreement to commit an offense and is an offense in common law. The penalty for conspiracy is at the discretion of the court. In practice, however, conspiracies are punished less than the predicate offenses.¹²²(3) Fraudulent application or use of trademark in relation to goods (Section 92 of the Trade Marks Act 1996). The penalty on summary

¹²² Law Reform Commission, Report: Inchoate Offenses, 2010 (LRC 99–2010), pp 17–18

conviction is a fine to a maximum of €1,270 or a term of imprisonment not exceeding 6 months or both. On indictment, it is imprisonment for a term not exceeding five years or a fine to a maximum of €126,970, or both.

Money laundering (s.7 Criminal Justice (Money Laundering and Terrorist Financing) Act 2010): the penalty on summary conviction for a money laundering offense is a fine of up to €5,000 and/or imprisonment of up to 12 months. The penalty on conviction on indictment is a fine and/or imprisonment of up to 14 years.

UNNITTED
KINGDOM

7

UNITED KINGDOM:

Tackling Illicit Tobacco

Tessa Langley¹, Anna Gilmore², Allen Gallagher³, and Deborah Arnott⁴

Chapter Summary

Background

The United Kingdom (UK) has implemented a comprehensive package of tobacco control measures in the last 20 years and has seen significant decreases in smoking prevalence. In 2016, adult smoking prevalence was 16 percent. A crucial component of UK tobacco control policy has been high tobacco taxation, which has been implemented as both a public health and a tax revenue-generating measure. Following a series of tax rises, the illicit tobacco trade increased rapidly in the 1990s. This trend was due in particular to well-documented tobacco industry practices: tobacco manufacturers increasingly produced and exported cigarettes in volumes much greater than the known demand in their stated markets. These products were then smuggled, with no duty paid, into the UK (This type of illicit tobacco is known as “tobacco industry (TI) illicit.”) The revenue losses associated with the illicit tobacco trade were significant, equivalent to 25 percent of all tobacco revenue due, and the availability of tobacco at a fraction of the usual price undermined the public health impact of the tax increases.

¹ University of Nottingham

² University of Bath

³ University of Bath

⁴ Action on Smoking and Health (ASH), UK.

Approach to Tackling the Illicit Tobacco Trade in the UK

In 2000, the UK embarked on a comprehensive strategy to reduce the illicit tobacco trade. The strategy focused on supply-side measures, investing in a range of operational responses including disrupting the supply and distribution chains for illegal tobacco products and reducing the rewards from smuggling by increasing sanctions. The strategy has been regularly revised since 2000, in response to ongoing TI involvement in the illicit market and newly emerging threats, such as counterfeit products and cheap whites. The UK illicit tobacco strategy is underpinned by the principle that smuggling is an enforcement issue, rather than being caused by high tobacco prices.

The UK's customs and immigration authorities (HM Revenue and Customs and Border Force) currently share responsibility for tackling the illicit tobacco trade. Responsibilities include detecting and disrupting the supply of illicit tobacco and arresting and investigating those suspected of smuggling offences. Abroad, a team of Fiscal Crime Liaison Officers is responsible for liaising with international fiscal and law enforcement agencies and developing intelligence to intercept illicit tobacco destined for the UK market. In some regions, partnerships between stakeholders have been effective in raising awareness of key issues relating to illicit tobacco such as its links to crime and its availability to children. At the local level, local governments are responsible for local intelligence, and for detecting and seizing illicit tobacco products. Recent developments include the introduction of a registration scheme for anyone carrying out activities using raw tobacco and a tobacco machinery licensing scheme.

A number of enforcement mechanisms are in place. Supply chain legislation places a legal obligation on tobacco manufacturers not to facilitate smuggling. Sanctions to punish individuals linked to the illicit trade include seizure of goods, criminal prosecution with custodial sentences, and fines. Fiscal marks and anti-counterfeiting technology aid the identification of illicit products.

Strong governance including effective implementation of Article 5.3 has helped to ensure the success of the illicit tobacco strategy and its full independence from the TI. Key governance processes include the publication of monitoring data to ensure transparency, and reports on progress in tackling illicit tobacco published by parliamentary committees. Activity to combat the illicit tobacco trade in the UK is supported by action at the international level. This includes legal agreements between the EU and all the major multinational tobacco companies, which independent reviews suggest have not served their intended purpose. The UK is a Party to the Illicit Trade Protocol of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), which comes into force in September 2018, with a first Meeting of the Parties in October.

Results of Measures to Tackle the Illicit Tobacco Trade

The UK government collates data on the illicit market share, revenue losses associated with the illicit trade, seizure volumes, and the number and results of criminal investigations. During the first ten years of the illicit tobacco strategy, the illicit market share for cigarettes was nearly halved, falling from 22 percent to 12 percent (central estimates). The illicit market share of handrolling tobacco (HRT) saw a drop from 61 percent to 44 percent (central estimates) during the same period. The strategy has continued to have some success in recent years, with continued decreases in the illicit market share of HRT. However, while smoking prevalence has decreased, the illicit market for cigarettes has become a larger proportion of a declining market. This may reflect cuts in funding for local-level enforcement in recent years.

The scale and success of the enforcement effort is also indicated by the large volumes of seizures of both cigarettes and HRT. In 2015/16, an estimated 1.7 billion cigarettes and nearly 300 tonnes of HRT were seized, representing a total revenue value of over £600 million. Furthermore, significant revenue losses have been prevented as a result of enforcement activity.

A formal evaluation of the financial costs and benefits of the illicit tobacco strategy has not been published; however, data published in the public domain indicate that funding measures to tackle the illicit trade have delivered a significant return on investment.

The Ongoing Role of the Tobacco Industry in Illicit Trade and the Importance of Civil Society

Government data suggest a recent decline in the proportion of illicit tobacco that is TI illicit. However, a range of UK and international data sources indicate that these data significantly underestimate the proportion of the illicit market that consists of TI illicit, and that TI illicit remains the single largest problem. There is evidence that the industry has continued to oversupply its products, and fines in response to this practice have to date been small. Furthermore, the tobacco industry has repeatedly presented misleading data and arguments, including claims that tax increases and standardized tobacco packaging drive the illicit trade, with many of these data being collected and communicated by individuals and organizations paid by the industry itself.

Civil society has played a central role in exposing tobacco-industry misconduct and misleading data and arguments, and has thereby enabled the advancement of evidence-based government policy. For example, independent analyses have been able to counter industry claims around tobacco tax and standardized packaging; high taxes on tobacco remain a key component of UK tobacco control policy, and standardized packaging was implemented in 2016.

What Else Can Be Done?

The strategy is widely regarded as having been a success, but further action is needed. The collection and publication of detailed data on tobacco sales, profits, marketing, and research

would allow analysis of market developments and inform tobacco control policy. Anti-illicit trade partnerships between stakeholders across regions have been successful in parts of the UK, and should be rolled out nationally. Positive supply chain licensing schemes are arrangements whereby businesses have to demonstrate that they meet required standards. To apply such schemes to the whole tobacco supply chain could help drive out those involved in the supply of illicit tobacco at all levels.

Lessons Learned and Implications for Other Countries

The UK experience demonstrates that the illicit tobacco trade can be addressed effectively even in the presence of high tobacco taxes. The overarching approach of focusing on supply-side measures has proved successful, although demand side measures may also be appropriate where there is cultural acceptance of illicit tobacco and/or a lack of awareness of its implications.

The fundamental components of an illicit tobacco strategy are improved detection and enforcement and penalties for those involved. While some technology – such as x-ray scanners and anti-counterfeiting technology – is required, investment in human resources is essential in developing intelligence, detecting illicit products, and undertaking criminal investigations.

Several studies have highlighted the association between corruption and the illicit tobacco trade; good governance and government commitment are essential for a successful illicit trade strategy. The ongoing role of the tobacco industry and its repeated efforts to mislead the public and decision makers in relation to the causes, effects, and scale of illicit trade demonstrate that strategies to tackle this problem must be developed and implemented independently from the tobacco industry. While significant upfront investment is required, the substantial long-term return on investment in activity to combat the illicit trade is a key incentive for government intervention and enforcement.

1. What Has Been Done to Address the Illicit Trade in Tobacco? What Are the Results?

1.1 Background

OVERVIEW OF TOBACCO CONTROL POLICY IN THE UNITED KINGDOM

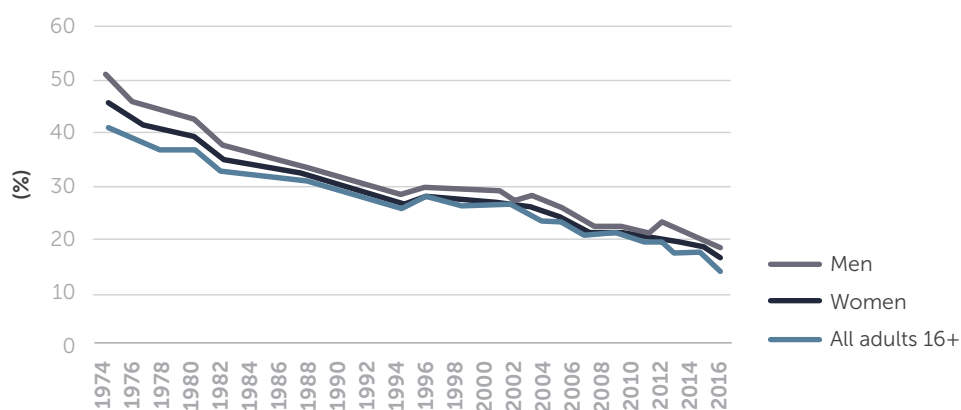
Despite evidence of the health harms caused by tobacco use, implementation of policies to reduce smoking prevalence in the United Kingdom (UK) was slow until the late 1990s. The first comprehensive UK tobacco control policy document, *Smoking Kills*, was published in 1998.⁽¹⁾ It defined a package of population- and individual-level policies and interventions, and since then the UK has implemented comprehensive measures to support quitting, reduce uptake, and reduce the harms caused by secondhand smoke exposure.

Table 1. Summary of Tobacco Control Policies in the UK

POLICY AREA	SUMMARY OF MEASURES
Restrictions on smoking	<ul style="list-style-type: none"> › Legislation prohibiting smoking in public places introduced in Scotland in 2006, then in Wales, NI, and England in 2007 › Ban on smoking in private cars in the presence of children in October 2015 in England and Wales and December 2016 in Scotland
Tobacco tax	<ul style="list-style-type: none"> › High levels of taxation have been a feature of tobacco control policy in the UK
Illicit trade	<ul style="list-style-type: none"> › Strategy to tackle illicit tobacco trade implemented from 2000
Mass media campaigns (MMCs)	<ul style="list-style-type: none"> › Large-scale MMCs have been a key component of UK tobacco control strategy since the early 2000s, although funding has been much reduced in recent years
Health warnings	<ul style="list-style-type: none"> › Text warnings became a legal requirement in the UK in 1971 › From 2008, graphic pictorial warnings covering 40% of the back of the pack, and text warnings covering 30% of the front of the pack were required › From 2016, picture and text warnings covering at least 65% of the front and back of tobacco packaging
Advertising and promotion	<ul style="list-style-type: none"> › Television advertising for tobacco products banned in 1965 › UK Tobacco Advertising and Promotion Act 2002 banned print media and billboard advertising from February 2003, tobacco direct marketing from May 2003, and sponsorship in July 2003 › Point-of-sale displays in large retailers banned in England, NI, and Wales in 2012 and in Scotland in 2013 › Point-of sale displays in smaller shops prohibited across UK in 2015 › Standardized tobacco packaging implemented in May 2016
Youth access	<ul style="list-style-type: none"> › Minimum age of sale raised from 16 to 18 in 2007 in England, Scotland, and Wales, and NI in 2012 › Vending machine ban implemented between 2011 and 2013 › Ban on proxy purchasing by adults in Scotland in 2010, England and Wales in 2015, and NI in 2016
Treatments to help smokers quit	<ul style="list-style-type: none"> › Extensive provision of free stop-smoking services providing counselling and access to pharmacotherapy from 2000 onwards › Nicotine replacement therapy (NRT), bupropion and varenicline, available on prescription; NRT available on general sale › E-cigarettes available on general sale. National smoking cessation guidance states that the evidence suggests that e-cigarettes are substantially less harmful to health than smoking but are not risk free (3)

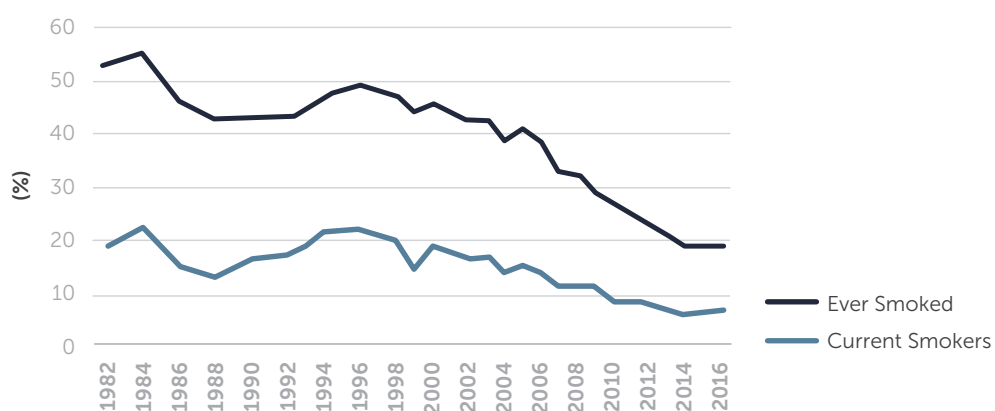
Powers for health in the UK are devolved to national governments (England, Scotland, Wales, and Northern Ireland (NI)). As a result, many measures have been implemented at different times within the UK. UK tobacco control policy is also guided by the Framework Convention on Tobacco Control (FCTC, ratified in 2004) and the European Union (EU). In 2016, the UK led the European Tobacco Control Scale, a ranking of country-level activity on tobacco control.(2) The key tobacco control policy measures which have been implemented in the UK are summarized in Table 1.

Figure 1. Adult (16+) Smoking Prevalence in Great Britain, 1974-2016



Source: Office for National Statistics. Adult smoking habits in the UK: 2016 (Adult Smoking Habits in Great Britain dataset)(4)

Figure 2. Prevalence of Adolescent (11-15 Years) Smoking in England, 1982-2016



Source: Health and Social Care Information Centre. Smoking, Drinking and Drug Use Among Young People in England – 2016 (Chapter 2 tables - smoking prevalence)(10)

TRENDS IN TOBACCO USE IN THE UK

Adult prevalence. Over the past four decades, there has been a significant decline in rates of adult smoking in the UK (Figure 1).(4-6) In 2016, smoking prevalence in the UK was 15.8 percent.(6)

Smoking prevalence has consistently been higher in men than in women (Figure 1) and is highest among low socioeconomic groups.(4)

Youth prevalence. Smoking prevalence among adolescents in England has declined over time, with 6 percent of 11-15 year olds in England reported to be current (regular or occasional) smokers in 2016 (Figure 2). Youth smoking prevalence has also fallen in other parts of the UK.(7-9)

Types of products. The majority of smokers in Britain smoke exclusively manufactured cigarettes (55 percent).(4) While only one-third smoke exclusively hand-rolling tobacco (HRT), and 10 percent smoke both, the proportion of smokers using HRT has increased over time, in line with a trend of more smokers smoking cheap tobacco.(11, 12) Younger and low-SES smokers are more likely to smoke HRT.(11) The sale, purchase, and use of electronic cigarettes (e-cigarettes) are legal in the UK. The prevalence of current e-cigarette use among adults in Britain is in the region of 6 percent, with use almost entirely restricted to current and ex-smokers.(13)

OVERVIEW OF THE HISTORY OF TOBACCO TAXES IN THE UK

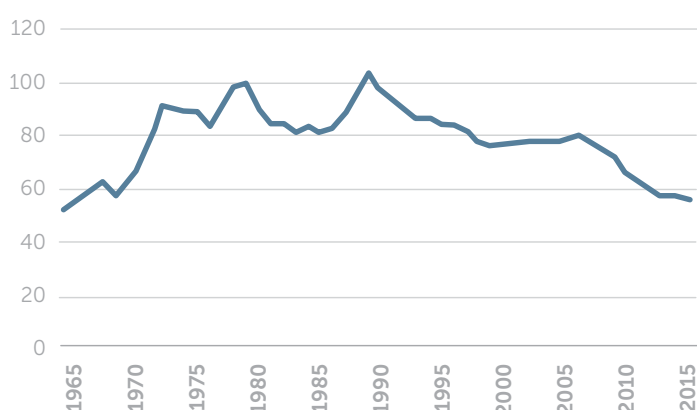
Summary. In the 1990s, a policy of increasing tobacco taxes above inflation was implemented by the UK government, designed both to increase government revenues and reduce smoking prevalence (Table 2). Between 2001 and 2008, the Government increased taxes in line with inflation. From 2009 onwards tobacco taxes were again increased above inflation. Tobacco affordability has now dropped to its lowest level since the mid-1960s (Figure 3).

Tobacco tax policy since the 1990s. In the mid- to late twentieth century, tobacco became increasingly affordable in the UK, as tax increases failed to keep pace with income growth. Affordability reached its peak in 1989-90 (Figure 3). In the 1990s, a policy of increasing tobacco excise taxes above inflation was implemented by the UK government. To begin with, this was on an ad hoc basis, but in the 1993 Budget, the Government announced that tobacco duties would rise by "at least 3 per cent a year in real terms (i.e., above inflation) in future Budgets." Increasing tax above the rate of inflation is known as a tax escalator. This was explicitly a health as well as revenue measure, with the Chancellor stating that, "I believe that the approach we are adopting in Britain is the most effective way to reduce smoking."(14)

Illicit trade also increased rapidly during this period, particularly as a result of the tobacco industry (TI) facilitating the evasion of UK duty (see section 1.5).(15) In 2000, the government therefore announced the introduction of a comprehensive strategy to tackle tobacco smuggling, asserting that, "The Government is determined that criminal activity will not undermine its policies to improve the nation's health."(16) Despite TI pressure, between 2001 and 2008,

the Government increased taxes in line with inflation while the illicit market was brought under control. The strategy had immediate impact. It did not simply halt the rapid growth of the illicit market, but drove it downwards (see section 1.4). In the 2009 Budget, tobacco excise taxes were once again increased above inflation.(17)

Figure 3. Tobacco Affordability Index, 1965-2016



Source: Beyond Smoking Kills, 1965-1980 [England] (19), NHS Digital, 1980-2016 [UK] (20)

Table 2. Timeline of Tobacco Tax Increases for Manufactured Cigarettes and Hand-Rolling Tobacco (HRT) in the UK

YEARS	TOBACCO TAXES
1989	Spring: No increase (Retail Price Index (RPI) increased by 7.8%)
1990	Spring: 10% (RPI increase = 9.5%)
1991	Spring: 15% (RPI increase = 5.9%)
1992	Spring: 10% (RPI increase = 3.7%)
	Spring: 6% (RPI increase = 1.6%)
1993	Autumn: 7.3%. Authorities committed to introduce an annual tobacco tax escalator of a minimum of 3% above projected RPI
1994	Autumn: 7.3% (RPI increase = 2.4%)
1995	Autumn: 3% above projected RPI for cigarettes, tax on HRT frozen (RPI increase= 3.5%)
1996	Autumn: 3% above projected RPI for cigarettes, increase at projected RPI for HRT
1997-1998	Commitment to annual tobacco tax escalator of 5% above projected RPI. Took effect in December 1997 and December 1998.
1999	Spring: 5% above projected RPI for cigarettes, no increase for HRT (RPI increase = 1.5%)

Table 2. Timeline of Tobacco Tax Increases for Manufactured Cigarettes and Hand-Rolling Tobacco (HRT) in the UK, Cont.

YEARS	TOBACCO TAXES
2000	Spring: Escalator abolished. Tobacco tax increased by 5% above projected RPI
2001-2008	Spring: annual increases in line with projected RPI
2009	Spring: 2% increase [NB RPI increase = -0.5%, so effective increase of 2.5%]
2010	Spring: 1% above projected RPI with commitment to escalator of 2% above RPI for all tobacco products for remainder of the parliament (2011-2015)
2011	Spring: 2% above projected RPI plus additional 10% increase on hand-rolled tobacco (HRT)
2012-2013	Spring: 2% above projected RPI
2014	Spring: 2% above projected RPI with commitment to continue tax escalator for the subsequent parliament from 2015-2020
2015	Spring: 2% above projected RPI
2016	Spring: 2% above projected RPI with additional 3% for HRT
	Spring: 2% above projected RPI
	20 May 2017: Introduction of Minimum Excise Tax (MET) of £268.63 per 1,000 cigarettes, setting a floor below which taxes cannot fall (see section 1.2).
2017	Autumn: one-off additional 1% for HRT. MET set at £280 per 1,000 cigarettes.
	A commitment to an annual escalator of 2% above projected RPI for all tobacco products for remainder of current parliament (until 2022).

Note: UK budgets are usually annual events, in Spring or Autumn (usually March or November).
Sources: (17, 21-50) See also ASH. Timeline of tobacco tax increases in the United Kingdom.(51)

The tax escalator has since been sustained in line with the Government's commitment to "maintain high duty rates for tobacco products to make tobacco less affordable."⁽¹⁸⁾ Reducing affordability, rather than just increasing price, is the key to reducing consumption and smoking prevalence. Prices therefore need to rise more than incomes and the level of inflation. A tax escalator is a simple way of achieving this. Tobacco is now no more affordable than it was in the mid-1960s (Figure 3), and the tax escalator will ensure that it becomes less and less affordable over time.

CURRENT STRUCTURE AND RATES OF TOBACCO TAX IN THE UK

Tobacco products duty is currently payable on:

- » Cigarettes
- » Cigars

- » Hand-rolling tobacco
- » Other smoking tobacco, for example pipe tobacco
- » Chewing tobacco
- » Cigarette rag and expanded tobacco, if it can be smoked without further processing
- » Herbal smoking products that do not contain tobacco or tobacco substitute (52)

The current duty rates are summarized in Table 3. Cigarettes are taxed using either a combination of a specific tax and an ad valorem tax or, since May 2017, using a Minimum Excise Tax (MET) – whichever is higher. A specific tax alone is applied to all other products. In 2017, the weighted average price for a pack of 20 cigarettes in the UK was £7.81.(53)

Table 3. Tobacco Tax Rates in the UK as of November 2017

TYPE OF PRODUCT	EXCISE DUTY RATE	MINIMUM EXCISE TAX (MET)
Cigarettes	Either £217.23 per 1,000 cigarettes plus 16.5% of retail price*	Or £280.15 per 1,000 cigarettes*
Hand rolling tobacco	£270.96/kg	Not applicable
Cigars	£221.18/kg	Not applicable
Other smoking and chewing tobacco	£119.13/kg	Not applicable

Source: Guidance: Excise Duty - Tobacco Duty rates(55) *Excise duty formula or MET – whichever is higher.

A MET sets a minimum level of excise duty for any packet of cigarettes, i.e., a floor below which tax on cigarettes cannot fall. MET was introduced in the UK in 2017 with a view to reducing the availability of very cheap cigarettes, which in turn encourages quitting, and to increase tax revenues.(54) The UK government has stopped short of introducing a Minimum Consumption Tax, to include VAT as well as excise tax, which would raise tax levels at the lower-priced end of the HRT market and limit the opportunity for downtrading within the HRT category.

Products become liable to the duty when they either enter the UK from overseas or reach a smokeable condition during manufacture. Products may be stored duty-suspended in approved excise warehouses. When goods are released from an excise warehouse for consumption, the excise duty must have been paid or accounted for before they leave the warehouse.(56)

EU law on tobacco tax. EU law imposes minimum rates of tobacco duty with a view to minimizing variation in the price of tobacco products between EU countries (Directive 2011/64/EU).(57)

For cigarettes, this minimum rate must consist of:

- » A specific component of between 7.5 percent and 76.5 percent of the total tax burden – a fixed amount per 1000 cigarettes
- » An ad valorem component - a percentage of the maximum retail selling price

In addition, the overall excise rate must be:

- » At least €90 per 1000 cigarettes
- » At least 60 percent of the weighted average retail selling price (unless excise duty \geq €115)

For HRT, Member States can apply a specific component (€54 per kilogram) or an ad valorem component (46 percent of the maximum retail selling price), or a combination of the two. The Directive also sets out minimum duty rates for other types of tobacco.

The UK is due to leave the EU in March 2019, and the implications of this for tobacco duty rates are as yet unconfirmed, although there is a commitment to increase tobacco taxes by 2 percent above RPI per annum until the end of the current parliament in 2022. However, the UK has historically implemented tobacco duty rates far in excess of EU-imposed minima, and it is therefore to be expected that tobacco taxes in the UK will remain high. In January 2018, the UK had the highest overall excise duty as a percentage of weighted average price in the EU (72.13 percent).(53)

The Problem of Smuggling Prior to Introduction of Measures to Reduce Illicit Trade: Evolution of the Illicit Trade in Tobacco in the 1990s

Sustained above-inflation tax increases were designed to reduce tobacco consumption, which threatened tobacco manufacturers' sales. The tobacco manufacturers' solution was to facilitate the growth of a parallel illicit market. This undermined the impact of the Government's tax strategy by ensuring that smokers -- particularly younger and poorer, thus more price-sensitive smokers -- had access to untaxed and therefore much cheaper tobacco products.

In the early 1990s, the illicit tobacco trade in the UK consisted mostly of small-scale cigarette smuggling from lower-tax jurisdictions in Europe. However, during the 1990s, tobacco manufacturers increasingly produced and exported cigarettes in volumes much greater than the known demand in their stated markets. These cigarettes were then smuggled, with no duty paid, back into the UK.(15) For example, the number of UK cigarettes exported to Andorra grew over a hundred-fold between 1993 and 1997, from 13 million to 1,520 million, enough for

every man woman and child in Andorra to smoke 140 cigarettes a day.(58) This was just one of many destinations where the supply massively outstripped plausible demand. As a Member of Parliament said to the chief executive of Imperial Tobacco, "One comes to the conclusion that you are either crooks or you are stupid, and you do not look very stupid. How can you possibly have sold cigarettes to Latvia, Kaliningrad, Afghanistan, and Moldova in the expectation that those were just going to be used by the indigenous population or exported legitimately to neighboring countries, and not in the expectation they would be smuggled?"(15)

This form of cigarette smuggling – involving shipping-container loads diverted from the legal to the black market while in international transit, with no duty paid – grew dramatically throughout the 1990s.(15) The share of the UK cigarette market accounted for by illicit manufactured cigarettes rose from only 3 percent in 1996-97 to 18 percent in 1999-2000. Most of these illicit cigarettes were estimated by Customs to be "duty not-paid" genuine UK brands (also referred to as tobacco industry illicit – representing 85 percent of seizures in 2000-01).(16, 59) The proportion of HRT which was illicit rose even faster, to reach nearly 80 percent by 1999.(16) HRT smuggling was largely of duty-paid product, smuggled into the UK from lower-tax European jurisdictions, in particular the Benelux countries.(60, 61)

The tobacco manufacturers were selling to intermediaries at the ex-tax price, still making their profits on the sales, but government revenues were undermined, as taxes were not paid.(15, 16) Indeed, as a study for the World Bank showed, the tobacco industry benefits from the existence of smuggling of its products, as smuggling reduces the average price (thereby increasing sales) and can provide access to closed markets.(62) In addition, the industry can use the increase in size of the illicit market to argue for reductions in tobacco taxes, an argument that industry spokespersons continue to deploy regularly.(63-65)

By 1999, the revenue losses associated with all forms of tobacco smuggling were estimated to be £2.5 billion, equivalent to 25 percent of all tobacco revenue (excise duty and Value-Added Tax (VAT)) due.(16) Furthermore, government projections suggested that the market share of illicit cigarettes would increase to over a third by 2003-04, in the absence of any action. The street price for a premium-brand pack of 20 illicit cigarettes was in the region of £2.50, compared with £4.20 for a legal pack (16). Given that, in 2000, the tax as a percentage of price among licit products in this price category was 80 percent, significant profits were clearly being made from smuggling.(66)

Summary of Approach to Reducing Illicit Tobacco in the UK since 2000

In response to the significant problem of tobacco smuggling, the UK customs authority (HM Revenue and Customs, HMRC) and economic and finance department (HM Treasury) introduced the UK's first anti-smuggling strategy in 2000.(16) This move coincided with widespread public exposure of the tobacco industry's involvement in tobacco smuggling,

Box 1: Types of Tobacco Products Available in the UK**LICIT TOBACCO**

GENUINE PRODUCT: Legally manufactured product of a tobacco manufacturer which owns all trademarks and branding featured on the product. The product is sold in compliance with all applicable laws.

ILLICIT TOBACCO

TOBACCO INDUSTRY ILLICIT: Genuine product of tobacco manufacturer that was en route to, imported into, distributed in or sold in a jurisdiction in violation of the applicable laws of that jurisdiction. The fact that this product was manufactured by a tobacco company does not imply that company is always responsible when its product ends up on the illicit market. Tobacco industry illicit comprises genuine UK brands on which UK duty is not paid and genuine non-UK brands.(74)

COUNTERFEITS: Products bearing a trademark of a tobacco manufacturer that are actually manufactured by a third party without the consent of the authorized cigarette manufacturer.

CHEAP WHITES (ALSO KNOWN AS ILLICIT WHITES): Cigarettes that are legally produced (usually not by a transnational tobacco company (TTC)), but have no legitimate market and are manufactured with the intent of being smuggled and sold outside of their country of production. These are defined by the European Commission as: “brands manufactured legitimately in one market, either taxed for local consumption or untaxed for export, and sold knowingly to traders who transport them to another country where the products are sold illegally without domestic duty paid.”(75)

Source: Adapted from Gilmore et al.(73)

prompting government inquiries and court cases (15, 67-72). As a result, the nature of the illicit market began to change. The tobacco industry began to alter its practices, and levels of tobacco-industry illicit declined. While tobacco industry illicit remained the leading source of illegally traded cigarettes in the country, other forms of illicit – cheap whites and counterfeit – emerged (Box 1).(73) The UK anti-smuggling strategy has been renewed and refreshed several times since 2000 in response to emerging threats and seeks to tackle each of these forms of illicit.

The UK's initial strategy was a comprehensive approach which included:

- » Estimating the size of the illicit market
- » Analyzing the problem
- » Investing in a range of operational responses to the problem identified:

- › Making it harder for criminals to source tobacco products
 - › Disrupting the supply and distribution chains for illegal tobacco products
 - › Reducing the rewards from smuggling by increasing the criminal and civil sanctions
 - › Reducing demand by raising public awareness to discourage purchases of illicit tobacco products
- » Committing to review the effectiveness of the strategy over time.

The strategy set a target of preventing the illicit market from increasing, stabilizing and then beginning to drive down the smuggled share of the cigarette market. Investment was weighted towards tackling the problem at source on the supply side, and in particular preventing illicit tobacco from entering the UK market. £209 million was invested over three years in 1000 more frontline and investigative staff and additional x-ray scanners to detect high volume cigarette smuggling in freight. The strategy also included the introduction of fiscal marks on UK duty-paid products and increased use of criminal and civil sanctions to deter smuggling and reduce its profitability. The strategy very explicitly set out that eradicating smuggling was an issue of enforcement, and that the arguments used by some that the solution was to cut duty were erroneous. The strategy's authors pointed out that many other countries in Europe with relatively low taxes suffer significant smuggling, indicating that low tax rates do not protect against smuggling.

The strategy had an immediate effect. Within three years, the market share of illicit cigarettes was on a steep downward trend (see section 1.4). The approach was so successful that a tougher target was introduced, of reducing the illicit market share to 17 percent by March 2006.⁽⁷⁶⁾ However, the illicit market evolved in response to the strategy, and the need for regular revision was clear. The market share of illicit HRT remained stubbornly high at 63 percent in 2000-01 and 55 percent in 2003-04.⁽⁷⁷⁾ Furthermore, smokers were increasingly downtrading from factory-made cigarettes to HRT, and HRT consumption was primarily of smuggled, non-UK duty-paid product. In addition, as the supply of smuggled genuine, UK-manufactured cigarettes (tobacco industry illicit) was increasingly brought under control, counterfeit cigarettes began to emerge as a problem.

Therefore, in 2006, a new strategy was launched, with investment in an additional 200 staff to focus on HRT and a 30 percent increase in the network of Fiscal Crime Liaison Officers (FCLOs) responsible for intelligence gathering and liaison between the UK and government investigators in other countries.⁽⁷⁸⁾ A specific new target was set of reducing the size of the illicit HRT market by 1,200 tonnes, the equivalent of around 20 percent of the market, by 2007-08. Memoranda of Understanding (MoUs) were signed with the tobacco manufacturers committing them to only sell their products in brands and amounts consistent with the legitimate demand in the export market. These commitments were backed up by legislation placing a legal duty on tobacco manufacturers and importers not to facilitate smuggling, with a penalty of up to £5 million for failure to comply.⁽⁷⁹⁾

In 2008, the UK Border Agency (the UK's immigration authority, now known as the UK Border Force) took over responsibility for the frontier work of HMRC. In recognition of this shift, an updated anti-smuggling strategy was developed.⁽⁸⁰⁾ Meanwhile, the illicit trade was continuing to evolve in response to enforcement approaches. Postal smuggling, particularly from China, emerged as a new threat. Although the overall size of the illicit HRT market was going down, counterfeit HRT was a growing problem, as the anti-smuggling strategy started to reduce the oversupply of genuine HRT to overseas markets. In addition, a new problem had emerged: non-UK branded cigarettes, manufactured for smuggling into the UK, known as "cheap/illicit whites," began to appear on the UK market.

By 2011, the size of the illicit market had been cut by almost half; however, tobacco fraud was still costing the government over £2 billion in tax revenues every year. A revised strategy was published, which committed to: increase resources; introduce new technology, intelligence, and detection capability; pursue proceeds of crime while applying new powers of assessment and penalties; and reduce the minimum indicative levels for personal imports from 3200 cigarettes and 3 kg HRT to 800 cigarettes and 1 kg HRT.⁽⁸¹⁾ These are only indicative limits, so are not a legal maximum, but imports above this level have to be justified to customs as genuinely for personal use.⁽⁸²⁾

A new strategy, the most recent, was published in 2015.⁽⁸³⁾ It outlined a continuation of the broad cross-government approach previously adopted, and placed increased emphasis on international engagement, undermining the profitability of illicit trade, and changing public perceptions of the illicit tobacco trade. It also set out plans for a review of sanctions for perpetrators, along with the introduction of a registration scheme for raw tobacco by the end of 2016, to tackle the growing problem of diversion into the illegal market in the form of counterfeit HRT.

Figure 4 summarizes the key challenges and responses over time. The approach has consistently focused on reducing the availability of illicit tobacco and punishing those involved in the illicit supply chain; while it is illegal to purchase illicit tobacco in the UK, enforcement has focused on suppliers as opposed to identifying and punishing consumers of illicit tobacco.

Tobacco industry involvement in the illicit trade has been and remains a particular challenge in the UK context (see section 1.5).

Overview of the Current Approach to Tackling the Illicit Tobacco Trade in the UK

While the illicit tobacco strategy has been regularly updated, the general approach remains weighted towards addressing the supply of illicit, covering both large- and small-scale smuggling, and aiming to tackle the problem both at home and abroad. Estimates of the size of the illicit market and analysis of the nature of the problem continue to inform activity.

The 2015 strategy emphasized the need for a strong focus on HRT with a view to reversing an upward trend in the illicit HRT market share. While the share of illicit HRT within the total market for HRT has decreased since then, recent data suggest that illicit cigarettes account for an increasing share of a declining cigarette market, indicating a need for renewed effort to tackle illicit cigarettes.

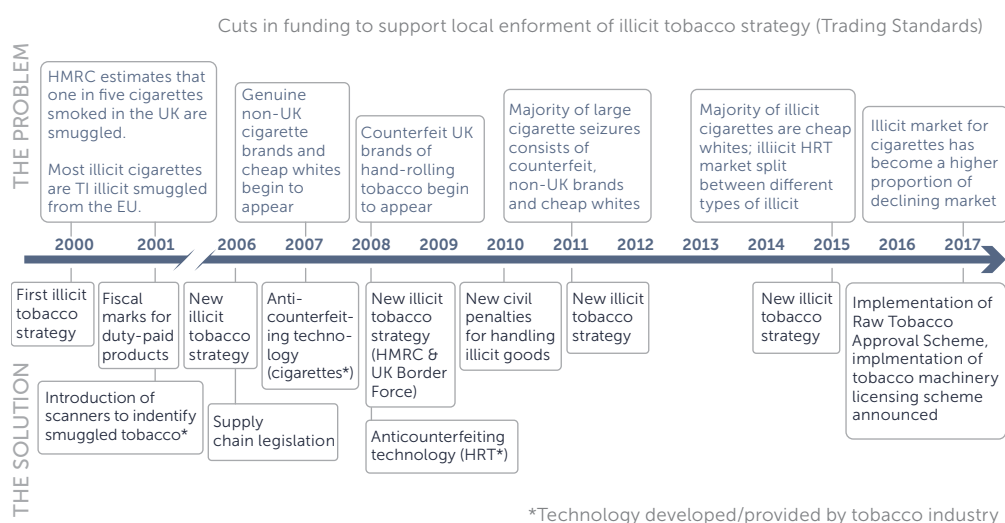
Developments since the 2015 strategy include the introduction of:

- » a registration scheme for anyone carrying out activities using raw tobacco (April 2017)
- » a tobacco machinery licensing scheme (August 2018)

The details of the current approach, including the legal and institutional frameworks, enforcement mechanisms, and packaging technology used are summarized in sections 1.2 and 1.3.

The UK is due to leave the European Union in 2019, and it is currently unclear what the implications of this for the illicit tobacco strategy and wider tobacco control will be. The UK is a frontrunner in the implementation of the FCTC and is a Party to the Illicit Trade Protocol (ITP) which comes into force in September 2018. Furthermore, UK tobacco regulation has generally exceeded EU minimum requirements. It is therefore unlikely that the UK's commitment to tobacco control will be diminished by departure from the EU. However, the UK's withdrawal may create barriers to collaborating with European partners to combat illicit trade. For example, UK officials may lose access to EU systems that support the reduction in illicit trade, such as the Excise Movement and Control System. Furthermore, at the time of

Figure 4. Timeline of Key Challenges and Responses to Illicit Tobacco Trade in the UK



Source: Adapted from National Audit Office. Progress in tackling tobacco smuggling. (85) Tackling Tobacco Smuggling. 2011.(81) Tackling illicit tobacco. 2015.(83)

writing, the UK has committed to leaving the European customs union. The disruption this is likely to cause could provide opportunities for those engaged in the illicit trade.

The illicit tobacco trade is by no means the only type of illicit trade in the UK; the country's total tax gap for 2015-16 was estimated at £34 billion (6 percent of tax liabilities), with tax evasion accounting for an estimated £5.2 billion.⁽⁸⁴⁾ Tobacco excise duties and VAT accounted for £2.4 billion of the tax gap. Efforts to reduce illicit tobacco therefore sit amidst wider efforts to tackle illicit trade in the UK.

1.2 DESCRIPTION OF CURRENT APPROACH TO REDUCING ILLICIT TRADE

Overview of Legal Framework for Tobacco Products

Regulation of tobacco manufacturers. Tobacco manufacturing has ceased in the UK; however, tobacco manufacturers who supply the UK market must comply with the full range of relevant legislation, including tobacco product regulations (86, 87) and supply chain legislation.

Licensing of wholesale and retail licensing. Wholesale and retail tobacco sellers are currently not licensed in the UK. Retailers are legally required to comply with a range of retail laws including age restrictions (minimum age of sale 18 years), standardized packaging, and point of sale tobacco display bans. These are enforced by local government.

Regulation of raw tobacco. Raw tobacco is not subject to excise duty, and there is therefore a risk of illegal manufacture of tobacco products and excise duty evasion. Since April 2017, businesses and individuals are prohibited from carrying on any activity involving raw tobacco unless they have obtained approval from HMRC.⁽⁸⁸⁾

Tobacco machinery licensing. Since April 2018, a registration scheme has been in operation to license manufacturing machinery used to make tobacco products. From August 2018, anybody manufacturing, purchasing, acquiring, owning, or in possession of tobacco-manufacturing machinery must hold a license issued by HMRC. The scheme has been introduced to reduce the risk of excise duty evasion and prevent the illegal manufacture of tobacco products. The creation of such a scheme was required to make the UK compliant with the WHO FCTC Illicit Trade Protocol.⁽⁸⁹⁾

Excise Movement and Control System. Under EU law, excise tax is paid in the country of final consumption. The Excise Movement and Control System (EMCS) is an EU-wide computer system which records duty-suspended movements of excise goods taking place within the EU.⁽⁹⁰⁾ Since January 2011, all movements of goods under duty suspension are monitored by the EMCS. The system records in real time the movement of tobacco and other excise products for which excise duties have still to be paid, and helps to ensure that the appropriate duties are paid at the final destination.

Internet and overseas sales. Buying some types of tobacco over the internet from another EU country for personal use is permitted; however, UK VAT and excise duty must be paid on the products prior to their entering the UK, and cigarettes and HRT may not be purchased in

this way, due to UK fiscal mark requirements. Sellers are required to register by completing a form which is submitted to HMRC, charge customers the relevant amount of tax, and make arrangements for these taxes to be paid.(91)

Tax is not required to be paid on tobacco products brought into the UK by travelers, as long as they are transported by the individual, they are for the traveler's own consumption or will be given away as gifts, and tax has been paid in the country of purchase. Travelers may bring in an unlimited amount of tobacco; however, guide levels are provided to help Customs officers distinguish between genuinely private imports and commercial importation.(92, 93) The guide levels for shoppers from within the EU are 800 cigarettes and 1 kg HRT.(94) Travelers from outside the EU may bring in up to 200 cigarettes or 250 g HRT.(95)

Current requirements for tobacco packaging in the UK. The appearance of tobacco packaging in the UK is determined by national and EU legislation. A recent EU Tobacco Products Directive (TPD) set out rules for the presentation of tobacco products, but stopped short of requiring standardized packaging of tobacco products (SPoT).(96) The UK government implemented UK-level SPoT from May 2016.(86) SPoT applies to manufactured cigarettes and HRT. The UK implementation of SPoT is too recent to assess whether it has had an impact on the illicit market; however, prior to its implementation, HMRC published an analysis which concluded that it was unlikely to have a significant impact.(97)

For all tobacco products, there are packaging requirements intended to avoid misleading customers. For example, the products must not feature information about the tar, nicotine, or carbon monoxide content or an indication that the product is less harmful than other products.

In addition, all tobacco products must carry combined health warnings (CHW) comprising a text warning, graphic warnings, and smoking cessation information. There are general conditions applicable to health warnings, such as that the health warning must cover the entire area that is reserved for it and that the exact wording prescribed must be used.

Packaging requirements are summarized in Tobacco Packaging Guidance published by the Department of Health.(98) The key requirements for cigarettes and HRT are summarized here.

All cigarette packs and individual cigarettes must be in standardized packaging, as follows:

- » external packet color Pantone 448C (a drab dark brown) with a matt finish
- » cuboid shape (rounded edges allowed)
- » a minimum of 20 cigarettes in each pack
- » packet made of carton or soft material
- » smooth surface with no texture or embossing
- » specified picture and text health warnings

Cigarette packs may not have

- » any other colors or markings

- » promotional images or logos
- » inserts / onserts
- » slim packets (but slim individual cigarette sticks are allowed)
- » indication of flavor of cigarette
- » non-standard noises or smells
- » features which change after sale

Similar to cigarettes, HRT packs must be a non-shiny, drab dark brown and adopt a pre-scribed shape. There are specifications as to featured text and internal packaging. HRT packs must be either a pouch, cylindrical, or cuboid in shape, and a unit pack must contain a minimum of 30 g of tobacco.

Brand names and variant names are permitted on cigarettes, cigarette packs, and HRT packs, but these must be in a standardized format (font, size, color, etc.).

CHWs on both cigarette packs and HRT packs must cover 65 percent of the front and back of pack (the same CHW on both sides), appear at the top edge of the surface, be positioned in the same direction as any other information on that surface, have minimum dimensions of 52 mm wide and 44 mm high, and have a graphic health warning taken from an approved set of images which are rotated annually.

Fiscal marks are required on both cigarette and HRT packs. An alphanumeric code is permitted. Packaging security features used in the UK are described in section 1.3. There are also requirements for the appearance of cigarette sticks and internal pack features (e.g., wrappers).

Overview of Institutional Framework for Tackling the Illicit Trade

National agencies. Since 2008, HMRC and the UK Border Force (previously Border Agency) have shared responsibility for tackling the illicit tobacco trade in the UK. They share responsibility for developing intelligence and reducing revenue losses, with distinct roles.

HMRC has responsibility for:

- » Collecting and enforcing tobacco duties
- » Investigating and disrupting criminal offences
- » Detecting and disrupting the supply of illicit tobacco inland
- » Excise and customs powers and legislation (80)

The UK Border Force has responsibility for

- » Detecting and seizing smuggled tobacco at the border
- » Arresting those suspected of smuggling offences and referring them to HMRC for investigation (80)

Table 4. Full-Time Equivalents of Staff Employed on Tackling Illicit Tobacco, 2005-2010

HMRC				UKBA*	TOTAL
YEAR	DETECTION	INVESTIGATION	INTELLIGENCE	DETECTION & INTELLIGENCE	FULL-TIME EQUIVALENTS
2005/06	1407	319	279	n/a	2005
2006/07	1557	278	295	n/a	2130
2007/08	1574	287	264	n/a	2125
2008/09	1500	395	255	n/a	2150
2009/10	153	360	172	1504	2189
2010/11	130	399	172	1504*	2205

*Note: For the UKBA, the figures provided are for staff assigned to detection and intelligence duties combined. n/a denotes "not available." The UKBA figures for 2010/11 and therefore the total for both agencies are estimates, since the UKBA has not yet released these data.

Source: ASH. UK Tobacco Control Policy and Expenditure. (99)

Table 5. Expenditure on Staff Employed on Tackling Illicit Tobacco, 2005-2010*

HMRC				UKBA*	TOTAL
YEAR	DETECTION	INVESTIGATION	INTELLIGENCE	DETECTION & INTELLIGENCE	
2006/07	£61,351,790.69	£13,246,434.95	£12,246,665.35	n/a	£86,844,890
2007/08	£65,037,870.02	£14,243,597.55	£11,271,899.07	n/a	£90,553,366
2008/09	£64,257,196.50	£19,998,544.53	£12,244,642.47	n/a	£96,500,383
2009/10	£ 5,362,740	£20,840,605	£ 7,946,658	£61,100,000	£95,250,003
2010/11	£ 5,504,241	£20,270,831	£ 6,152,047	£58,735,712	£90,662,831
2011/12	n/a separately	£25,636,005*	£ 8,143,109	n/a	n/a

*Note: includes detection, criminal investigation, and specialist civil investigation. Data from UKBA are not available for 2011/12.

Source: ASH. UK Tobacco Control Policy and Expenditure. (99)

The UK takes an "end-to-end" approach to disrupting the illicit supply chain, which requires activity both inland and overseas. Key to HMRC's efforts to tackle the illicit trade is its international network of Fiscal Crime Liaison Officers (FCLOs). The FCLOs are responsible for liaising with international fiscal and law-enforcement agencies and developing intelligence to intercept illicit tobacco destined for the UK market.

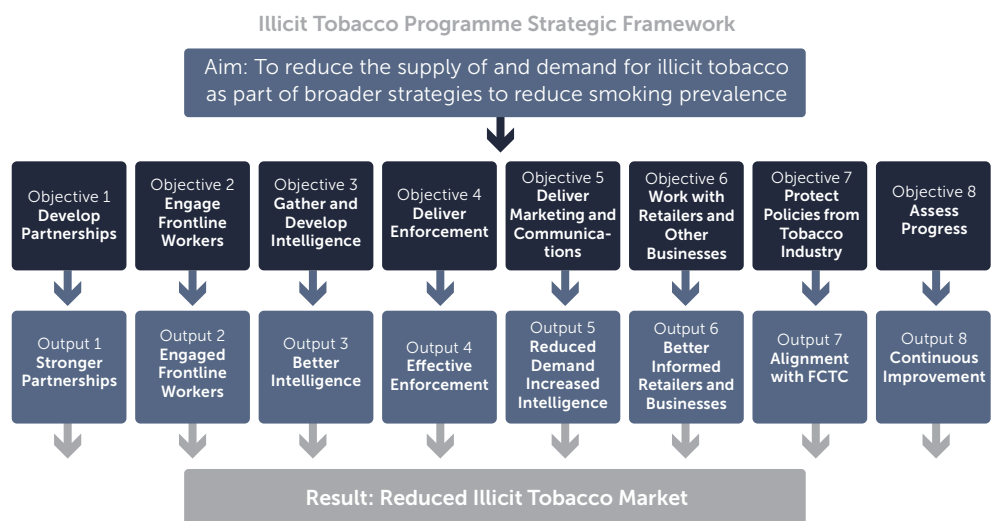
National staffing and expenditure. From 2000, a total of £209 million was invested over three years in 1000 more frontline and investigative staff, and additional x-ray scanners to detect high-volume cigarette smuggling in freight. Detailed data on levels of staffing and

expenditure are generally not published; some information was provided in response to a series of Parliamentary Questions. This information is summarized in Table 4 and Table 5. Since 2010/11, the Government has refused to provide this information, so more recent data are not available.

Local government. In the UK, Trading Standards are local government departments that promote and enforce fair, safe, and legal trading practices. Trading Standards are responsible for developing local intelligence and detecting and seizing illicit tobacco products.

The Trading Standards staff, who cover a wide range of consumer protection responsibilities and are crucial to effective collaborative working on illicit trade, are increasingly under threat. During the last six years, total spend nationally on Trading Standards has fallen from £213m in 2010 to £124m in 2016.⁽¹⁰⁰⁾ The National Audit Office (NAO) has calculated that the number of full-time equivalent Trading Standards staff decreased by 56 percent in seven years, from 3,534 in 2009 to 1,561 in 2016, with 81 percent of services considering that funding reductions have had a negative impact on their ability to protect consumers in their area.⁽⁸⁵⁾

Figure 5. The Illicit Tobacco Program Strategic Framework



COPYRIGHT 2016 TACKLING TOBACCO NORTH

Source: Illicit Tobacco Partnership.

Regional partnerships. Local government departments are well placed to tackle illicit trade, but need to work across wider geographical boundaries and with key stakeholders. In the UK, multi-agency regional partnerships designed to tackle the supply of illicit tobacco products in a coordinated way have been successful.

The North of England Tackling Illicit Tobacco for Better Health program was initially a partnership between public health, local, and national enforcement authorities. With the Illicit

Tobacco Partnership (a collaboration of Fresh, Action on Smoking and Health [ASH], and the UK Centre for Tobacco and Alcohol Studies [UKCTAS]⁵), the group has adopted an eight-strand strategic framework for reducing illicit tobacco as part of broader tobacco control measures. The strategy was refreshed and updated in 2016 (Figure 5).

In response to the results of research at the launch of the program, a number of policy responses were developed and delivered:

- » England's first sub-national demand-reduction social marketing campaign, "Get Some Answers," was launched in 2010, designed to inform the public of issues relating to illicit tobacco, for example, its links to crime and its availability to children.
- » Successful evaluation and evidence that the public had been "warmed up" to these issues led to the campaign's evolution into the "Keep It Out" campaign, which had a stronger call to action – if you know where illicit tobacco is being sold, report it. The campaign provided clear channels for reporting intelligence. It was refreshed and re-launched in the North East in 2017.
- » Local trading standards teams, based within local government, were provided with electronic handheld scanners to scan the anti-counterfeit marking on cigarette packs, helping determine the authenticity or otherwise of suspected illicit tobacco products. A regional post, working across the North East, also enhanced local enforcement capability and encouraged collaboration across boundaries.
- » Enhanced partnership working between local enforcement colleagues in trading standards and national partners in HM Revenue & Customs.
- » A commitment was made to track the size of the illicit tobacco market, and public opinion on the topic, every two years from the 2009 baseline.
- » Regular North East and national meetings to discuss illicit tobacco are convened, in line with obligations under Article 5.3 of the WHO FCTC.

The first two years of the North of England program were evaluated, and the partnership was deemed to be "an exemplar of partnership working ... and deserves to be widely disseminated."⁽¹⁰²⁾ This recommendation was supported by the National Audit Office (NAO), which scrutinizes public spending for Parliament.⁽⁸²⁾ Unfortunately, due to lack of funding, this has not been possible to date.

Enforcement Mechanisms

Supply chain legislation. Memoranda of Understanding (MoUs) between HMRC and tobacco companies have been consistently used as a means of restricting the availability of tobacco industry illicit; however, MoUs are voluntary agreements and are not legally binding.

⁵ Fresh is the UK's first dedicated regional tobacco control program. ASH is a campaigning public health charity that works to eliminate the harm caused by tobacco. UKCTAS is a network of universities conducting research, teaching, and policy work on tobacco and alcohol.

In 2006, the UK government introduced supply chain legislation (SCL) legally obligating tobacco manufacturers not to facilitate smuggling. The purpose of the legislation is to restrict the supply of genuine tobacco products to lower-tax EU countries with a view to these products' being smuggled back into the UK and becoming tobacco industry illicit. The legislation allows for penalties of up to £5 million for manufacturers that do not adequately control their supply chains.

In its 2013 report examining HMRC's progress in tobacco smuggling, the NAO highlighted that over-supply of genuine TI products was still a major concern and concluded that HMRC had not applied the full range of sanctions available under supply chain legislation. (85) Section 1.5 of this chapter describes the extent to which tobacco industry illicit (genuine product on the illicit market) remains a problem.

Sanctions. A range of sanctions are in place to punish individuals linked to all levels of the illicit tobacco trade. These include:

- » Seizure of goods
- » Seizures of vehicles/vessels and possible non-restoration
- » Seizure of cash under the proceeds of crime
- » Criminal prosecution with custodial sentences up to seven years
- » Confiscation of assets under the proceeds of crime
- » Assessment for the loss of duty
- » Financial wrongdoing penalties of up to 100 percent of the duty due
- » Civil action
- » Fines of up to £5000 for selling illicit tobacco not bearing appropriate fiscal marks
- » Prohibition on the sale of tobacco products for up to six months
- » Referral for withdrawal of haulier's licence
- » Naming & Shaming (83)

Governance processes in relation to tackling illicit tobacco in the UK

The UK government's anti-smuggling strategies are published in the public domain. The magnitude and impact of the illicit market is made public through annual publication of data about the size of the illicit market and quarterly reports on tax revenues and the quantity of tobacco released for sale.(103, 104) The Government also publishes information on the delivery of the objectives of its anti-smuggling strategies, including seizures and enforcement activity, although at the time of writing this had not been updated since July 2016.(105)

In addition, the NAO scrutinizes public spending for Parliament and helps Parliament hold the government to account and improve public services. The NAO published a report on HMRC's progress in tackling the illicit tobacco trade in 2013.(85) Parliamentary oversight is provided by

parliamentary select committees. The primary committee with oversight of HM Revenue and Customs performance is the Public Accounts Committee, which published specific reports on tobacco smuggling in 2002 and 2013.(15, 106) However, Inquiries covering issues relating to the illicit trade in tobacco were also carried out by the Health Select Committee in 2000 and the Home Affairs Select Committee in 2014.(107, 108) The Government is required to respond to Select Committee Inquiry reports and recommendations.

The UK government has also committed to fulfilling its obligations under Article 5.3 of the WHO FCTC to protect its public policy with respect to tobacco from the commercial and vested interests of the tobacco industry.(18, 109, 110) It has committed to publishing the details of all policy-related meetings between the tobacco industry and government departments. However, this excludes meetings to discuss operational matters to reduce the illicit trade in tobacco and bilateral meetings between tobacco manufacturers and HM Revenue & Customs.(111)

The oversight and scrutiny provided by these mechanisms has been helpful in ensuring that the Government's anti-illicit strategies have been regularly reviewed in the light of the evidence. The Finance Ministry works collaboratively with the Department of Health and with civil society to ensure that government policies take into account not just the need to protect revenues but also public health.(83) The publication and regular updating of government strategies on tackling the illicit trade in tobacco and the outcomes of these strategies ensure that the action taken by government to tackle the illicit trade can be subjected to public scrutiny.

International Action to Tackle Illicit Tobacco

Activity to combat the illicit tobacco trade in the UK is supported by action at the international level, in particular, legal agreements between the EU and all the major multi-national tobacco companies. The first Agreement, in 2004, was with Philip Morris International in settlement of legal action in the US courts to recover excise duties lost through smuggling. (112) Philip Morris International (PMI) committed to paying the EU £1.25 billion over twelve years and to control its supply chain in future, with financial penalties due if it were found not to have done so. Similar agreements were subsequently signed with Japan Tobacco International (JTI) in 2007 (expiring 2022), and with British American Tobacco (BAT) and Imperial in 2010 (expiring 2030).(112-114) The UK was not originally a party to the Agreements but signed up in 2009.(115)

An independent evaluation suggests these agreements have not served their intended purpose and instead have tended to benefit the industry.(72) Fines (referred to as payments), for example, have been tiny and an insufficient deterrent to ongoing TI involvement in illicit trade. The total paid out by TTCs as a result of the agreements between 2004-12 amounted to only 0.08 percent of the estimated loss of revenue in the EU caused by illicit trade during this period.(72, 73) Meanwhile, the industry's own data suggest that TI product accounted for the vast majority of the illicit market during that period (Figure 9). Following criticisms of its effectiveness, the PMI Agreement was not renewed when it came to an end in 2016.(72, 73)

The UK is a Party to the Illicit Trade Protocol of the WHO FCTC, which comes into force in September 2018, with a first Meeting of the Parties in October. A cost-benefit analysis of implementing the Protocol suggested that it could reduce smuggling in the UK by up to 80 percent, save 760 lives a year, and be worth £5.7 billion to the UK in net present value.(116)

1.3 INNOVATIVE AND TECHNOLOGICAL SOLUTIONS (FOR PACKAGING)

Fiscal Marks

A fiscal mark is required on cigarettes and HRT imported into the UK to indicate that UK duty has been paid (Note: this also applies to products produced in the UK, but UK-based production has recently ceased). Other tobacco products are exempted. The products must be marked before they enter the UK, and there are penalties for supplying or selling non-compliant products. The requirements for the mark are clearly specified.(117) In brief, the words "UK DUTY PAID" are required in Helvetica black bold type against a white background, and must be written indelibly, clearly, and legibly. The mark must not be hidden or obscured, nor must the mark obscure any health warning or other written or pictorial matter.

Anti-Counterfeiting Technology

An anti-counterfeit marking scheme has been in place in the UK since 2007, with a view to deterring and detecting counterfeit products, and to prevent legitimate retailers from being unfairly disadvantaged. The marks consist of a covert (not visible with the naked eye) taggant. A taggant is a chemical element which is added to the ink, and is detectable using hand-held scanners.(118, 119) The implementation of anti-counterfeiting technology was the result of a voluntary agreement between the industry and the UK government. The marks were introduced for cigarettes in October 2007 and extended to HRT in October 2008.(81) The UK government has also allowed the tobacco industry to trial its Codentify system in the UK as a means for testing product authenticity, so that it could examine whether it could provide a useful additional tool to enable product authentication. Given (1) the TI's attempts to promote Codentify as a track-and-trace system and (2) widely held concerns about Codentify, it is important to note that the trial is concerned only with the use of Codentify for product authentication. No other aspect of the system is being used or evaluated, and the government has made clear that it does not endorse this product in any way.(120-122)

Tracking and Tracing

Tracking and tracing involves monitoring the production, movement, and trade of tobacco products using secure and unique identifiers on such products. The new EU Tobacco Products Directive (2014/40/EU) requires EU member states to introduce an EU-wide tracking and tracing system by May 2019.(96) The Illicit Trade Protocol, to which the UK is a Party, also requires the implementation of a tracking and tracing system.(123)

1.4 RESULTS OF REFORMS TO ADDRESS ILLICIT TRADE - GOVERNMENT DATA

The UK government makes a concerted effort to collate data on the illicit tobacco trade, both to measure revenue losses and to evaluate its anti-illicit strategy. This is essential in understanding the size and nature of the problem, identifying emerging issues, and assessing the effectiveness of the strategy. This section gives an overview of the methods of measurement used by government to measure the illicit trade and the data they provide to evaluate the illicit tobacco strategy:

- » The illicit market share
- » Revenue losses associated with the illicit trade
- » Seizure volumes
- » Number and results of criminal investigations

Illicit Market Shares and Associated Revenue Losses

Measurement methods. HMRC publishes tax gap estimates for cigarettes and HRT each year. Up-to-date survey data currently allow HMRC to publish these in a timely fashion, with a lag of around six months.

The general approach has remained consistent since the first publication in 2001, but the methodology has been modified over time to take account of changes to data collection. Each year, previous estimates are re-estimated using the revised methodology, to ensure that they are comparable over time.

The most recent data on illicit market shares and associated revenue losses were published in 2017. The methods used are made public in a detailed methodological annex and are summarized here.⁽¹²⁴⁾

Calculating illicit consumption and market share. HMRC adopt a top-down approach to measuring tax gaps for tobacco, whereby they estimate total consumption and subtract legitimate consumption to estimate illicit consumption:

$$\text{ILLICIT CONSUMPTION} = \text{TOTAL CONSUMPTION} - \text{LEGITIMATE CONSUMPTION}$$

Illicit market share is calculated as:

$$\text{ILLICIT MARKET SHARE} = (\text{ILLICIT CONSUMPTION} / \text{TOTAL CONSUMPTION}) * 100$$

Total consumption per year is calculated using:

- » Estimates of prevalence of cigarette and HRT use and levels of consumption based on national survey data

- » Estimates of the adult population
- » An uplift factor to account for under-reporting (see below)

Legitimate consumption is calculated as:

LEGITIMATE CONSUMPTION = UK DUTY PAID CONSUMPTION + CROSS-BORDER SHOPPING + DUTY FREE

Estimates of UK duty paid are taken directly from HMRC returns. Cross-border shopping is based on a survey of air and sea passengers, while duty free estimates are based on commercial data.

Calculating revenue losses. Revenue losses are calculated by combining illicit market data with information on duty rates and VAT:

REVENUE LOSS = (SPECIFIC DUTY + (AD VALOREM + VAT FRACTION)*AVERAGE PRICE) * ILLICIT VOLUME

VAT fraction is the portion of the retail price that is VAT. HMRC acknowledge that because some illicit product is sold in legitimate outlets, assuming that the VAT fraction is lost on all purchases overestimates the losses.

The average price used is the weighted average price (WAP) of all cigarettes/HRT that were UK duty paid. The WAP is calculated by weighting the retail price of each product by the share of clearances in the cigarette/HRT market.

Measuring illicit market shares and associated revenue losses - limitations. A key limitation of the way that HMRC calculates the tax gap is that the approach relies heavily on self-reported survey data on prevalence and consumption; an uplift factor is used to account for underreporting. The uplift factor applied to estimates of consumption is based on estimates of consumption in a base year in which there is believed to have been little or no illicit market, i.e. legitimate consumption accounts for all consumption.

There is uncertainty about some of the estimates that contribute to the calculations of illicit market magnitude and revenue losses. HMRC publishes a range for the tobacco tax gap to reflect the extent of this uncertainty.

Results. The government's tax gap estimates indicate that during the first ten years of the illicit tobacco strategy, from 2000-01 to 2009-10, the illicit market share for cigarettes was nearly halved, dropping from 22 percent to 12 percent (central estimates) (Figure 6). The illicit market share for HRT fell less consistently, but saw a drop from 61 percent to 44 percent (central estimates) during the same period (Figure 7).

The estimated range for the revenue losses associated with illicit cigarettes and HRT is large, and the estimates need to be considered in the context of changes in smoking prevalence, changes in duty rates, and of the overall size of tax evasion in the UK. However, the estimates for cigarettes suggest a significant fall during this period (Table 6). The trend for HRT is less clear.

Overall, these estimates demonstrate the success of the illicit trade strategy during this period.

Figure 6 suggests that, contrary to the first ten years of the strategy, the illicit market share of cigarettes increased between 2010-11 and 2016-17. Due to a decline in smoking prevalence, the size of the illicit market remained fairly stable during this period at around 5 billion cigarettes per year (Table 6) (125); taken together, these estimates indicate that the illicit market for cigarettes has become a larger proportion of a declining overall cigarette market.

Figure 6. Cigarettes: Estimated Range of Illicit Market Shares, 2000-01 - 2016-17

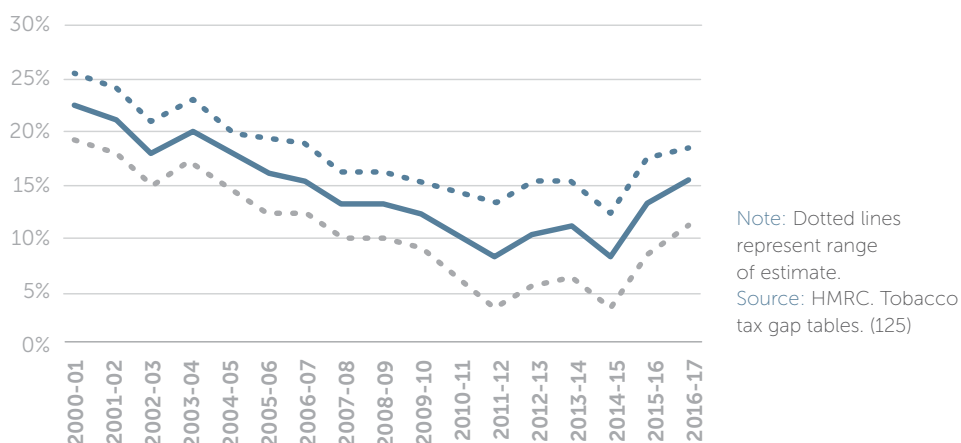


Figure 7. HRT: Estimated Range of Illicit Market Shares, 2000-01 - 2016-17

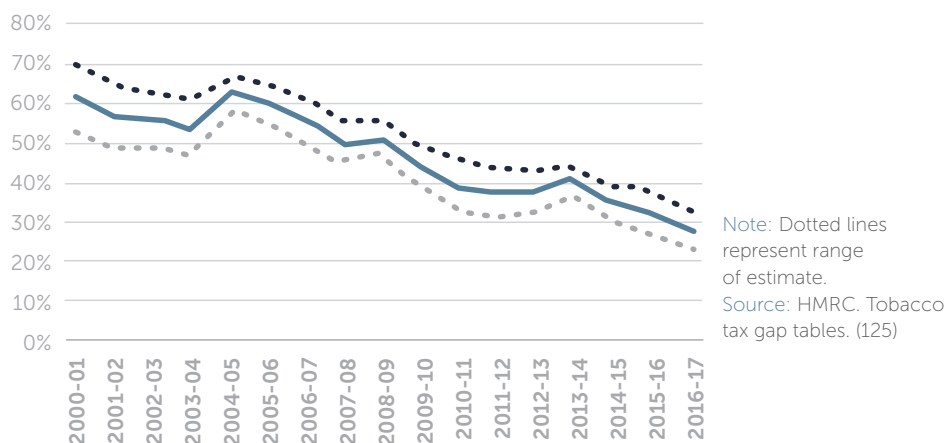


Table 6. Illicit Market Volumes and Associated Revenue Losses, 2000-01 - 2016-17

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
CIGARETTE ILLICIT MARKET VOLUMES (BILLION CIGARETTES)																	
Upper estimate	20.0	19.5	16.5	18.0	14.5	12.5	12.0	9.5	9.5	9.0	7.5	6.5	7.0	6.5	5.0	7.0	7.0
Central estimate	17.0	16.5	13.5	15.5	12.5	10.0	9.5	7.5	7.5	7.0	5.0	4.0	4.5	4.5	3.0	5.0	5.5
Lower estimate	14.0	13.5	10.5	12.5	10.0	7.5	7.5	5.5	5.0	5.0	3.0	1.5	2.5	2.5	1.5	3.0	4.0
CIGARETTE REVENUE LOSSES (£ MILLION)																	
Upper estimate	3200	3200	2800	3200	2600	2400	2300	1900	1900	1900	1700	1600	1900	2000	1500	2200	2300
Central estimate	2800	2700	2300	2700	2200	1900	1800	1500	1500	1500	1200	1000	1300	1400	900	1600	1800
Lower estimate	2300	2200	1800	2200	1800	1400	1400	1100	1100	1000	700	400	600	800	400	1000	1200
HRT ILLICIT MARKET VOLUMES (THOUSAND KG)																	
Upper estimate	7,000	7,400	7,300	6,600	7,700	7,200	6,800	5,700	6,500	5,600	5,200	4,900	5,200	5,500	4,400	4,000	3,400
Central estimate	5,600	5,900	6,000	5,400	6,700	6,100	5,700	4,700	5,500	4,700	4,200	4,000	4,200	4,700	3,700	3,300	2,700
Lower estimate	4,200	4,500	4,700	4,200	5,800	5,000	4,500	3,700	4,600	3,800	3,200	3,100	3,300	3,800	3,000	2,500	2,100
HRT REVENUE LOSSES (£ MILLION)																	
Upper estimate	800	900	900	900	1000	1000	1000	800	1000	900	900	1000	1100	1200	1000	1000	900
Central estimate	700	700	700	700	800	800	800	700	800	700	700	800	900	1100	900	800	700
Lower estimate	500	600	600	500	800	700	600	600	700	600	500	600	700	900	700	600	500

Source: HMRC. Tobacco tax gap tables. (125)

During the same period, the illicit HRT market continued to decrease, both in terms of market share (Figure 7) and in terms of volume. The market volume of illicit tobacco was estimated at 4,200,000 kg in 2010-11 and 2,700,000 kg in 2016-17 (Table 6).(125)

These findings suggest that, while the strategy has continued to have some success, this may have been undermined by cuts in funding for local-level enforcement in recent years; however, the reasons for the change in trend have not been comprehensively evaluated. (126)

Volume and Composition of Products Seized

Measurement methods. The volumes of seizures reported by HMRC and Border Force are based on estimates made at the point of seizure. While seizure volumes can reflect levels of illicit, they more clearly reflect the scale of the enforcement effort and fluctuations in the ease of detection resulting from changes in the nature of the illicit market.

The composition of seizures – in terms of the proportions of the illicit trade which consist of T1 illicit, cheap whites, and counterfeit - is an indicator of the success of efforts to control the supply chain, particularly supply chain legislation. However, these data are only compiled on large seizures (250,000 cigarettes or more from 2004-05 to 2006-07 and 100,000 or more cigarettes thereafter).

Results. UK government data indicate the high volume of seizures since the implementation of the strategy in 2000. During the first 10 years of the illicit tobacco strategy, more than 20 billion cigarettes and 2700 tonnes of HRT were seized.(81) Table 7 summarizes the volume and revenue value of seizures since 2008-09.

Between 2008-09 and 2015-16, cigarette seizures were relatively constant; the illicit market share declined during much of that period, indicating an increase in the interdiction rate (the volume of goods seized as a proportion of the total volume of illicit goods targeted at the UK).(85) HRT seizures fluctuated between 259 tonnes and 572 tonnes. In 2012-13, over two-thirds of cigarettes seized were seized abroad, while approximately three-quarters of HRT was seized at the border.(85)

Data on large seizures suggest that the share of the illicit cigarette market accounted for by genuine UK brand cigarettes has declined under recent supply-chain legislation, from 31 percent in 2004-05 to 5 percent in 2012-13.(85) For HRT (based on large seizures consisting of 50 kg of HRT or more), the proportion fell from 75 percent in 2007-08 to 17 percent in 2012-13, but this proportion has fluctuated significantly over time.(85)

Significant concerns have been raised about the accuracy of seizure data. In particular, experts have questioned the practice of basing seizure composition reports entirely on data from large seizures.(73, 122) The UK government has therefore recently invested in compiling comprehensive seizure data.(127, 128)

Table 7. Total Illicit Cigarette and HRT Seizures by HMRC and Border Force, 2008-09 - 2015-16

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
CIGARETTES								
Volume (billion)	1.8	1.7	1.7	1.7	1.9	1.4	1.7	1.7
Revenue value (£ million)	n/a	n/a	n/a	n/a	n/a	410	542.7	561
HRT								
Volume (tonnes)	259	403	389	572	483	330	313	286
Revenue value (£ million)	n/a	n/a	n/a	n/a	n/a	74.6	73.8	70

*Note: NAO report did not report value of seizures.

Source: 2008-09 – 2012-13: National Audit Office. Progress in tackling tobacco smuggling. (85); 2013-14 – 2015-16: HMRC Tackling tobacco smuggling: outputs(105)

Number and results of criminal investigations

Measurement methods. HMRC publishes a range of data on levels of criminal enforcement activity and civil penalties related to the illicit tobacco trade, including numbers of prosecutions and the revenue loss prevented as a result of criminal enforcement activity. These data provide a further indication of the benefits of efforts to tackle illicit trade.

HMRC's key indicator of the impact of its investigations against organized crime is an estimate of revenue loss prevented. HMRC's estimates of revenue loss prevented through criminal enforcement activity are calculated at the point of first intervention (seizure or arrest). The scale of the fraud disrupted is estimated, and then extrapolated based on the prevention of 12 months of future fraudulent activity.

The NAO underlines that this method can either under-report benefits (if initial estimates of the scale of the fraud are conservative) or over-report benefits (for example, if a case does not progress to full prosecution).(85) While reporting the impact at outcome (e.g., successful prosecution) would be more accurate, this would weaken the link between the activity and benefit reported within a year.

Results. Between 2011 and 2015, annual prosecutions for tobacco offences rose by 50 percent, with 177 people being convicted of organized tobacco crime offences, and 605 people convicted of smaller-scale tobacco crime offences.(83) While detailed data on the prosecutions are not published, cases are in the public domain and press releases about cases are regularly published.(129)

HMRC's key measure in relation to lower-level criminal activity is the value of civil assessments and penalties issued. In 2011-12, these reached £8.2 million; in 2012-13 their value

Table 8. Criminal Enforcement Activity and Civil Penalties, 2013-14 to 2015-16

CRIMINAL ENFORCEMENT ACTIVITY	2013-14	2014-15	2015-16
Number of individuals prosecuted	328	417	431
Number of individuals convicted	271	237	268
Number of tobacco related confiscation orders	28	36	38
Value of tobacco related confiscation orders (£ million)	3.50	1.4	1.32
Revenue loss prevented (£ million)	606	968.1	983.1
CIVIL PENALTIES			
Number of tobacco related wrongdoing penalties issued	1,571	1,339	1,335
Value of tobacco related wrongdoing penalties issued (£ million)	3.2	2.5	2.2
Number of assessments for tobacco products duty issued	1,659	1,376	1,461
Value of tobacco products duty assessments issued (£ million)	15	7.6	15.7

Source: HMRC Tackling tobacco smuggling: outputs (105)

was £17.7 million.⁽⁸⁵⁾ Between 2011 and 2015, £49 million was raised in assessments and penalties.⁽⁸³⁾

The results of criminal investigations and civil penalties issued from 2013-14 to 2015-16 are summarized in Table 8 below. The revenue loss prevented in recent years has been estimated at close to £1 billion.

1.5 COSTS AND BENEFITS OF THE ILLICIT TOBACCO STRATEGY

A formal evaluation of the financial costs and benefits of the illicit tobacco strategy has not been published; nor has the effect of the strategy on smoking prevalence been assessed. In the absence of detailed data on expenditure on tackling illicit tobacco, it is not possible to fully assess the return on investment. Nevertheless, the data presented above give some indication of the financial costs and benefits, which are summarized here.

In 2000, £209 million was invested in extra staff and x-ray scanners to support implementation of the illicit tobacco strategy.⁽¹⁶⁾ The limited data published more recently indicate staff expenditures by HMRC and the Border Agency on detection, investigation, and intelligence of around £90 million per year.⁽⁹⁹⁾ These data do not capture all relevant costs, such as expenditure on new technology or trading standards, but are likely to represent the bulk of expenditure on the illicit tobacco strategy.

It is not possible to determine what the value of revenue losses would have been in the absence of the illicit tobacco strategy; however, when the first strategy was published, smuggling was on an upward trend and it was predicted that the market share of illicit tobacco would grow from 21 percent to a third within two years in the absence of action.

As described above, the strategy successfully reversed the increasing trend. The value of seizures, estimates of revenue losses prevented by criminal investigations, and reductions in estimated revenue losses - despite regular tax increases - demonstrate that the financial benefits are significant.

In 2016-17, the estimated revenue losses associated with illicit cigarettes were £1 billion lower than in 2000-01; in 2014-15, they were nearly £2 billion lower.⁽¹²⁵⁾ The revenue value of cigarettes and HRT seized by HMRC and the Border Agency has been over £600 million in recent years.⁽¹⁰⁵⁾ The future revenue loss prevented by criminal enforcement activity increased to close to £1 billion for the year 2015-16.⁽¹⁰⁵⁾

Taken together, the available data indicate that investment in measures to tackle the illicit trade has delivered a significant return on investment.

1.6 ONGOING CHALLENGES: TACKLING THE TOBACCO INDUSTRY'S ROLE IN THE ILLICIT TOBACCO TRADE

Sections 1.4 and 1.5 described the success of the government strategy since 2000 but underlined that the problem of illicit tobacco in the UK remains significant. Furthermore, the data presented above do not capture comprehensive information about the nature of the illicit market. This section describes the nature of the illicit market in the UK. It offers evidence of the industry's ongoing role in the illicit tobacco trade and explores approaches to tackling that involvement.

Data Suggesting Ongoing Industry Involvement - Tobacco Industry Illicit Remains the Single Largest Problem

Based on the composition of cigarette seizures, experts deduce the proportions of the illicit trade which consist of tobacco industry illicit, cheap whites, and counterfeit. This information can be vital in identifying underlying problems and directing appropriate supply chain interventions. As outlined above, HMRC and UK Border Force data on the composition of seizures only cover large seizures (consisting of 250,000 cigarettes or more from 2004-05 and 100,000 or more from 2006-13). These data indicate that UK-branded TI illicit as a proportion of the illicit cigarette market has declined since supply chain legislation was implemented, falling from 17 percent to 5 percent in 2012-13.⁽⁸⁵⁾ For HRT, the proportion has fallen since 2007-08 (75 percent), to 17 percent in 2012-13.⁽⁸⁵⁾

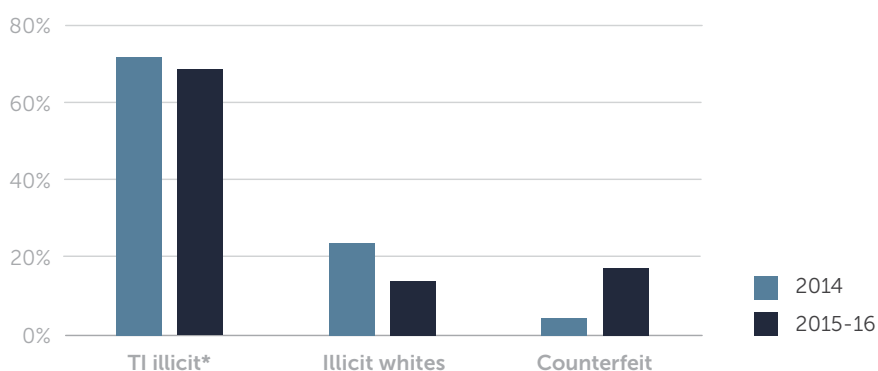
However, as previously noted, significant concerns have been raised about the quality and relevance of large-seizure data.⁽⁷³⁾ Other data sources (including those based on seizures regardless of size) indicate that estimates based only on large seizures significantly underestimate the proportion of the illicit market that comprises tobacco industry illicit product.^(72, 73) This is thought to reflect a number of issues: (i) counterfeit products are now transported in large quantities and are therefore likely to be seized in large batches, while TI illicit is increasingly transported in smaller quantities; (ii) TTCs investigate and alert government authorities to other forms of illicit (counterfeits and cheap whites), which are therefore more

likely to be seized; (iii) TTCs play a role in evaluating which seized products are counterfeit and which genuine. For example, following litigation brought against the major tobacco transnationals for their involvement in tobacco smuggling, the EU reached legal agreements with the firms. (130-133) Under these arrangements, the companies were required to pay ongoing penalties, should their products continue to be found in illicit seizures. However, the tobacco firms themselves were asked to help determine which seized products were genuine and which counterfeit.(72, 73)

The need for independent data on the nature of the illicit market is clear. The UK Department of Health therefore funded the Trading Standards Institute to systematically collect data on tobacco seizures regardless of size. Two periods of data collection in 2014 and 2015-16 suggested that approximately 70 percent of seized cigarettes were tobacco industry illicit (Figure 8).(122, 127, 128) Other data sources support that finding.(122) The latest World Customs Organization data indicate that, globally, approximately 70 percent of seizures are tobacco industry illicit (Figure 10). Even data funded by the tobacco industry itself show that tobacco industry illicit remains the largest category of illicit cigarettes across the EU (Figure 9), with TI illicit comprising an estimated 89 percent of the illicit market in 2007 and 58 percent in 2016.

In short, diverse data consistently show that across the UK, the EU, and globally, the single largest component of the illicit tobacco market is tobacco industry illicit.(122) This is despite regular claims by the tobacco industry that the main problems are cheap whites and counterfeit.

Figure 8. Operation Henry Results: % Share of UK Illicit Market by Type With Correction for 2015/16 data* Estimates

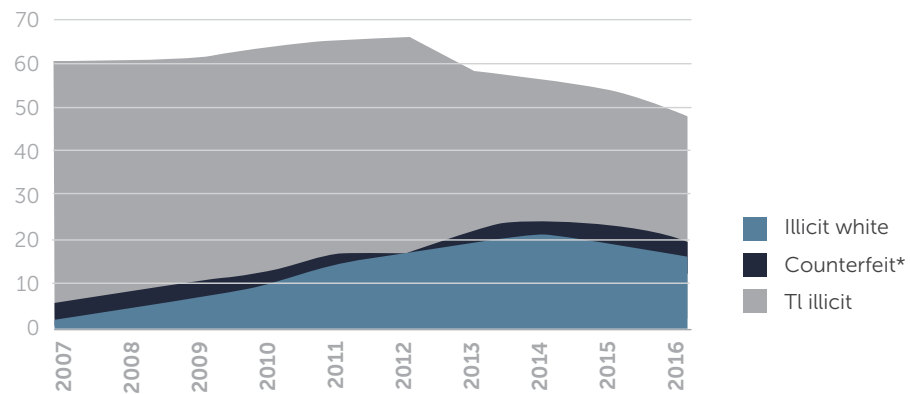


Source: Trading Standards Institute.(127, 128) Based on systematically collected seizure data from nine English regions between April-November 2014 and December-April 2016.

*Graphs and corrected analysis by Gilmore

This report identified the two most-seized products, West and Winston, as cheap whites. However, these are tobacco industry brands, sold in the UK by Imperial Tobacco and Japan Tobacco International, respectively. In the above graphs, these products have therefore been recoded as tobacco industry illicit. This is more likely to give an accurate picture. It is unclear if a determination was made as to whether these seized products were genuine or counterfeit. However, these products are generally not widely sold in the UK. Thus, it is thought unlikely that counterfeiters would target counterfeit West and Winston at the UK market.

Figure 9. Nature of Illicit Cigarettes in the European Union – Collated Results from the Project Sun and Star Reports Of Volume and Type (billions of sticks)

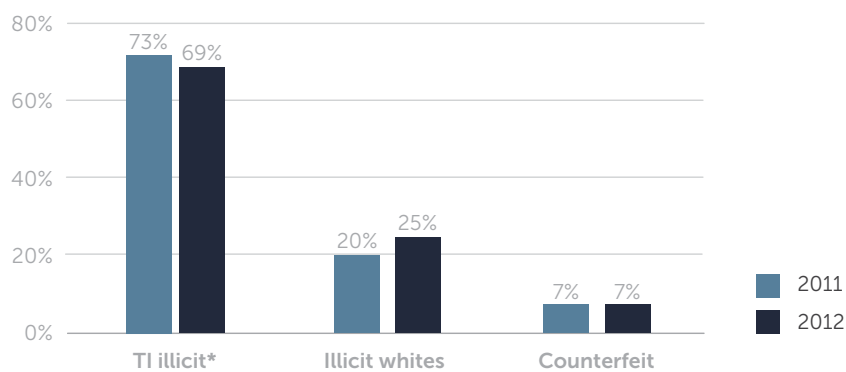


Source: Data (based on sales figures, empty pack surveys, and consumer surveys) taken from the Project Sun and Project Star reports published by KPMG and funded by the tobacco industry. KPMG’s 2017 Project Sun report (with data for 2016) was funded by the Royal United Services Institute which receives funding from the tobacco industry.(134-140)

* The Counterfeit data in the Project Sun/Star reports comprises just counterfeit PMI brands from 2007-11 and counterfeited brands for all 4 TTCs from 2013 onward.

Analysis and graphs by Gilmore

Figure 10. WCO Latest Available Global Data Showing the % of Cigarettes Seized by Type



Source: WCO data taken from the WCO Illicit Trade Report 2012.(141) Based on data of seizures of all quantities. Analysis and graphs by Gilmore

Other Evidence of Ongoing Tobacco Industry Involvement

These data suggest that, at best, the TI is failing to control its supply chain: how else could such large numbers of tobacco-company products end up on the illicit market? Growing evidence from diverse sources, including industry whistleblowers,(142) investigative journalists,(143) researchers,(144) and government investigations, suggests that TTC involvement may, however, be less passive.(85, 122, 145) UK government reports highlight that the

tobacco industry has continued to oversupply its products to low-tax jurisdictions, in the knowledge that these products would leak back into the UK.(15, 76, 85, 145)

The National Audit Office noted that 2011 estimates showed “actual supply of some brands of hand-rolling tobacco exceeded legitimate demand by 240 per cent.”(85) The Public Accounts Committee argued the need “to put a stop to the abuse of exports by tobacco manufacturers.” Approaches should include naming and shaming those who fail to co-operate.(106) In line with these conclusions, BAT was recently fined £650,000, reduced on appeal to £100,000, for over exporting hand-rolled tobacco to Belgium, which then found its way back to the UK.(146-148) While such fines are small compared to industry income, the maximum penalty is a more substantial £5 million and the threat of such supply chain fines can be used by HMRC to encourage change in TTC behavior.

The Role of Civil Society in Supporting Evidence-Based Government Policy on Tax and Illicit and Addressing TI Misconduct

The tobacco industry in the UK, as elsewhere, has increasingly used the threat of illicit tobacco to argue against tobacco tax increases and other tobacco control policies, perhaps most notably plain packaging. Such arguments can hold sway given governments’ fears about potential revenue losses. Civil society in the UK, including close collaboration between researchers and NGOs, has long played a key role in exposing tobacco industry misconduct and countering the industry’s misleading data and arguments. This has enabled the advancement of evidence-based government policy.

Refuting industry arguments that tax increases drive illicit trade. The tobacco industry consistently argues that high taxes inevitably lead to high levels of illicit, ignoring the strong correlation between the level of corruption and tobacco smuggling, as well as the role of enforcement.(62) Although in some jurisdictions industry arguments have been successful in influencing policy,(58) in the UK, civil society organizations, working with the media, were able to expose the tobacco industry’s facilitation of the smuggling of its own products, spurring parliamentary committees to carry out Inquiries.(63, 149, 150) These Inquiries led to reports containing strong recommendations to Government and further negative publicity about tobacco industry misbehavior both within the UK(151) and internationally (108, 110). As a result, tobacco industry claims that tobacco taxes are the sole driver of illicit trade have been met with skepticism.

Despite initial civil-society successes, however, the TI continued to argue that tax increases spur illicit trade.(152) More recent research on tobacco industry profitability and pricing played a key role in showing that, in fact, half of recent cigarette price increases in the UK were due to the tobacco industry’s raising its own prices over and above tax increases.(153) This result suggested that, since tobacco firms were still able to increase profits by raising prices, additional scope remained for the UK to raise its tobacco taxes, despite already imposing some of the highest tobacco taxes in the world.(153)

Exposing the misleading nature of industry data and how firms use this data to scaremonger and confuse. In recent years, the tobacco industry has increasingly commissioned its own data on illicit tobacco to try to underpin its arguments that tax drives illicit trade. Much of these data come from empty pack surveys (EPS), where discarded cigarette packs are collected, assessed, and categorized.(154) While such surveys can, if conducted properly, provide useful data on non-domestic goods (i.e., products which have not paid local duties), they cannot in fact determine which of those products are legal (for example, duty-free products brought into the country by tourists, students, or workers from abroad) and which are illegal (i.e., illicit). Hence, these surveys cannot directly measure the illicit tobacco trade. Moreover, the TI and those doing surveys for it are notoriously opaque about their methodologies, generally volunteering no details (152) and refusing to provide clarification when asked.(155)

Nevertheless, in the UK, the TI has presented EPS data to the press in such a way as to give the impression that they reliably measure the illicit tobacco market. Consequently, media stories based on TI data have been found to routinely exaggerate the scale of the illicit tobacco trade.(154) Such efforts, alongside alarming and misleading videos on TTC websites(156) and TI misrepresentation of government data (the industry routinely cites the upper rather than mid-point government estimate of illicit in its reports (154)), are designed to create confusion about illicit. (154, 157)

Other industry-funded data have been produced by major accountancy firms such as KPMG, Deloitte, and PricewaterhouseCoopers (134-140, 158-162), with European data produced by KPMG based on modelled estimates. Independent evaluation shows that, by inputting EPS and other data provided by the TI into its model with no external validation, KPMG tends to overestimate illicit.(73) Further, at the moment when standardized packaging was being debated in the UK, KPMG changed its methodology in just two countries (Italy and the UK) in a way that led to a sudden overestimate of illicit trade levels in these two markets. The firm's report was released early, accompanied by a press release highlighting this ostensible sudden increase, in an apparent attempt to influence policy decisions about standardized packaging.(73) Only once an independent critique of this methodology change (73) was made public did KPMG reanalyze its data (a year later) and produce a lower, more realistic estimate.(163)

Elsewhere, the TTCs have commissioned KPMG or other accountancy firms to prepare reports on the illicit tobacco trade which have, almost without fail, also been shown to exaggerate levels of illicit compared with independent data.(73, 144, 154, 155, 164-190) There is growing consensus, therefore, that such reports are produced primarily to serve TI interests. (73, 164, 191, 192)

Exposing the poor quality of tobacco industry evidence that standardized packaging drives illicit. Most recently, the industry argued that standardized cigarette packaging would fuel illicit trade and ultimately lead to policy failure and adverse social and economic consequences.(152, 154, 164, 169) The number of media stories citing industry data on illicit was shown to increase rapidly following the UK government's announcement that it was

considering the option of standardized packaging, at a time when levels of illicit were in fact falling.(154) As usual, industry arguments sought to exploit policy makers' fears of losing revenue through an expansion of the illicit tobacco trade.

Independent analyses showed that these arguments had no foundation (193) and that industry "evidence" on this issue amounted to little more than anecdote and the opinion of persons in the industry's pay.(164) Subsequent analyses commissioned by the UK and Irish governments supported the conclusion that there was no convincing evidence that the introduction of standardized packaging would lead to an increase in illicit tobacco.(97, 194-196) Both governments proceeded to introduce plain, standardized packaging.

Exposing industry third parties. Much of the questionable data we have discussed is collected by individuals and organizations paid by the tobacco industry. It is generally these individuals and entities, rather than the tobacco companies funding them, that are given prominence in press stories.(197) Many of these figures are ex-policemen that the industry pays to provide it, in industry spokespersons' own words, with a "credible voice."(198-203) Such efforts create an aura of respectability and independence.

Similarly, analysis of the industry's "evidence" that standardized packaging would increase illicit showed that most of the findings has been produced by industry third parties. The TI almost entirely failed to disclose this circumstance in its submissions to government.(164) For example, TI submissions cited evidence from the Tobacco Retailers Alliance, the British Brands Group, and the Anti-Counterfeiting Group, without mentioning that all of these organizations were created (and in some instances entirely financed by) the tobacco industry itself.(164)

Numerous other individuals (see e.g. 204, 205) and organizations, the latter including retailer front groups (206), research organizations (207-209), and think tanks (210, 211) with close links to the tobacco industry, have repeatedly argued that tobacco control will increase illicit trade. Most recently, in 2017, an All Party Parliamentary Group (APPG) on Illicit Trade, which has links to the tobacco industry, was set up "to investigate and raise awareness of illicit trade in Britain, support closer working with parliamentarians to bring fresh impetus and ideas to tackling illicit trade and to highlight the impact on local businesses, high streets and communities" (212, 213).

All Party Parliamentary Groups (APPGs) are informal cross-party groups that have no official status within Parliament. They are run by and for Members of the Commons and Lords, though many choose to involve individuals and organizations from outside Parliament in their administration and activities. In March 2018, the APPG on Illicit Trade launched its formal inquiry into the state of such commerce in the UK. The report on the group's findings was published in July 2018. The report recommended the creation of a UK Anti-Illicit Trade Group, which would see the government working together with industry to tackle the illicit trade challenge.⁶ The APPG report also echoed arguments described above that taxes

⁶ The APPG report can be consulted via the following link: Illicit trade in the UK. All Party Parliamentary Group on Illicit Trade. 2018. Available from <https://connectpa.co.uk/wp-content/uploads/2018/07/Illicit-Trade-APPG-report-2018LRi.pdf> [Accessed 14 August 2018].

introduced to reduce the consumption of unhealthy commodities, such as the soft drinks levy implemented in 2018, increase illicit trade. The report notably failed to mention the ITP, which will be essential in informing future strategies to tackle the illicit tobacco trade. The report was funded by PA Consulting, which has previously advised British American Tobacco on tobacco tracking and tracing initiatives, and Coca Cola.

It is impossible to exhaustively analyze the tobacco industry's complex third-party networks here. However, the website www.TobaccoTactics.org, with help from tobacco advocacy organizations such as ASH, publishes details on third-party links (157, 204, 214-216), so that civil servants, politicians, journalists, and others can learn more about tobacco industry practices and front groups and determine whether particular individuals and organizations may be acting on the tobacco industry's behalf. Through initiatives of this kind, civil society has increased the transparency of policy making and helped Government live up to its obligations under Article 5.3 of the WHO FCTC to protect tobacco policy from the commercial and vested interests of the tobacco industry.(18, 217)

Civil society support for evidence-based policy. In 1993, a pre-budget submission by a group of health organizations called for unique treatment of tobacco because of its health consequences and for a commitment to real increases in tobacco taxes, not just in the forthcoming budget, but for the longer term. In response, in the 1993 Budget, the Government introduced the tobacco tax escalator discussed above, explicitly to reduce smoking prevalence as well as raise revenue.(218) Confronting a large and rapidly growing illicit cigarette market in the 1990s, the UK Government tackled illicit trade by introducing a tough enforcement strategy rather than by cutting taxes.(16) Health organizations provided support for the Government's policy choice, which withstood vigorous lobbying efforts by the tobacco industry.

The Finance Minister, who is responsible for tobacco taxation and illicit trade, meets with the tobacco industry but also with civil society, as do other officials responsible for these policy areas. Representations from advocacy organizations, working with the research community, (163, 219-222) are taken seriously, and their recommendations are often adopted. From 2004 onwards, civil society organizations argued (in particular via ASH budget submissions) that the tax escalator should be reintroduced. In 2009, taxes were again increased above inflation, and the tobacco tax escalator was restored in 2010.

As noted, a diverse body of research examining tobacco industry profitability, pricing, evidence, data, and conduct has been used to refute the industry's misleading arguments and expose its failure to control its supply chain.(11, 58, 72, 73, 122, 153, 154, 164, 189, 223-226) This research has played a key role in enabling tobacco control policies, including high tobacco taxes, to advance. A 2009 cost-benefit analysis of the Illicit Trade Protocol was influential in ensuring that the UK supported its development and committed to ratification.(83, 116)

In 2010/11, civil society argued that, since the illicit market share of handrolled tobacco was declining, the gap between taxation of manufactured cigarettes and the much lower

taxation of handrolled tobacco needed tackling.(227) In the 2011 Budget, taxation on handrolled tobacco was increased above the standard tax escalator of 2% by a further 10%, then rose again in 2016 by an additional 3%. Research brought forth additional evidence on the behavior of the tobacco industry in gaming tax levels and causing a widening price gap between expensive and cheaper products, with implications for inequalities in smoking (11, 228). These findings were used to successfully advocate for the introduction of a Minimum Excise Tax. (220, 229) Following a consultation in 2014, the Minimum Excise Tax was introduced in 2017. (A general election in the intervening period initially delayed its implementation.)(230)

Evidence shows that prices are not a principal driver of illicit tobacco trade in Europe, and that supply-side factors are a more important determinant (189). Civil society has effectively used these findings, along with evidence that the tobacco industry itself remains involved in illicit activity, to persuade the UK government to renew the tobacco tax escalator in the current parliament.(50, 73, 222, 233)

1.7 CASE STUDY METHODOLOGY

This case study has been compiled using documents and data that are in the public domain. A full reference list is provided in Annex I. Fresh North East contributed information on regional partnerships, and HMRC were consulted to ensure the accuracy of information including that presented on fiscal marks and anti-counterfeiting technology.

2. Lessons Learned and What Else Can Be Done to Improve Results

2.1 LESSONS LEARNED

Tobacco taxation and strategies to reduce the illicit trade go hand-in-hand as measures which are intended both to improve public health and protect and increase government revenues. The UK experience underlines that eradicating smuggling is an issue of enforcement. Cutting tobacco taxes is not an effective method of reducing the illicit trade.(58)

The overarching approach should encompass predominantly supply-side measures that aim to tackle the illicit trade at home and overseas. Strategies should aim to disrupt supply and distribution chains, reducing the rewards and increasing the risks and penalties associated with the illicit trade of tobacco. In the case of illicit products that cross borders, an end-to-end approach and collaboration with international fiscal and law enforcement agencies is warranted.

There is a need to identify the size and nature of illicit trade using accurate data that are independent of industry, and to monitor this over time. Setting targets for key indicators can act as a motivator and mechanism for determining success. In the UK, regular monitoring has enabled evaluation of the effectiveness of the national strategy and highlighted emerging challenges; the strategy has been regularly refreshed in response to new threats.

Good governance serves to support the implementation and continued development of the illicit tobacco strategy. In the UK, active implementation of Article 5.3, on the publication of strategies and monitoring data in the public domain, ensures transparency. Reports published by the NAO and PAC have highlighted gaps in the strategy and its enforcement.

Despite efforts to tackle illicit tobacco in general, and tobacco industry illicit in particular, there is extensive evidence that the tobacco industry remains heavily involved in the illicit trade in the UK and funds the production and dissemination of misleading data about the illicit tobacco market. It is essential that measures to control the supply chain be fully enforced. Civil society (both academia and NGOs) plays a key role in providing unbiased evidence, including on industry pricing, profits, and conduct. Civil society voices advocate for stronger and more innovative evidence-based policy measures.

Strong policies on tax and the illicit trade are necessary but not sufficient to reduce smoking prevalence. They should be used as part of a comprehensive set of measures to tackle the burden of tobacco use.

2.2 WHAT ELSE CAN BE DONE?

The UK anti-smuggling strategy has achieved impressive results, but illicit tobacco continues to undermine efforts to reduce tobacco use in the UK, and the revenue losses associated with illicit tobacco remain substantial. Recent increases in the illicit market share of manufactured cigarettes are a particular concern.

When the UK government first introduced its anti-smuggling strategy, targets were set for a reduction in the tobacco market share accounted for by illicit tobacco. These targets committed the government to reduce the illicit market share from 22% in 2001-2 to 13% by 2007-8.^(16, 78, 234) These figures established a clear and transparent benchmark of what success meant, and helped maintain the incentive for agencies to invest resources in this effort. However, these targets expired at the end of 2008. In the 2008 joint HMRC UKBA strategy, no formal targets were set. Reference was made to a partnership agreement that foresaw sustaining the level of the illicit market at the target set for 2007-8, implying that no further progress beyond this level was expected.^(80, 234) The 2011 strategy was likewise vague about outcomes, stating only that the objective was “to achieve further sustainable downwards pressure on the illicit market in cigarettes and HRT through to 2015.”⁽⁸¹⁾

The latest strategy committed to “hold the cigarettes illicit market share at or below 10 per cent” and to “contain the illicit market share for hand-rolling tobacco and reverse the recent upward trend.”⁽⁸³⁾ In recent years, as smoking prevalence has declined significantly, the illicit market has come to represent a larger share of the total market, even though in absolute terms the illicit market has not grown significantly.⁽¹²⁶⁾ Given the joint objectives of public health and finance, to reduce smoking prevalence and minimize revenue losses, it would be more appropriate to define new objectives in terms of cutting revenue losses, rather than reducing the market share of illicit tobacco.

The evidence is clear that tobacco industry illicit remains a significant problem. It is essential to improve control of the illicit supply chain, as stipulated by both the EU Tobacco Products Directive and the Illicit Trade Protocol. Authorities must also ensure that implementation of the ITP remains independent of industry.⁽¹²²⁾ In addition to maintaining and reinforcing existing strategies, policy makers can weigh additional measures that may reignite reductions in the illicit market and halt or reverse the revenue losses associated with illicit trade growth. We will briefly review several of these policy options now.

Detailed Data Collection and Publication

Article 20 of the FCTC sets out requirements in relation to monitoring and surveillance of the tobacco industry. The government collects some data from the industry, but access to these data is currently only allowed if the industry gives its permission, which clearly limits the usefulness of the arrangement. The collection and publication of detailed data on tobacco sales, profits, marketing, and research would, among other benefits, facilitate independent academic analyses of market developments. Such unbiased analyses, in turn, could inform the development of tobacco control and tax policy, aiding the identification and understanding of illicit market trends over time at local level. Publication of the following data in an easy-to-use format are recommended.⁽²²²⁾

At national and international level on an annual basis:

- » Profits
- » Taxes (excise duties and corporation tax)

At national level, on a monthly basis:

- » Brand-specific price and sales data for all products
- » Marketing spend by category
- » Research spend by subject area

At local authority level

- » Sales data by product type for all products

Regional Partnerships

As described above in section 1.2, regional partnerships to reduce the illicit trade in the UK have been successful. Key components of regional activity have included social marketing campaigns to reduce demand, local trading standards teams, and partnership working between local enforcement colleagues and national partners in HMRC.

Despite the NAO's calling for further roll out of such regional partnerships,⁽⁸⁵⁾ the only partnership of this type that is currently functioning is in the North East; other partnerships in the South West and North West have disappeared due to cuts in funding. There is a need for greater encouragement and funding for regions to collaborate across boundaries to tackle the illicit tobacco market.

Effective regional collaboration relies on adequate funding of trading standards staff to protect consumers. Given that the financial benefit from reducing the illicit market and so increasing revenues accrues to central government and to HMRC, it would be appropriate for additional funding to be provided by HMRC, unless and until measures which require tobacco manufacturers to foot these costs are implemented.

Supply Chain Licensing

Better control of the illicit supply chain is essential to reducing illicit trade; a supply chain licensing scheme covering the full tobacco supply chain, including manufacturers, wholesalers, retailers, importers, and exporters, has been recommended by a number of organizations.⁽²²²⁾ A positive licensing scheme – whereby businesses have to demonstrate that they meet the required standards – could help to drive out those involved in the supply of illicit tobacco at all levels of the supply chain, protect the business of legitimate retailers, and help to protect tax revenues. The UK government rejected a positive tobacco licensing scheme for retailers in 2017; however, public support for tobacco retailer licensing is strong, and retailers have also been found to be supportive.^(222, 235)

The license fee would generate a revenue stream to support administration and enforcement. Requiring the tobacco manufacturers to meet the costs of licensing would spare retailers, who make limited profits from selling tobacco, from having to pay more than a small administrative fee. If the cost is passed on to consumers by manufacturers, this should encourage quitting or shifting to less harmful products such as e-cigarettes.

Negative licensing schemes/registration for retailers have been implemented in some parts of the UK; however, this type of legislation does not involve prior assessment of whether retailers are fit to sell tobacco. Furthermore, if there is no license fee, there is no revenue stream to support administration and enforcement.

3. Implications for Other Countries

Many of the lessons just outlined may be relevant to other governments seeking to tackle the problem of illicit tobacco. The overarching approach of focusing on supply-side measures, enlisting the support of all relevant government agencies, and cooperating and collaborating with other countries and international agencies is recommended for all countries. The fundamental components of an illicit tobacco strategy are improved detection and enforcement and stronger penalties for those involved in the illicit tobacco trade.

In most settings, tackling the illicit trade is the responsibility of customs and tax administrators. The oligopolistic nature of the tobacco industry means that some key aspects, such as tax collection and controlling tobacco industry illicit, should be feasible as long as key legislative frameworks are in place and are enforced. Appropriate human resources measures and technologies, supportive judicial systems, and increased collaboration and coordination between customs and enforcement agencies within and between countries have been identified as essential mechanisms for improving agencies' effectiveness in combating illicit trade.⁽²³⁶⁾

Controlling the illicit tobacco trade requires investment in technology – such as x-ray scanners to identify illicit products in cargo – but also significant investment in human resources in the form of intelligence networks and coordination and communication within customs. (236) As the UK case demonstrates, domestic and international activity and collaboration with a range of stakeholders at home and abroad is warranted.

Given the potential for substantial profits from the illicit trade, there is, however, a high risk of corruption in settings with poor governance; several studies have highlighted the association between corruption and the illicit tobacco trade.(236) Government commitment to combating the illicit tobacco trade is essential. Assessing the scale of the problem is a key step in highlighting the potential benefits of investing in a strategy to tackle the illicit tobacco trade. The UK experience demonstrates that the benefits of measures to tackle the illicit trade significantly exceed the costs when implemented effectively.

Policymakers must be aware of the role of the tobacco industry in the illicit tobacco market and its efforts to mislead the public and decision makers regarding the causes, effects, and scale of the illicit trade. Strategies to tackle the illicit trade must be developed and implemented independently from the tobacco industry, in line with Article 5.3 of the FCTC.

Cultural acceptance of the illicit trade may also contribute to the problem.(237) Demand-side activity to inform the public about the criminal nature of illegal trade, the implications of illicit tobacco, and the consequences of being caught engaging in such illegal activities has been shown to be effective in the UK.(102)

Ratification of the ITP is a key step which will place legal obligations on governments to implement national measures that would strengthen control over the supply chain, including through the implementation of tracking and tracing of tobacco products. While significant up-front investment is required, the long-term return on investment in activity to combat the illicit trade, along with increased tobacco taxes, is substantial. All the more so, given that the Protocol recommends cost recovery from the tobacco industry. Governments should seek guidance from other governments and international organizations to ensure that appropriate measures are commissioned, which may in some cases initially require external financial support.

References

1. DH. Smoking Kills. A White Paper on Tobacco. Department of Health. 1998. Available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260754/4177.pdf [Accessed 27 February 2018]. London: Department of Health; 1998.
2. Joossens L, Raw M. The Tobacco Control Scale 2016 in Europe. Association of European Cancer Leagues. 2017. Available from https://www.cancer.be/sites/default/files/tobacco_control_scale.pdf [Accessed 27 February 2018].
3. NICE. NICE guideline [NG92]: Stop smoking interventions and services. National Institute of Health and Care Excellence. 2018. Available from <https://www.nice.org.uk/guidance/ng92> [Accessed 4 May 2018].
4. ONS. Adult smoking habits in the UK: 2016 (Adult Smoking Habits in Great Britain dataset). Office for National Statistics. 2016. Available from <https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/drugusealcoholandsmoking/datasets/adultsmokinghabitsingreatbritain> [Accessed 25 January 2018].
5. NISRA. Continuous Household Survey - Smoking. Northern Ireland Statistics and Research Agency. Available from <https://www.nisra.gov.uk/publications/chs-smoking> [Accessed 15 May 2018].
6. ONS. Adult smoking habits in the UK: 2016 (Smoking habits in the UK and its constituent countries dataset). Office for National Statistics. 2016. Available from <https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/datasets/smokinghabitsintheukanditsconstituentcountries> [Accessed 25 January 2018].
7. Scottish Government. Scottish Schools Adolescent Lifestyle and Substance Use Survey (SALSUS) Smoking Report (2015). Scottish Government. 2016. Available from <http://www.gov.scot/Topics/Research/by-topic/health-community-care/social-research/SALSUS> [Accessed 25 January 2018].
8. Welsh Government. 2013/14 Health Behaviour in School-aged Children (HBSC) Wales: key findings. Welsh Government. 2015. Available from <http://gov.wales/statistics-and-research/health-behaviour-school-aged-children/?lang=en> [Accessed 25 January 2018].
9. PHA. Tobacco Control Northern Ireland. Public Health Agency. 2015. Available from <http://www.publhealthagency.org/sites/default/files/Tobacco%20Control%20Northern%20Ireland%202015.pdf> [Accessed 25 January 2018].
10. HSCIC. Smoking, Drinking and Drug Use Among Young People in England – 2016 (Chapter 2 - smoking prevalence tables). Health and Social Care Information Centre. Available from <https://digital.nhs.uk/data-and-information/publications/statistical/smoking-drinking-and-drug-use-among-young-people-in-england/smoking-drinking-and-drug-use-among-young-people-in-england-2016> [Accessed 4 May 2018].
11. Gilmore A, Tavakoly B, Hiscock R, Taylor G. Smoking patterns in Great Britain: the rise of cheap cigarette brands and roll your own (RYO) tobacco. *Journal of Public Health*. 2015;37(1):78-88.

12. Partos T, Gilmore A, Hitchman S, Hiscock R, Branston R, McNeill A. Availability and Use of Cheap Tobacco in the United Kingdom 2002–2014: Findings From the International Tobacco Control Project. *Nicotine & Tobacco Research*. 2017.
13. ASH. Use of e-cigarettes among adults in Great Britain 2017. Action on Smoking and Health. Available from <http://ash.org.uk/information-and-resources/fact-sheets/use-of-e-cigarettes-among-adults-in-great-britain-2017/> [Accessed 19 April 2018].
14. House of Commons Hansard Debates 30 Nov 1993 vol 233 col 939.
15. PAC. Public Accounts - Third Report. Public Accounts Committee. 2002. Available from <https://publications.parliament.uk/pa/cm200203/cmselect/cmpubacc/143/14302.htm>. [Accessed 4 May 2018].
16. HMRC. Tackling Tobacco Smuggling. HM Revenue and Customs, HM Treasury. 2000.
17. Budget 2009. 2009. Available from http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/bud09_completereport_2520.pdf [Accessed 4 May 2018].
18. DH. Towards a Smokefree Generation: A Tobacco Control Plan for England. Department of Health. July 2017. Available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630217/Towards_a_Smoke_free_Generation_-_A_Tobacco_Control_Plan_for_England_2017-2022__2_.pdf [Accessed 6 February 2018].
19. ASH. Beyond Smoking Kills. Action on Smoking and Health. 2008. Available from <http://ash.org.uk/information-and-resources/reports-submissions/reports/beyond-smoking-kills/> [Accessed 27 February 2018].
20. NHS Digital. Statistics on Smoking, England - 2017. NHS Digital. 2017. Available from <http://digital.nhs.uk/catalogue/PUB24228> [Accessed 26 February 2017].
21. ONS. Time Series: RPI All Items Index: Jan 1987=100. Office for National Statistics. Available from <https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw/mm23> [Accessed 4 May 2018].
22. Budget Statement. 1989. Available from <http://fc95d419f4478b3b6e5f-3f71d0fe2b653c4f-00f32175760e96e7.r87.cf1.rackcdn.com/F57F3276C99F4D109EA20A35AF7FA8A1.pdf> [Accessed 4 May 2018].
23. Budget Statement. 1990. Available from <http://www.johnmajor.co.uk/page2510.html> [Accessed 4 May 2018].
24. Budget Statement. 1991. Available from <http://www.johnmajor.co.uk/page4280.html> [Accessed 4 May 2018].
25. Budget Statement. 1992. Available from <http://www.johnmajor.co.uk/page4281.html> [Accessed 4 May 2018].
26. Spring Budget Statement. 1993. Available from <http://www.johnmajor.co.uk/page4282.html> [Accessed 4 May 2018].
27. Autumn Budget Statement. 1993. Available from <http://www.johnmajor.co.uk/page4283.html> [Accessed 4 May 2018].
28. Budget Statement. 1994. Available from <http://www.johnmajor.co.uk/page4284.html> [Accessed 4 May 2018].

29. Budget Statement. 1995. Available from <http://www.johnmajor.co.uk/page4285.html> [Accessed 4 May 2018].
30. Budget Statement. 1996. Available from <http://www.johnmajor.co.uk/page4286.html> [Accessed 4 May 2018].
31. Budget Statement. 1997. Available from <https://api.parliament.uk/historic-hansard/commons/1997/jul/02/budget-statement> [Accessed 4 May 2018].
32. HMT. Financial Statement and Budget Report March 1998. HM Treasury. 1998. Available from <https://www.gov.uk/government/publications/financial-statement-and-budget-report-march-1998> [Accessed 4 May 2018].
33. HMT. Budget 99. HMT. 1999. Available from <https://www.gov.uk/government/publications/budget-report-march-1999> [Accessed 4 May 2018].
34. HMT. Budget: March 2000. HM Treasury. 2000. Available from <https://www.gov.uk/government/publications/budget-march-2000> [Accessed 4 May 2018].
35. HMT. Budget 2001. HM Treasury. Available from <http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/435.pdf> [Accessed 4 May 2018].
36. Budget 2002. 2002. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/4/1/Budget_2002.pdf [Accessed 4 May 2018].
37. Budget 2003. 2003. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/Budget_2003.pdf [Accessed 4 May 2018].
38. Budget 2004. 2004. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/Budget_2004.pdf [Accessed 4 May 2018].
39. Budget 2005. 2005. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/bud05_completereport_147.pdf [Accessed 4 May 2018].
40. Budget 2006. 2006. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/bud06_completereport_2320.pdf [Accessed 4 May 2018].
41. Budget 2007. 2007. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/bud07_completereport_1757.pdf [Accessed 4 May 2018].
42. Budget 2008. 2008. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/250345/0388.pdf [Accessed 4 May 2018].
43. Budget 2010. 2010. Available from http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/budget2010_complete.pdf [Accessed 4 May 2018].
44. Budget 2011. 2011. Available from <http://webarchive.nationalarchives.gov.uk/20130129110422/http://www.hm-treasury.gov.uk/2011budget.htm> [Accessed 4 May 2018].
45. Budget 2012. 2012. Available from http://webarchive.nationalarchives.gov.uk/20130129110540/http://www.hm-treasury.gov.uk/budget2012_documents.htm [Accessed 4 May 2018].
46. Budget 2013. 2013. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/221885/budget2013_complete.pdf [Accessed 4 May 2018].
47. Budget 2014. 2014. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/293759/37630_Budget_2014_Web_Accessible.pdf [Accessed 4 May 2018].

48. Budget 2015. 2015. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/416330/47881_Budget_2015_Web_Accessible.pdf [Accessed 4 May 2018].
49. Budget 2016. 2016. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/508193/HMT_Budget_2016_Web_Accessible.pdf [Accessed 4 May 2016].
50. HMT. Autumn Budget 2017. HM Treasury. 2017. Available from <https://www.gov.uk/government/publications/autumn-budget-2017-documents/autumn-budget-2017> [Accessed 27 February 2018].
51. ASH. Timeline of tobacco tax increases in the United Kingdom. Action on Smoking and Health. Available from <http://ash.org.uk/information-and-resources/taxation-illicit-trade/taxation/ash-analysis-of-tobacco-tax-increases-in-the-united-kingdom/> [Accessed 4 May 2018].
52. HMRC. Guidance: Tobacco Products Duty. HM Revenue and Customs. 2017. Available from <https://www.gov.uk/guidance/tobacco-products-duty> [Accessed 13 February 2018].
53. European Commission. Excise Duty Tables: Part III - Manufactured Tobacco. 2017. Available from https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf [Accessed 13 February 2018].
54. HMRC. Policy paper: Minimum Excise Tax for Cigarettes. HM Revenue and Customs. Available from <https://www.gov.uk/government/publications/minimum-excise-tax-for-cigarettes/minimum-excise-tax-for-cigarettes> [Accessed 13 February 2018].
55. HMRC. Guidance: Excise Duty - Tobacco Duty Rates. HM Revenue and Customs. November 2017. Available from <https://www.gov.uk/government/publications/rates-and-allowances-excise-duty-to-bacco-duty/excise-duty-tobacco-duty-rates> [Accessed 13 February 2018].
56. HMRC. Guidance: Receiving, storing and moving excise goods. HM Revenue & Customs. Available from <https://www.gov.uk/guidance/receiving-storing-and-moving-excise-goods#storing-excise-goods-in-duty-suspension-in-the-uk> [Accessed 13 February 2017].
57. Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco.
58. Joossens L, Raw M. Turning off the tap: the real solution to cigarette smuggling. *The International Journal of Tuberculosis and Lung Disease*. 2003;7(3):214-22.
59. HMRC. Select Committee on Treasury: Supplementary memorandum submitted by HM Customs & Excise. HM Revenue & Customs. Available from <https://publications.parliament.uk/pa/cm200405/cmselect/cmtreasy/126/126we18.htm> [Accessed 27 February 2018].
60. Clarke, H. Tobacco smugglers roll their own market. *The Independent*. 8 March 1998. Available from <https://www.independent.co.uk/news/business/tobacco-smugglers-roll-their-own-market-1148905.html>. Accessed 15 May 2018. .
61. Blackhurst, C. Bootleg tobacco market booms. *The Independent*. 18 September 1995. Available from <https://www.independent.co.uk/news/uk/bootleg-tobacco-market-booms-1601770.html>. [Accessed 15 May 2018].
62. Jha P, Chaloupka F. *Curbing the Epidemic: Governments and the economics of tobacco control*. Washington: World Bank; 1999.

63. BBC. Cigarette giants in smuggling scandal. 1998. Available from <http://news.bbc.co.uk/1/hi/business/210260.stm> [Accessed 14 February 2018].
64. TMA. Nearly three quarters of UK smokers avoid paying tobacco duties. The Tobacco Manufacturers Association. 2017. Available from <http://the-tma.org.uk/2017/09/27/nearly-three-quarters-of-uk-smokers-avoid-paying-tobacco-duties/> [Accessed 14 January 2018] [press release].
65. Gilmore A, Fooks G, Drope J, Bialous SA, Jackson RR. Exposing and addressing tobacco industry conduct in low-income and middle-income countries. *The Lancet*. 2015;385(9972):1029-43 15.
66. HMRC. Tobacco Factsheet November 2013. HM Revenue & Customs. 2013. Available from <https://www.uktradeinfo.com/Statistics/StatisticalFactsheet/Pages/FactsheetArchive.aspx?viewname=Tobacco%20Duties%20Archive> [Accessed 24 April 2018].
67. US District Court. THE EUROPEAN COMMUNITY, Plaintiff, v. RJR NABISCO, INC., et al., Defendants. DEPARTMENT OF AMAZONAS, et al., Plaintiffs, v. PHILIP MORRIS COMPANIES, INC., et al., Defendants. New York: United States District Court, Eastern District of New York. 16 July 2001. Available from: <http://uniset.ca/other/cs6/150FSupp2d456.html> [Accessed 27 February 2018].
68. US District Court. European Community complaint against Philip Morris, RJ Reynolds and Japan Tobacco. New York: United States District Court, Eastern District of New York 03 Nov 2000.
69. Garaufis J, Pohorelsky M. The European Community (plaintiffs) against RJR Nabisco Inc, RJ Reynolds Tobacco Company, RJ Reynolds Tobacco International Inc., RJR Acquisition Corp, Nabisco Group Holdings Corp., RJR Nabisco Holdings Corp., RJ Reynolds Tobacco Holdings Inc. (defendants). United States District Court Eastern District of New York; 2002 30 October 2002.
70. JUSTIA US Law. U.S. Court of Appeals for the Second Circuit - 355 F.3d 123 (2d Cir. 2004). Argued: January 29, 2003. Decided: January 14, 2004 2017. Available from <https://law.justia.com/cases/federal/appellate-courts/F3/355/123/500439/> [Accessed 27 February 2018].
71. Hache T. Tobacco-Related Litigation in Canada. March 2010. Available from http://nsra-adnf.ca/wp-content/uploads/2016/07/Tobacco-related_Litigation_in_Canada_2010.pdf [Accessed 27 February 2018].
72. Joossens L, Gilmore A, Stoklosa M, Ross H. Assessment of the European Union's illicit trade agreements with the four major Transnational Tobacco Companies. *Tobacco Control*. 2016;25(3):254-60.
73. Gilmore AB, Rowell A, Gallus S, Lugo A, Joossens L, Sims M. Towards a greater understanding of the illicit tobacco trade in Europe: a review of the PMI funded 'Project Star' report. *Tobacco Control*. 2014;23(E1):E51-E61.
74. ITP. What is illicit tobacco? Illicit Tobacco Partnership. Available from <https://www.illicit-tobacco.co.uk/problem/illicit-tobacco/> [Accessed 4 May 2018].
75. European Parliament. Parliamentary questions: Answer given by Mr Šemeta on behalf of the Commission. 9 February 2011. Available from <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2010-011191&language=EN> [Accessed 27 February 2018].
76. House of Commons, Committee of Public Accounts. Third report: tobacco and smuggling. London: Houses of Parliament; 2003 2003.
77. HMRC. Measuring Indirect Tax Losses – 2005. HM Revenue and Customs. 2005.

78. HMT and HMRC. New responses to new challenges: Reinforcing the Tackling Tobacco Smuggling Strategy. HM Treasury and HM Revenue & Customs. 2006.
79. HMRC. Excise Notice 477: tobacco products duty - control of supply chains. HM Revenue & Customs. 2014. Available from <https://www.gov.uk/government/publications/vat-notice-477-tobacco-products-duty-control-of-supply-chains/vat-notice-477-tobacco-products-duty-control-of-supply-chains> [Accessed 14 January 2018].
80. HMRC and UKBA. Tackling Tobacco Smuggling Together. HM Revenue & Customs and UK Border Agency. 2008. .
81. HMRC & UKBA. Tackling Tobacco Smuggling - building on our success. HM Revenue and Customers and UK Border Agency. 2011. Available from <https://www.gov.uk/government/publications/tackling-tobacco-smuggling-building-on-our-success> [Accessed 26 January 2018].
82. HMRC. Tax information and Impact Note: Reducing the Minimum Indicative Levels for Tobacco Products. HM Revenue & Customs. Available from <http://webarchive.nationalarchives.gov.uk/20130606003850/http://www.hmrc.gov.uk/thelibrary/tobacco-products.pdf> [Accessed 4 May 2018].
83. HMRC. Tackling illicit tobacco: From leaf to light. HM Revenue and Customs. 2015. Available from <https://www.gov.uk/government/publications/tackling-illicit-tobacco-from-leaf-to-light> [Accessed 26 January 2018].
84. HMRC. Measuring tax gaps 2017 edition. HM Revenue and Customs. 2017. Available from <https://www.gov.uk/government/statistics/measuring-tax-gaps> [Accessed 26 January 2018].
85. NAO. Progress in Tackling Tobacco Smuggling. National Audit Office. 2013. Available from <https://www.nao.org.uk/wp-content/uploads/2013/06/10120-001-Tobacco-smuggling-Full-report.pdf> [Accessed 6 February 2018].
86. The Standardised Packaging of Tobacco Products Regulations 2015. 2015.
87. No.507 The Tobacco and Related Products Regulations 2016. 2016.
88. HMRC. Excise Notice 2003: Tobacco Duty - the Raw Tobacco Approval Scheme. HM Revenue & Customs. 2016. Available from <https://www.gov.uk/government/publications/excise-notice-2003-tobacco-duty-the-raw-tobacco-approval-scheme/excise-notice-2003-tobacco-duty-the-raw-tobacco-approval-scheme> [Accessed 25 April 2018].
89. HMRC. Excise Notice 2004: Tobacco Duty - Tobacco Products Manufacturing Machine Licensing Scheme. HM Revenue & Customs. 2018. Available from <https://www.gov.uk/government/publications/excise-notice-2004-tobacco-duty-tobacco-products-manufacturing-machine-licensing-scheme/excise-notice-2004-tobacco-duty-tobacco-products-manufacturing-machine-licensing-scheme> [Accessed 25 April 2018].
90. EC. Excise Movement and Control System. European Commission. Available from https://ec.europa.eu/taxation_customs/business/excise-duties-alcohol-tobacco-energy/excise-movement-control-system_en [Accessed 25 April 2018].
91. HMRC. VAT: overseas business selling goods in the UK. HM Revenue and Customs. 2014. Available from <https://www.gov.uk/guidance/vat-what-to-do-if-youre-an-overseas-business-selling-goods-in-the-uk> [Accessed 19 April 2018].

92. Border Force. Travelling to the UK: What you can bring in, what you can't bring in, what you must declare. Border Force. 2017. Available from <https://www.gov.uk/government/publications/travelling-to-the-uk> [Accessed 18 April 2018].
93. Seely, A. Personal imports of duty-paid goods. House of Commons Library. 2013. Available from <http://researchbriefings.files.parliament.uk/documents/SN01223/SN01223.pdf> [Accessed 19 April 2018].
94. Bringing goods into the UK. Available from <https://www.gov.uk/duty-free-goods/arrivals-from-eu-countries> [Accessed 27 February 2018].
95. Bringing goods into the UK. Available from <https://www.gov.uk/duty-free-goods/arrivals-from-outside-the-eu> [Accessed 27 February 2018].
96. Directive 2014/40/EU of the European Parliament and the Council on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC.
97. HMRC. The Introduction of Standardised Packaging for Tobacco: HMRC's Assessment of the Potential Impact on the Illicit Market. 15 August 2014. Available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/403495/HMRC_impact_report.pdf [Accessed 27 February 2018].
98. DH. Tobacco Packaging Guidance. Department of Health. 2017. Available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/596139/Tobacco_Packaging_Guidance.pdf [Accessed 13 February 2018].
99. ASH. UK Tobacco Control Policy and Expenditure: An overview. Action on Smoking and Health. 2016. <http://ash.org.uk/information-and-resources/briefings/uk-tobacco-control-policy-and-expenditure-an-overview/> [Accessed 18 February 2018].
100. CTSI. Chartered Trading Standards Institute Workforce Survey. Chartered Trading Standards Institute. 2016. Available from <https://www.tradingstandards.uk/media/documents/policy/strategy/ctsi-workforce-survey-2016.pdf> [Accessed 18 February 2018].
101. ITP. Illicit Tobacco Programme Strategic Framework. Illicit Tobacco Partnership. Available from <https://www.illicit-tobacco.co.uk/wp-content/uploads/2017/07/Illicit-Tobacco-Programme-Strategic-Framework.pdf> [Accessed 18 February 2018] [
102. UKCTCS & FUSE. Tackling Illicit Tobacco for Better Health: Final Evaluation Report Executive Summary. UK Centre for Tobacco Control Studies & FUSE. https://www.newcastle.gov.uk/sites/default/files/wwwfileroot/business/trading_standards/illicit_tobacco_evaluation1.pdf [Accessed 18 February 2018].
103. HMRC. Measuring Tax Gaps. HM Revenue and Customs. Available from <https://www.gov.uk/government/statistics/measuring-tax-gaps> [Accessed 27 February 2018].
104. HMRC. Tobacco Bulletin. HM Revenue & Customs. Available from <https://www.gov.uk/government/statistics/tobacco-bulletin> [Accessed 27 February 2018].
105. HMRC. Tobacco Strategy Outputs Delivered. HM Revenue & Customs. Available from <https://www.gov.uk/government/publications/tackling-tobacco-smuggling-2013-to-2014-outputs/quarter-3-and-4-outputs-october-2015-to-march-2016#tobacco-strategy-outputs-delivered> [Accessed 20 February 2018].

106. PAC. HM Revenue & Customs: Progress in tackling tobacco smuggling - Twenty-third report of session 2013-14. House of Commons Committee of Public Accounts. 2013. Available from <https://publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/297/297.pdf> [Accessed 7 February 2018].
107. HAC. Home Affairs Committee - First Report:Tobacco smuggling. 2014. Available from <https://publications.parliament.uk/pa/cm201415/cmselect/cmhaff/200/20002.htm> [Accessed 20 February 2018].
108. Health - Second Report. Health Select Committee. 2000. Available from <https://publications.parliament.uk/pa/cm199900/cmselect/cmhealth/27/2702.htm> [Accessed 20 February 2018].
109. WHO. Guidelines for implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control . World Health Organization. Available from http://www.who.int/fctc/guidelines/article_5_3.pdf [Accessed 27 February 2018].
110. Health - Minutes of Evidence. Session 1999-2000. 2000. Available from <https://publications.parliament.uk/pa/cm199900/cmselect/cmhealth/27/0021601.htm> [Accessed 20 February 2018].
111. Healthy lives, healthy people: a tobacco control plan for England. HM Government. 2011. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/213757/dh_124960.pdf [Accessed 4 May 2018]. Department of Health; 2011.
112. Questions and Answers on: Fighting the illicit trade of tobacco products. European Commission. 2015. Available from https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/q_and_a_en.pdf [Accessed 18 February 2018].
113. European Commission and JT International (Japan Tobacco) sign 15-year Agreement to combat contraband and counterfeit cigarettes. European Commission Press Release. 2007. Available from http://europa.eu/rapid/press-release_IP-07-1927_en.htm [Accessed 28 February 2018].
114. European Commission and British American Tobacco sign agreement to combat illicit trade in tobacco. European Commission Press Release. 2010. Available from http://europa.eu/rapid/press-release_IP-10-951_en.htm [Accessed 19 February 2018].
115. All EU Member States now signatories to the agreements to combat illicit trade in tobacco products. European Commission Press Release. 2009. Available from http://europa.eu/rapid/press-release_IP-09-610_en.htm?locale=en [Accessed 18 February 2018].
116. Johnson P. Cost Benefit Analysis of the FCTC Protocol on Illicit Trade in Tobacco Products. Action on Smoking and Health. 2009. Available from <http://ash.org.uk/information-and-resources/reports-submissions/reports/cost-benefit-analysis-of-the-fctc-protocol-on-illicit-trade-in-tobacco-products/> [Accessed 19 February 2018].
117. Excise Notice 476: Tobacco Products Duty. Available from: <https://www.gov.uk/government/publications/excise-notice-476-tobacco-products-duty/excise-notice-476-tobacco-products-duty> [Accessed 6 February 2018].
118. FCA. Technology and the Fight against Illicit Tobacco Trade. Framework Convention Alliance. Available from http://www.fctc.org/images/stories/2008/INB-2_Media%20briefing_Technology_and_Illicit_Trade.pdf [Accessed 18 February 2018].
119. TMA. Track & Trace and Security Features. Tobacco Manufacturers Association. Available from <http://the-tma.org.uk/policy-legislation/tobacco-products-directive/track-trace-security-features> [Accessed 18 February 2018].

120. HM Treasury. Tobacco: Smuggling: Written question - 31258. Answered by Damian Hinds. 23 March 2016. Available from <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2016-03-15/31258/> [Accessed 4 May 2018].
121. Joossens L, Gilmore A. The transnational tobacco companies' strategy to promote Codentify, their inadequate tracking and tracing standard. *Tobacco Control*. 2014;23:e3-e6.
122. Gilmore A, Gallagher A, Rowell A. The tobacco industry's elaborate attempts to control a global track and trace system and fundamentally undermine the Illicit Trade Protocol. *Tobacco Control* (In press). 2018.
123. Protocol to eliminate illicit trade in tobacco products. 2013. Available from http://apps.who.int/iris/bitstream/handle/10665/80873/9789241505246_eng.pdf;jsessionid=3C166C0E362E-A8AF1B42FFE65B6231AB?sequence=1 [Accessed 15 May 2018].
124. HMRC. Measuring tax gaps 2017 edition: Methodological annex. HM Revenue & Customs. Available from <https://www.gov.uk/government/statistics/measuring-tax-gaps> [Accessed 26 January 2018].
125. HMRC. Tobacco tax gap tables. HM Revenue & Customs. Available from <https://www.gov.uk/government/statistics/tobacco-tax-gap-estimates> [Accessed 19 February 2018].
126. ASH. Tobacco Tax Gaps: Illicit cigarettes as a growing proportion of a declining market - enforcement funding cuts must be addressed [Press release]. Action on Smoking and Health. 2017. Available from <http://ash.org.uk/media-and-news/press-releases-media-and-news/tobacco-tax-gaps-illicit-cigarettes-a-growing-proportion-of-a-declining-market-enforcement-funding-cuts-must-be-addressed/> [Accessed 26 January 2018].
127. MacGregor J. Operation Henry 2 "OH2": A coordinated operation to tackle the supply of illicit tobacco in England. Commissioned by the Department of Health Tobacco Policy Team. London: Chartered Trading Standards Institute. August 2016. Available from: <https://www.tradingstandards.uk/media/documents/news--policy/tobacco-control/oh2-final-version-august-15.compressedamended.pdf> [Accessed 27 February 2018].
128. MacGregor J. Operation Henry: Tackling the supply of illicit tobacco products in England 2014. Commissioned by the Department of Health Tobacco Policy Team London: Chartered Trading Standards. 2014. Available from https://www.tradingstandards.uk/media/documents/policy/improving-the-health-of-society/oh_final_for_publication-1.pdf [Accessed 27 February 2018].
129. Mynewsdesk Press Releases. Available from <http://www.mynewsdesk.com/uk/hm-revenue-customs-hmrc/pressreleases/tag/cigarettes#filter-list-items> [Accessed 11 May 2018].
130. European Commission. Cooperation Agreement between British American Tobacco (Holdings) Limited and The European Union as represented by the European Commission and The Signatory Member States of the European Union. 15 July 2010. Available from https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/bat_main_agreement.pdf [Accessed 27 February 2018].
131. European Commission. Co-operation Agreement dated as of 27 September 2010 among Imperial Tobacco Limited and The European Union Represented by the European Commission and Each Member State Listed on the Signature Pages Hereto. 27 September 2010. Available from https://ec.europa.eu/anti-fraud/investigations/eu-revenue/imperial_tobacco_en [Accessed 27 February 2018].
132. European Commission. JT International SA, JT International Holding BV and the European Community and the participating Member States. Brussels: European Union; 2007.

133. European Commission. Anti-contraband and anti-counterfeit agreement and general release dated as of July 9, 2004 among Philip Morris International Inc., Philip Morris Products Inc., Philip Morris Duty Free Inc., and Philip Morris World Trade SARL, The European Community Represented by the European Commission and Each Member State Listed on the Signature Pages Hereto. 9 July 2004. Available from https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/agreement_2004.pdf [Accessed 27 February 2018].
134. KPMG, Royal United Services Institute. Project Sun: A Study of the Illicit Cigarette Market in the European Union, Norway and Switzerland, 2016 Results. 2017. Available from <https://rusi.org/publication/other-publications/project-sun-study-illicit-cigarette-market-european-union-norway-and> [Accessed 27 February 2018].
135. KPMG. Project Sun: A study of the illicit market in the European Union, Norway and Switzerland, 2015 Results. 2016. Available from <https://home.kpmg.com/uk/en/home/insights/2016/05/project-sun.html> [Accessed 27 February 2018].
136. KPMG. Project Sun: A study of the illicit cigarette market in the European Union, Norway and Switzerland, 2014 Results. 2015. Available from: http://kpmg.co.uk/creategraphics/2015/06_2015/CRT026736/files/assets/basic-html/index.html#1 [Accessed 27 February 2018].
137. KPMG. Project Sun: A study of the illicit cigarette market in the European Union, 2013 Results. 2014. Available from <https://www.pmi.com/resources/docs/default-source/pmi-sustainability/sun-report-2013.pdf?sfvrsn=0> [Accessed 27 February 2018].
138. KPMG. Project Star 2012: Presentation of results: KPMG LLP. 2 July 2013. Available from <https://www.asktheeu.org/en/request/2181/response/8322/attach/7/Annex%20%202013%20PMI%20annual%20meeting%20Project%20Star%202012%20presentation.pdf> [Accessed 27 February 2018].
139. KPMG. Project Star - 2011 Results. London: KPMG LLP. 19 June 2012. Available from https://www.pmi.com/resources/docs/default-source/pmi-sustainability/star-report-2011.pdf?sfvrsn=3f02b0b5_0 [Accessed 27 February 2018].
140. KPMG. Project Star - 2010 Results. 22 August 2011. Available from https://www.pmi.com/resources/docs/default-source/pmi-sustainability/star-report-2010.pdf?sfvrsn=1f02b0b5_0 [Accessed 27 February 2018].
141. World Customs Organization. Illicit Trade Report 2015. 2016. Available from https://illicittrade.com/reports/downloads/OMD_ITR_Complete_LR_2016_12_04.pdf [Accessed 27 February 2018].
142. Holland J, Jovanovic B, Dojcinovic S. Big trouble at Big Tobacco: Organized Crime and Corruption Reporting Project (OCCRP). 2011. Available from: http://www.reportingproject.net/troubles_with_big_tobacco/ [Accessed 27 February 2018].
143. Lavrov V. Ukraine's 'Lost' Cigarettes Flood Europe: Big tobacco's overproduction fuels \$2 billion black market: International Consortium of Investigative Journalists. 30 May 2009. Available from <https://www.icij.org/investigations/tobacco-underground/ukraines-lost-cigarettes-flood-europe/> [Accessed 27 February 2018].
144. Skařida V, Silver KE, Recheł BPD, Gilmore AB. Change in tobacco excise policy in Bulgaria: the role of tobacco industry lobbying and smuggling. Tobacco Control. 2014;23:e-75-e84.
145. PAC. HM Revenue & Customs: Progress in tackling tobacco smuggling - Twenty-third report of session 2013-14. House of Commons Committee of Public Accounts. 2013. Available from <https://>

publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/297/297.pdf [Accessed 7 February 2018].

146. First-Tier Tribunal Tax Chamber. TC05659: Appeal number: TC/2014/05060. 14 February 2017. Available from <http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j9633/TC05659.pdf> [Accessed 27 February 2018].
147. Monckton Chambers. British-American Tobacco Ltd v HMRC. First-tier Tribunal (Tax Chamber). 14 February 2017; [2017] UKFTT 167 (TC): Tribunal clarifies tobacco manufacturers' anti-smuggling duties. 7 March 2017. Available from <https://www.monckton.com/british-american-tobacco-ltd-v-hmrc-first-tier-tribunal-tax-chamber-14-february-2017-2017-uk-ftt-167-tc-tribunal-clarifies-tobacco-manufacturers-anti-smuggling-duties/> [Accessed 27 February 2018].
148. British American Tobacco. Social performance: Society. Undated. Available from http://www.bat.com/group/sites/UK__9UANCV.nsf/vwPagesWebLive/DO9USUXV [Accessed 27 February 2018].
149. Maguire K, Campbell D. Tobacco giant implicated in global smuggling schemes. *The Guardian*. 2000.
150. Imperial profits from smuggling – ASH calls for an inquiry. ASH Press Release. 2002. Available from <http://ash.org.uk/media-and-news/press-releases-media-and-news/imperial-profits-from-smuggling-ash-calls-for-an-inquiry/> [Accessed 20 February 2018].
151. Twenty First Report. Select Committee on Public Accounts. 2003. Available from <https://publications.parliament.uk/pa/cm200203/cmselect/cmpubacc/398/39802.htm> [Accessed 20 February 2018].
152. Japan Tobacco International. The billion pound drop - The impact of tobacco smuggling and cross-border shopping in the UK. October 2012.
153. Gilmore AB, Reed H. The truth about cigarette price increases in Britain. *Tobacco Control*. 2014;23(E1):e15-e6.
154. Rowell A, Evans-Reeves K, Gilmore AB. Tobacco industry manipulation of data on and press coverage of the illicit tobacco trade in the UK. *Tobacco Control*. 2014;23:e35-e43.
155. Stoklosa M, Ross H. Contrasting academic and tobacco industry estimates of illicit cigarette trade: evidence from Warsaw, Poland. *Tobacco Control*. 2014;23:e30-e4.
156. British American Tobacco. Illegal tobacco trade: a growing black market. Undated. Available from <http://www.bat.com/theman#> [Accessed 27 February 2018].
157. Tobacco Control Research Group. Scotland Plain Packaging: Scaremongering over Illicit Tobacco. University of Bath. 12 March 2017. Available from http://www.tobaccotactics.org/index.php/Scotland_Plain_Packaging:_Scaremongering_over_Illicit_Tobacco [Accessed 27 February 2018].
158. Deloitte. Illicit trade of tobacco in Australia. A report prepared for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited. February 2011. Available from <http://www.webcitation.org/69THNRS81> [Accessed 27 February 2017].
159. KPMG. Illicit tobacco in Australia: 2014 full year report. 30 March 2015. Available from <http://www.webcitation.org/6mv3eTWBV> [Accessed 27 February 2018].
160. KPMG. Illicit tobacco in Australia: 2013 full year report. 2 April 2014. Available from <http://www.webcitation.org/6mv3yrKLs> [Accessed 27 February 2018].

161. Pricewaterhouse Coopers. Australia's illegal tobacco market: counting the cost of Australia's black market. Sydney. February 2010. Available from [http://www.bata.com.au/group/sites/bat_9rnflh.nsf/vwPagesWebLive/DOA3CLZ5/\\$FILE/medMD82D43K.pdf?openelement](http://www.bata.com.au/group/sites/bat_9rnflh.nsf/vwPagesWebLive/DOA3CLZ5/$FILE/medMD82D43K.pdf?openelement) [Accessed 27 February 2018].
162. Tobacco Control Research Group. University of Bath. Roger Bate. 1 June 2012. Available from http://www.tobaccotactics.org/index.php/Roger_Bate [Accessed 27 February 2018].
163. UKCTAS, ASH. 2015 Budget submission to the Chancellor of the Exchequer. 2015. Available from <http://ash.org.uk/information-and-resources/reports-submissions/submissions/ash-tobacco-tax-in-the-march-2015-budget/> [Accessed 27 February 2018].
164. Evans-Reeves KA, Hatchard JL, Gilmore AB. 'It will harm business and increase illicit trade': an evaluation of the relevance, quality and transparency of evidence submitted by transnational tobacco companies to the UK consultation on standardised packaging 2012. *Tobacco Control*. 2015;24:e168-e77.
165. Ross H. Understanding and measuring cigarette tax avoidance and evasion: a methodological guide. 2015. Available from <https://tobacconomics.org/research/understanding-and-measuring-cigarette-tax-avoidance-and-evasion-a-methodological-guide/> [Accessed 27 February 2018].
166. Ross H. A Critique of the ITIC/OE Asia-14 Illicit Tobacco Indicator 2013. 2015. Available from https://seatca.org/dmdocuments/Asia%2014%20Critique_Final_20May2015.pdf [Accessed 27 February 2018].
167. Scollo M, Bayly M, Wakefield M. Availability of illicit tobacco in small retail outlets before and after the implementation of Australian plain packaging legislation. *Tobacco Control*. 2015;24(E1):E45-E51.
168. Scollo M, Zacher M, Coomber K, Wakefield M. Use of illicit tobacco following introduction of standardised packaging of tobacco products in Australia: Results from a national cross-sectional survey. *Tobacco Control*. 2015;24:ii76-ii81.
169. Scollo M, Zacher M, Durkin S, Wakefield M. Early evidence about the predicted unintended consequences of standardised packaging of tobacco products in Australia: a cross-sectional study of the place of purchase, regular brands and use of illicit tobacco. *BMJ open*. 2014;4(8):e005873-e.
170. Stoklosa M. Is the illicit cigarette market really growing? The tobacco industry's misleading math trick. *Tobacco Control*. 2016;25(3):360-NIL_147.
171. van Walbeek C. Measuring changes in the illicit cigarette market using government revenue data: the example of South Africa. *Tobacco Control*. 2014;23(E1):E69-E74.
172. Quit Victoria, Cancer Council Victoria. Illicit trade of tobacco in Australia. A report prepared by Deloitte for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited. A critique prepared by Quit Victoria, Cancer Council Victoria. March 2011 (updated 18 Nov 2011). Available from http://www.cancervic.org.au/downloads/mini_sites/Plain-facts/CommtsDeloitte18.11.11.pdf [Accessed 27 February 2018].
173. Quit Victoria. Illicit trade of tobacco in Australia. A report prepared by Deloitte for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited: A critique prepared by Quit Victoria, May 2012. 2012. Available from https://www.cancervic.org.au/downloads/plainfacts/CritiqueDeloitte_May_2012_Update_.pdf [Accessed 27 February 2018].
174. Cancer Council Victoria. How big a problem is illicit tobacco and has it increased since the introduction of plain packaging in Australia - a critique of the KPMG October 2014 half-year report

on illicit tobacco in Australia and compilation of data from ACBPS seizures and data from survey of smokers and retail audits. 25 November 2014 (updated Feb/Mar 2015). Available from http://www.cancervic.org.au/downloads/plainfacts/Nov14critique_of_KPMG13Oct2014_HlfYr_0215.pdf [Accessed 27 February 2018].

175. Cancer Council Victoria. Analysis of KPMG LLP report on use of illicit tobacco in Australia 2013 Full year report. 11 November 2014 (updated March 2014). Available from http://www.cancervic.org.au/downloads/mini_sites/Plain-facts/analysis-kpmg-llp-report-illicit-tobacco-aust-2013.pdf [Accessed 27 February 2018].
176. Cancer Council Victoria. Analysis of KPMG LLP, illicit tobacco in Australia: 2014 Full Year Report, 30th March 2015. 2015. Available from https://www.cancervic.org.au/downloads/plainfacts/Analysis_IllicitAusKPMG_full_year_2014_29May15.pdf [Accessed 27 February 2018].
177. Cancer Council Victoria. Plain packaging of tobacco products: a review of the evidence. 2011. Available from https://www.cancer.org.au/content/pdf/CancerControlPolicy/PositionStatements/TCUCCVBkgrndResrchPlainPak270511ReEnd_FINAL_May27.pdf [Accessed 27 February 2018].
178. Cancer Council Victoria. Comments on survey of Australian retailers views about plain packaging. Undated. Available from http://www.cancervic.org.au/downloads/plainfacts/CCV_Critique_PMLSurvey280714.pdf [Accessed 27 February 2018].
179. Cancer Council Victoria. Questions and answers on plain packaging in Australia, Facts sheet no. 3: What has happened to use of illicit tobacco since the introduction of legislation to standardise the packaging of tobacco products in Australia? 2015. Available from http://tobacco.cleartheair.org.hk/wp-content/uploads/2015/11/Facts_Sheet_no_1_Impact_PP_legis_16062015.pdf [Accessed 27 February 2018].
180. Scollo, MM, Winstanley, MH [editors]. Tobacco in Australia: Facts and Issues. Third Edition. Melbourne: Cancer Council Victoria; 2008. Available from http://s3.amazonaws.com/zanran_storage/www.tobaccoinaustralia.org.au/ContentPages/2477825652.pdf [Accessed 27 February 2018].
181. NZIER. Review of Ernst & Young's Report on New Zealand's Illicit Tobacco Market: A Report for ASH New Zealand. 2010.
182. Clarke H, Prentice D. Will plain packaging reduce cigarette consumption? Economic Papers: A journal of applied economics and policy. 2012;31(3):303-17.
183. Ciecierski C. The Market for Legal and Illegal Cigarettes in Poland: A Closer Look at Demand and Supply-Side Characteristics. 2007. Available from https://assets.publishing.service.gov.uk/media/57a08c0c40f0b64974000f72/Grant_223_Smuggling_in_PL_Manuscrip.pdf [Accessed 27 February 2018].
184. Chapman S, Freeman, B. Removing the emperor's clothes: Australia and tobacco plain packaging. 2014. Sydney University Press. Available from https://ses.library.usyd.edu.au/bitstream/2123/12257/7/9781743324295_Chapman_RemovingtheEmperorsClothes_FT.pdf [Accessed 27 February 2018].
185. Blecher E. A mountain or a molehill: Is the illicit trade in cigarettes undermining tobacco control policy in South Africa? Trends in Organized Crime. 2010;13(4):299-315.
186. Chen J, McGhee SM, Townsend J, Lam TH, Hedley AJ. Did the tobacco industry inflate estimates of illicit cigarette consumption in Asia? An empirical analysis. Tobacco Control. 2015;24(E2):E161-E7.

187. Fooks G, Peeters S, Evans-Reeves K. Illicit trade, tobacco industry-funded studies and policy influence in the EU and UK. *Tobacco Control*. 2014;23:81-3.
188. South East Asia Tobacco Control Alliance. Asia-11 Illicit Tobacco Indicator 2012. More myth than fact. A critique by SEATCA. June 2014 [updated September]. Available from http://seatca.org/dmdocuments/ITIC%20report_More%20Myth%20than%20Fact_2%20July%202014.pdf [Accessed 27 February 2018].
189. Joossens L, Lugo A, La Vecchia C, Gilmore AB, Clancy L, Gallus S. Illicit cigarettes and hand-rolled tobacco in 18 European countries: a cross-sectional survey. *Tobacco Control*. 2014;23(E1):E17-E23.
190. ASH. Illicit tobacco: monitoring and mitigating risk in New Zealand. 2010.
191. Joossens L, Gilmore AB, Stoklosa M, Ross H. Assessment of the European Union's illicit trade agreements with the four major Transnational Tobacco Companies. *Tobacco Control*. 2016;25(3):254-60.
192. Gallagher A, Evans-Reeves K, Hatchard J, Gilmore A. Tobacco industry data on illicit tobacco trade: A systematic review of existing assessments. *Tobacco Control*. 2018 (in press).
193. Joossens L. Smuggling, the tobacco industry, and plain packs. *Cancer Research UK*. 2012. Available from https://www.cancerresearchuk.org/sites/default/files/smuggling_fullreport.pdf [Accessed 27 February 2018].
194. Hammond D. Standardized packaging of tobacco products: Evidence review. March 2014. Available from <http://davidhammond.ca/wp-content/uploads/2014/12/2014-Ireland-Plain-Pack-Main-Report-Final-Report-March-26.pdf> [Accessed 27 February 2018].
195. Chantler C. Standardised packaging of tobacco: Report of the independent review undertaken by Cyril Chantler. 2014.
196. Department of Health. Standardised packaging of tobacco products: Impact Assessment. 10 February 2015. Available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/403493/Impact_assessment.pdf [Accessed 27 February 2018].
197. Luke A. Undercover investigators highlight illicit tobacco trade in Gateshead. 13 April 2015. Available from <http://www.chroniclive.co.uk/news/north-east-news/undercover-investigators-highlight-illicit-tobacco-9028255> [Accessed 27 February 2018].
198. Tobacco Control Research Group. University of Bath. Will O'Reilly. 27 February 2017. Available from http://www.tobaccotactics.org/index.php/Will_O%2780%99Reilly [Accessed 27 February 2018].
199. Evans-Reeves KA, Hatchard JH, Rowell A, Gilmore AB. Content analysis of tobacco industry data on the illicit tobacco trade in UK newspapers during the standardised packaging debate. *The Lancet*. 2016;388(supplement 2):S6.
200. Tobacco Control Research Group. University of Bath. Third Party Techniques. 27 February 2017. Available from http://tobaccotactics.org/index.php/Third_Party_Techniques [Accessed 27 February 2018].
201. Tobacco Control Research Group. University of Bath. The Common Sense Alliance. 5 October 2016. Available from http://www.tobaccotactics.org/index.php/The_Common_Sense_Alliance [Accessed 27 February 2018].
202. Imperial Tobacco Canada. CORA AIT Strategy: Raising Public Awareness & Demanding Government Action. August 2012.

203. Tobacco Control Research Group. University of Bath. Roy Ramm. 22 August 2016. Available from http://www.tobaccotactics.org/index.php/Roy_Ramm [Accessed 27 February 2018].
204. Tobacco Control Research Group. University of Bath. Mark Littlewood. 2 January 2018. Available from http://www.tobaccotactics.org/index.php?title=Mark_Littlewood [Accessed 27 February 2018].
205. Tobacco Control Research Group. University of Bath. Christopher Snowdon. 2 January 2018. Available from http://www.tobaccotactics.org/index.php?title=Christopher_Snowdon [Accessed 27 February 2018].
206. Tobacco Control Research Group. University of Bath. National Federation of Retail Newsagents . 27 February 2017. Available from http://www.tobaccotactics.org/index.php?title=National_Federation_of_Retail_Newsagents [Accessed 27 February 2018].
207. Tobacco Control Research Group. University of Bath. Oxford Economics . 9 August 2017. Available from http://www.tobaccotactics.org/index.php?title=Oxford_Economics [Accessed 27 February 2018].
208. Tobacco Control Research Group. University of Bath. Transcrime . 19 May 2016. Available from <http://www.tobaccotactics.org/index.php?title=Transcrime> [Accessed 27 February 2018].
209. Tobacco Control Research Group. University of Bath. International Tax and Investment Center . 12 July 2017. Available from http://www.tobaccotactics.org/index.php?title=International_Tax_and_Investment_Center [Accessed 27 February 2018].
210. Tobacco Control Research Group. University of Bath. Institute of Economic Affairs . 18 October 2017. Available from http://www.tobaccotactics.org/index.php?title=Institute_of_Economic_Affairs [Accessed 27 February 2018].
211. Tobacco Control Research Group. University of Bath. Adam Smith Institute . 27 July 2017. Available from http://www.tobaccotactics.org/index.php?title=Adam_Smith_Institute [Accessed 27 February 2018].
212. Register Of All-Party Parliamentary Groups: All-Party Parliamentary Group on Illicit Trade. Available from <https://publications.parliament.uk/pa/cm/cmllparty/170928/Illicit-trade.htm> [Accessed 26 April 2018].
213. Tobacco Control Research Group. All-Party Parliamentary Group on Illicit Trade . University of Bath. 22 January 2018. Available from [http://www.tobaccotactics.org/index.php?title=All-Party_Parliamentary_Group_\(APPG\)_on_illicit_trade](http://www.tobaccotactics.org/index.php?title=All-Party_Parliamentary_Group_(APPG)_on_illicit_trade) [Accessed 4 May 2018].
214. Tobacco Control Research Group. University of Bath. Eamonn Butler . 6 April 2012. Available from http://www.tobaccotactics.org/index.php?title=Eamonn_Butler [Accessed 27 February 2018].
215. Tobacco Control Research Group. University of Bath. Patrick Basham . 2 January 2018. Available from http://www.tobaccotactics.org/index.php?title=Patrick_Basham [Accessed 27 February 2018].
216. Tobacco Control Research Group. University of Bath. Letter to the Editor . 22 August 2014. Available from http://www.tobaccotactics.org/index.php?title=Letter_to_the_Editor [Accessed 27 February 2018].
217. Healthy lives, healthy people: a tobacco control plan for England. Department of Health; 2011.

218. HMRC. Report on Tobacco Taxation in the United Kingdom. Excise Social Policy Group, HM Customs and Excise. WHO. Available from http://www.who.int/tobacco/training/success_stories/en/best_practices_united_kingdom_taxation.pdf [Accessed 19 February 2018].
219. UKCTAS, ASH. 2013 Budget submission to HM Treasury and HMRC. 2013. Available from <http://ash.org.uk/information-and-resources/reports-submissions/submissions/ash-tobacco-tax-in-the-2013-budget/> [Accessed 27 February 2018].
220. UKCTAS, ASH. 2014 Budget submission to HM Treasury and HMRC. 2014. Available from <http://ash.org.uk/information-and-resources/reports-submissions/submissions/ash-tobacco-tax-in-the-2014-budget/> [Accessed 27 February 2018].
221. UKCTAS, ASH. 2016 Budget submission to HM Treasury and HMRC. 2016. Available from <http://ash.org.uk/information-and-resources/reports-submissions/submissions/ash-tobacco-tax-in-the-2016-budget/> [Accessed 27 February 2018].
222. ASH & UKCTAS. HM Treasury Budget 2017: Representation from ASH and the UK Centre for Tobacco and Alcohol Studies to the Chancellor of the Exchequer. Action on Smoking and Health and UK Centre for Tobacco and Alcohol Studies. 2017. Available from: <http://ash.org.uk/information-and-resources/taxation-illicit-trade/taxation/ash-tobacco-tax-in-the-2017-autumn-budget> [Accessed 27 February 2018].
223. Smith KE, Savell E, Gilmore AB. What is known about tobacco industry efforts to influence tobacco tax? A systematic review of empirical studies. *Tobacco Control*. 2013;22(2):144-53.
224. Joossens L, Raw M. Cigarette smuggling in Europe: who really benefits? *Tobacco Control*. 1998;7(1):66-71.
225. Gilmore A, Branston R, Sweanor D. The case for OFSMOKE: how tobacco price regulation is needed to promote the health of markets, government revenue and the public. *Tobacco Control*. 2010;19:423-30.
226. Branston R, Gilmore A. The case for Ofsmoke: the potential for price cap regulation of tobacco to raise £500 million per year in the UK. *Tobacco Control*. 2014;23(1):45-50.
227. UKCTAS, ASH. 2011 Budget submission to HM Treasury. 2011.
228. Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the UK cigarette market. *Addiction*. 2013;108(7):1317-26.
229. ASH and UKCTAS response to the MET consultation. Available from <http://ash.org.uk/download/metresponse-pdf/> [Accessed 15 May 2018].
230. HMT. Consultation: Minimum Excise Tax. Available from <https://www.gov.uk/government/consultations/minimum-excise-tax/minimum-excise-tax> [Accessed 20 February 2018].
231. Tobacco Manufacturers' Association. Tobacco Smuggling & Crossborder Shopping. Available from: <http://the-tma.org.uk/policy-legislation/tobacco-smuggling-crossborder-shopping/> [Accessed 27 February 2018].
232. JTI. JTI Response to UK Budget 2012: An Open Invitation to Crooks, Criminals and Counterfeiters. March 2012. Available from https://www.jti.com/sites/default/files/country-news-pdfs/JTI_UK_budget_response_to_duty_increase_2012-03-21_Final.pdf [Accessed 27 February 2018].

233. Gilmore A. Cigarette smuggling: current issues and data concerns. Workshop on Cigarette Smuggling. European Parliament. 22 Jan 2014.
234. HMRC. Annual Report 2005-06. HM Revenue & Customs. Available from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/243210/6983.pdf [Accessed 4 May 2018].
235. ASH. Counter Arguments. Action on Smoking and Health. 2016. Available from <http://ash.org.uk/information-and-resources/reports-submissions/reports/counter-arguments-how-important-is-tobacco-to-small-retailers/> [Accessed 4 May 2018].
236. NCI. Monograph 21: The Economics of Tobacco and Tobacco Control. National Cancer Institute. Available from <https://cancercontrol.cancer.gov/brp/tcrb/monographs/21/monograph21.html> [Accessed 20 April 2018].
237. Ramos A. Illegal trade in tobacco in Mercosur countries. Working paper. Montevideo, Uruguay: Centro de Investigacion de la epidemia de tabaquismo (CIET-Uruguay); 2009. Available from: http://www.fctc.org/images/stories/INB-3/INB3_report_illegal_trade_in_MERCOSUR.pdf [Accessed 24 April 2018].

**LATIN
AMERICA
& THE
CARIBBEAN**

ORGANIZATION OF EASTERN CARIBBEAN STATES (OECS)
AND TRINIDAD AND TOBAGO

8

CHILE

9

COLOMBIA

10

ECUADOR

11

MEXICO

12

URUGUAY

13

ORGANIZATION OF
EASTERN CARIBBEAN
STATES (OECS) AND
TRINIDAD AND
TOBAGO

8

ORGANIZATION OF EASTERN CARIBBEAN STATES (OECS) AND TRINIDAD AND TOBAGO

Caribbean Regional Report on Illicit Tobacco Trade

*Karl Theodore, Althea La Foucade, Christine Laptiste, Ewan Scott, Charmaine Metivier,
Samuel Gabriel, Daren Conrad, and Malini Maharaj¹*

Chapter Summary

This chapter focuses on selected countries in the English-Speaking Caribbean, namely the members of the Organization of Eastern Caribbean States (OECS) and Trinidad and Tobago. Apart from the protocol (full) member countries (Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines), the OECS also includes associate members Anguilla, British Virgin Islands, and Martinique.

The illicit tobacco trade is a major obstacle in the effort to control tobacco consumption in the Caribbean. The findings of this review suggest that the countries of the region need to significantly strengthen their efforts to control the illicit tobacco trade. While the countries have ratified conventions and passed legislation, the review points to widespread weaknesses in implementation and enforcement.

¹ Centre for Health Economics, The University of the West Indies

There is no question that a major limitation to grappling with the illicit trade in the region is the data situation. Countries face a paucity of reliable data on the extent of the illicit trade. Contrary to good practice, data on illicit trade and other tobacco issues are largely derived from the tobacco industry. The review concludes that there are benefits to be gained from closing this information gap and that this should be treated as a matter of urgency.

Complementing the call for a major improvement in data collection and analysis, this chapter also points to the need for upgrading and modernizing the technological response to the illicit tobacco trade. Finally, the study highlights the need for the illicit tobacco response in the Caribbean to be characterized by a more regional approach.

1. Introduction

It has been estimated that, in low- and middle-income countries, the average percentage of illicit tobacco consumption ranged from 11.8 percent (middle-income) to 16.8 percent (low-income)². These levels were relatively higher than for high-income countries, where the percentage of illicit tobacco consumption was estimated at 9.8 percent of tobacco consumed. Interestingly, in low- and middle-income countries, the average legal prices were lower than in high-income countries. This suggests that price is by no means the only or most important consideration in understanding (and controlling) the illicit tobacco trade.

1.1 Context and Content of Tobacco Control Efforts

Patterns of tobacco supply and consumption in the region. Cigarette smoking is the most popular form of tobacco consumption in the English-speaking Caribbean. WHO STEPS surveys across various years have found that the percentage of smokers who use manufactured cigarettes ranges from 51.8 percent in St. Kitts and Nevis to 97.6 percent in the Cayman Islands. Of the nine countries for which recent data were available, seven recorded manufactured-cigarette smoking rates of above 76 percent.

In addition to legal imports from outside the Caribbean, a major legal supply of cigarettes originates within the region itself. The West Indian Tobacco Company (WITCO), a public company based in Trinidad and Tobago, was established in 1904 and is a member of the British American Tobacco (BAT) Group. The company supplies 25 brands in 137 stock-keeping units (SKUs) both to the local Trinidad and Tobago market and regionally to 16 Caribbean Community (CARICOM) members and associate countries. These include: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica,

² Joossens, Luk, David Merriman, Hana Ross and Martin Raw M. 2009. How Eliminating the Global Illicit Cigarette Trade Would Increase Tax Revenue and Save Lives. Paris: International Union Against Tuberculosis and Lung Disease.

Montserrat, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname, Bermuda, British Virgin Islands and the Cayman Islands (West Indian Tobacco 2018).

Tobacco control policies in study countries. According to the World Health Organization (WHO), the countries comprising the OECS have implemented smoke-free policies in up to two public places and some cessation programs, of which at least one is cost-covered. In the case of Trinidad and Tobago, all public places are covered by smoke-free policies. The country also has cessation policies and requires large warnings on cigarette packaging. In the case of the OECS countries, imported products include warnings on their packaging. However, with the exception of Antigua and Barbuda, none of the countries conducted national anti-smoking campaigns between 2014 and 2017

Taxes applied on tobacco products include excise taxes, import duties, value-added taxes (VAT), and customs service charges. In the case of Dominica and Antigua and Barbuda, respectively, an environmental surcharge and a revenue recovery charge are applied. Total taxation as a percentage of the retail price of the most-sold brands of cigarettes in 2010 ranged from 12 percent in Antigua and Barbuda to 49 percent in Grenada. By 2016, the percentage ranged from 15.5 percent in Antigua and Barbuda to 53.1 percent in St. Lucia. Using the WHO measure of affordability of cigarettes, there has been no significant change in the OECS since 2008. Although Antigua and Barbuda has the lowest share of tax in price, that country achieved unusually positive results on affordability, relative to other countries in the region. Cigarettes became less affordable in Antigua and Barbuda between 2008 and 2016 (WHO 2017). Cigarettes also became less affordable in Trinidad and Tobago. Table 1 summarizes the tobacco control efforts of the countries under study.

Most of the countries have implemented monitoring measures in the form of recent surveys related to the prevalence of smoking (Table 2). In the cases of Antigua and Barbuda, Dominica, St. Kitts and Nevis, and St. Lucia, these surveys were limited to the prevalence of tobacco use among youth. St. Vincent and the Grenadines and Trinidad and Tobago have moved towards smoke-free environments, with Trinidad and Tobago leading in this measure, as well as that of the display of health warnings. The British Virgin Islands (BVI) has also stipulated, in its Tobacco Control Regulations, the mandate for health warnings regarding tobacco products and smoke-free environments.

Table 1. Tobacco Control Policies Implemented by the OECS and Trinidad and Tobago (2010 to 2017)

MEASURES	GRENADA	ST. LUCIA	ST. KITTS AND NEVIS	ST. VINCENT AND THE GRENADINES
Monitoring: Prevalence data	Recent and representative data for both adults and youth	Recent and representative data for both adults and youth	No known data or no recent data or data that are not both recent and representative	Recent and representative data for both adults and youth
Smoke-Free Policies: Policies on smoke-free environments	Complete absence of ban, or up to two public places completely smoke-free	Complete absence of ban, or up to two public places completely smoke-free	Complete absence of ban, or up to two public places completely smoke-free	Complete absence of ban, or up to two public places completely smoke-free
Cessation Programs: Treatment of tobacco dependence	NRT and/or some cessation services (at least one of which is cost-covered)	NRT and/or some cessation services (at least one of which is cost-covered)	NRT and/or some cessation services (neither cost-covered)	NRT and/or some cessation services (neither cost-covered)
Health Warnings: Health warnings on cigarette packages	No warnings or small warnings	No warnings or small warnings	No warnings or small warnings	No warnings or small warnings
Mass Media: Anti-tobacco campaigns	No national campaign conducted between July 2014 and June 2016 with duration of at least three weeks	No national campaign conducted between July 2014 and June 2016 with duration of at least three weeks	No national campaign conducted between July 2014 and June 2016 with duration of at least three weeks	Data not reported
Advertising bans: Bans on advertising, promotion and sponsorship	Complete absence of ban, or ban that does not cover national television, radio and print media	Complete absence of ban, or ban that does not cover national television, radio and print media	Complete absence of ban, or ban that does not cover national television, radio and print media	Complete absence of ban, or ban that does not cover national television, radio and print media
Taxation: Share of total taxes in the retail price of the most sold brand of cigarettes (2010 & 2016)*	49% & 46.7%	31% & 53.1%	14% & 19.8%	16% & 20.7%
Affordability	No trend change in affordability of cigarettes since 2008.	No trend change in affordability of cigarettes since 2008.	No trend change in affordability of cigarettes since 2008.	No trend change in affordability of cigarettes since 2008.

*: The first figure reflects data from 2010 and the second figure data from 2016.

** : Ministry of the Attorney General and Legal Affairs. 2015a. Laws of Trinidad and Tobago, Tobacco Control Act of 2009 http://rgd.legalaffairs.gov.tt/laws2/alphabetical_list/lawspdfs/30.04.pdf

NRT: Nicotine replacement therapy.

Source: Compiled by authors from WHO Report on the Global Tobacco Epidemic, 2017.

Table 1. Tobacco Control Policies Implemented by the OECS and Trinidad and Tobago (2010 to 2017), Cont.

MEASURES	DOMINICA	ANTIGUA AND BARBUDA	TRINIDAD AND TOBAGO
Monitoring: Prevalence data	No known data or no recent data or data that are not both recent and representative	No known data or no recent data or data that are not both recent and representative	Recent and representative data for both adults and youth
Smoke-Free Policies: Policies on smoke-free environments	Complete absence of ban, or up to two public places completely smoke-free	Complete absence of ban, or up to two public places completely smoke-free	All public places completely smoke-free (or at least 90% of the population covered by complete subnational legislation)
Cessation Programs: Treatment of tobacco dependence	NRT and/or some cessation services (neither cost-covered)	NRT and/or some cessation services (neither cost-covered)	NRT and/or some cessation services (at least one of which is cost-covered)
Health Warnings: Health warnings on cigarette packages	No warnings or small warnings	No warnings or small warnings	Large warnings with all appropriate characteristics
Mass Media: Anti-tobacco campaigns	Data not reported	National campaign conducted with one to four appropriate characteristics	No national campaign conducted between July 2014 and June 2016 with duration of at least three weeks
Advertising bans: Bans on advertising, promotion and sponsorship	Complete absence of ban, or ban that does not cover national television, radio and print media	Complete absence of ban, or ban that does not cover national television, radio and print media	Yes, with the exception of publications with adult readership of over 85%, publications sent to adults by mail and places where children are not permitted by law.**
Taxation: Share of total taxes in the retail price of the most sold brand of cigarettes (2010 & 2016)*	26% & 24.3%	12% & 15.5%	34% & 25.8%
Affordability	No trend change in affordability of cigarettes since 2008.	Cigarettes less affordable – per capita GDP needed to buy 2000 cigarettes of the most sold brand increased on average between 2008 and 2016	Cigarettes less affordable – per capita GDP needed to buy 2000 cigarettes of the most sold brand increased on average between 2008 and 2016

*: The first figure reflects data from 2010 and the second figure data from 2016.

** : Ministry of the Attorney General and Legal Affairs. 2015a. Laws of Trinidad and Tobago, Tobacco Control Act of 2009 http://rgd.legalaffairs.gov.tt/laws2/alphabetical_list/lawspdfs/30.04.pdf

NRT: Nicotine replacement therapy.

Source: Compiled by authors from WHO Report on the Global Tobacco Epidemic, 2017.³

³ http://www.who.int/tobacco/surveillance/policy/country_profile/en/

Table 2. Smoking Prevalence and Tobacco Share of Deaths: Selected Caribbean Countries

PREVALENCE BY GENDER		ANTIGUA BARBUDA		DOMINICA		GRENADA		ST. KITTS & NEVIS		ST. LUCIA		ST. VINCENT & THE GRENADINES	
		2010	2015	2007/8	2015	2010/11	2015	2007	2015	2010	2015	1991	2015
Male	...	4.97	9.7	7.34	19.2	11.4	11.4	11.4	...	16.04	17.4	12.02	
Female	...	2.45	0.9	1.29	2.8	2.73	0.7	...	...	1.96	1.9	1.99	
CHILDREN SMOKING PERCENT USING TOBACCO DAILY 2015													
Male	0.38	0.76	0.79	4.8 (2007)	1.11	0.59							
Female	0.56	0.55	0.66	3.2 (2007)	0.42	0.39							
PERCENTAGE OF DEATHS CAUSED BY TOBACCO 2016													
Male	4.73	8.46	9.92	...	9.16	9.2							
Female	2.53	3.65	4.64	...	3.96	3.98							

Source: Drope and Schluger, Tobacco Atlas 2018⁴ for 2015 prevalence and 2016 percentage of deaths caused by tobacco; WHO Global Report on Trends in Prevalence of Tobacco Smoking 2015⁵

⁴ <https://tobaccoatlas.org/>

⁵ http://apps.who.int/iris/bitstream/handle/10665/156262/9789241564922_eng.pdf;jsessionid=E80CFA4D939F89EB56669786A12C7B02?sequence=1

2. Tobacco Revenue and Pricing in the Caribbean

Tobacco revenue: regional comparisons. The revenue derived from tobacco taxation by selected countries of the OECS is shown in Table 3. The data show total revenues as well as sub-categories for all tobacco products. For many countries in the region, the bulk of tax revenues are collected from total excise, which consists of either a specific or an ad valorem tax. Revenue from tobacco taxation as a percentage of total tax revenue ranged from a low of 0.14 percent in Antigua and Barbuda to 2.15 percent in Grenada.

Table 3. Annual Tax Revenues from Tobacco Products: Selected OECS Countries (2015)

COUNTRIES	ST. KITTS & NEVIS	ST. VINCENT & THE GRENADINES	GRENADA	ST. LUCIA	ANTIGUA & BARBUDA	DOMINICA
	All Tobacco Products	All Tobacco Products	All Tobacco Products	All Tobacco Products	All Tobacco Products	All Tobacco Products
Year	2013	2015	2015	2015	2015	2015
Currency	XCD	XCD	XCD	XCD	XCD	XCD
Total Excise ¹	220,269.11	705,427.02	8,178,933.34	9,905,000.00	-	354,845.65
VAT and other sales taxes	225,620.05	1,315,703.46	2,429,344.47	2,455,000.00	403,470.00	76,260.71
Import duties and all other taxes ²	209,787.50	524,105.84	810,112.13	521,000.00	515,123.00	98,381.46
Total (Local Currency)	655,676.66	2,545,236.32	11,418,389.94	12,881,000.00	918,593.00	529,487.82
% of Total Tax Revenues**	0.16%	0.57%	2.15%	1.41%	0.14%	0.16%
Total Revenues as a % of GDP	0.031%	0.12%	0.42%	0.29%	0.025%	0.037%
Total (USD)	242,843.21	942,680.12	4,229,033.31	4,770,740.74	340,219.63	196,106.60

¹ Specific and ad valorem.

² Excluding corporate taxes on tobacco companies.

Source: Compiled from Drope and Schluger, Tobacco Atlas, 2018, WHO Report on the Global Tobacco Epidemic, 2017; ** Eastern Caribbean Currency Union (ECCU) Central Statistical Offices and Eastern Caribbean Central Bank.

All countries in the region have to some extent taxed tobacco products (Table 4). They have, however, done so to widely varying degrees. All rates still remain far below the WHO target of 75 percent of retail price (Table 5).

Table 4. Tobacco Taxes and Bases among Selected Member Countries of OECS

TAXES	ST. KITTS AND NEVIS (2017)		SAINT VINCENT AND THE GRENADINES (2017)		GRENADA (2017)		ST. LUCIA (2017)		ANTIGUA & BARBUDA (2017)	
	RATE	BASE	RATE	BASE	RATE	BASE	RATE	BASE	RATE	BASE
Import Duty / Common External Tariff	\$18 - cigarettes	per kg	35% - Cigar and cigarettes 5% - raw tobacco	CIF	35% - cigarettes 5% - tobacco	CIF	5% - stemmed/striped tobacco 45% - cigars, cigarettes, and other forms of tobacco and tobacco products	CIF	35% - cigarettes	CIF
Excise Tax	20% - cigarettes	CSC + ID	14% - cigars \$1.55 per 100 cigarettes 6% raw tobacco 12% other 6% - tobacco substitute	ID+CIF	105% - cigarettes	CSC+CET+ CIF	\$176 per 1,000 Sticks on cigarettes \$125.60 per kg on cigars and other tobacco products.			
Value Added Tax	17%	EXT+CSC+ ID	16%	CSC+EXT+ ID+CIF	15%	EXT+CSC+ CET+CIF	12.5%	EXT+CSC+ ID+CIF	15%	CIF + ID
Customs Service Charge	6%	ID	5%	EXT+ID+ CIF	6%	CET+CIF	6%			
Other taxes (Revenue Recovery Charge)							ID+CIF		10%	CIF

Notes: CET - Common External Tariff, CSC - Customs Service Charge, CIF - Cost Insurance and Freight, RRC - Revenue Recovery Charge, EXT: Excise Tax; ID - Import Duty

Source: Statistical Offices and Customs and Excise Divisions of OECS countries.

Table 5. % Share of Total Taxes in the Retail Price of the Most Widely-Sold Brand of Cigarettes (2008 - 2016)

COUNTRY	2008	2010	2012	2014	2016
Antigua and Barbuda	14.77	14.77	15.00	14.63	15.47
Dominica	25.61	25.61	23.40	23.40	24.30
Grenada	40.50	49.48	...	47.76	46.73
Saint Kitts and Nevis	18.20	14.00	19.96	19.76	19.76
Saint Lucia	30.08	26.54	29.91	62.88	53.09
Saint Vincent and the Grenadines	16.15	15.99	15.96	16.76	20.69
Trinidad and Tobago	36.69	33.73	32.58	29.61	25.76

Source: WHO Report on the Global Tobacco Epidemic, 2017.

Retail prices of tobacco products: variation between and within countries. A 2017 survey of cigarette prices in the OECS revealed that smokers in St. Lucia paid the highest overall prices for cigarettes. The price per pack of 20 cigarettes (full pack) showed wide variations within and between countries, ranging between EC\$5.85 and EC\$22.00 per pack in St. Lucia, and between EC\$4.00 and EC\$9.20 in Antigua and Barbuda, which has the lowest cigarette prices (Table 6). Similarly, the price per pack of 10 cigarettes (half pack), varied between EC\$3.25 and EC\$5.00 in St. Kitts and Nevis, and between EC\$5.00 and EC\$16.00 in St. Lucia.

Table 6. Price Ranges per Pack of 20 and 10 Cigarettes, Selected OECS Countries

COUNTRIES	PRICE RANGES (PACK OF 20s, EC\$)	PRICE RANGES (PACK OF 20s, USD)	PRICE RANGES (PACK OF 10s, EC\$)	PRICE RANGES (PACK OF 10s, USD)
Antigua and Barbuda	4.00 - 9.20	1.48 - 3.41	3.95 - 4.75	1.46 - 1.76
Grenada	6.15 - 15.00	2.28 - 5.56	3.75 - 5.50	1.39 - 2.04
St. Kitts and Nevis	3.50 - 18.87	1.30 - 6.99	3.25 - 5.00	1.20 - 1.85
St. Lucia	5.85 - 22.00	2.17 - 8.15	5.00 - 16.00	1.85 - 5.93
St. Vincent and the Grenadines	4.00 - 20.00	1.48 - 7.41	3.50 - 6.00	1.30 - 2.22

Source: HEU, Centre for Health Economics, The University of the West Indies, 2017.

3. Regional and International Cooperation in Tobacco Control

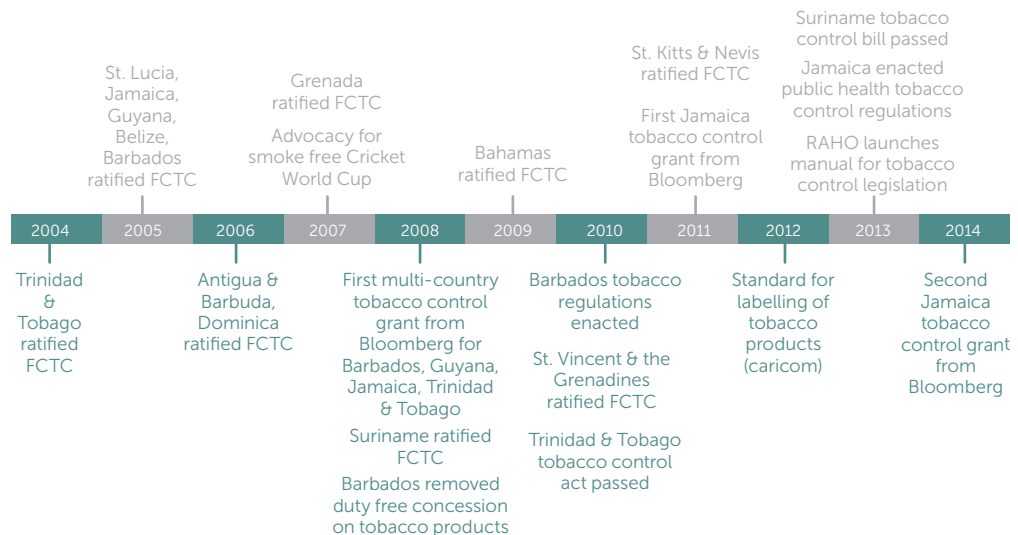
3.1 Regional Commitment to the FCTC

Countries and institutions engaged. WHO in its 2017 report on the global tobacco epidemic indicated that Trinidad and Tobago and all OECS countries, with the exception of the British territories, had signed and ratified the WHO Framework Convention for Tobacco Control (FCTC). The British territories are part of the United Kingdom and therefore cannot sign on to the FCTC as separate jurisdictions (PAHO/WHO 2016b). Nevertheless, in order to advance the FCTC goals, the British Virgin Islands passed Tobacco Control Laws, while the other British territories have implemented some of the Convention's articles. Trinidad and Tobago also passed the Tobacco Control Act in 2010, under which Section 38 (1) details Tobacco Control Regulations. Draft Tobacco Control legislation has been developed for Grenada. CARICOM has also established a Regional Standard for the labeling of retail packages of tobacco products. The Regional Standard was adopted by the CARICOM Council for Trade and Economic Development (COTED) in 2012. Key regional institutions with a stake in combating the illicit tobacco trade also include the Caribbean Customs Law Enforcement Council, which operates under the umbrella of the World Customs Organization.

Tackling illicit trade under the FCTC and Protocol: implementation gaps. Parties to the Convention have all undertaken the responsibility to implement a range of anti-illicit trade measures. However, there has been some stickiness with regard to effective implementation and enforcement. The Healthy Caribbean Coalition (HCC) suggested that, although countries in the Caribbean have ratified the FCTC, few have implemented the provisions of the anti-illicit trade Protocol (HCC 2016). Figure 1 illustrates.

Constraints on multilateral action. It should be noted that an effective multilateral approach through an international agency that deals with health alone may be fraught with challenges. One of the main difficulties is that, at the national level, measures required to effectively address illicit trade fall within the ambit of various customs agencies, law enforcement, and justice departments. Internationally, bodies such as the United Nations Office on Drugs and Crime and the World Customs Organization have resources to combat illicit activities such as smuggling and illicit manufacturing of tobacco products. The FCTC Secretariat and the WHO did not initially have these forms of expertise in 2011 (Lieberman et al. 2011), though the Secretariat has since developed some capacity in these areas.

Figure 1. Timeline of Tobacco Control Policy, Legislation, and Advocacy in the Caribbean (2004-2014)



Source: Adapted from HCC (2016)

4. Tobacco Policies/Reforms Enacted in the Eastern Caribbean

4.1 Overview of Legal Frameworks

Tobacco control policies in the region are broadly framed. An assessment of the existing policies and reforms in the region suggests that the regulative and legislative framework favors policies designed to control tobacco use, in general, rather than specifically targeting the illicit tobacco trade. However, although data are limited, governments are aware of the presence of the illicit tobacco trade within the region.

Import restrictions. Most of the countries have imposed restrictions on imports that are also aimed at providing some level of control of illicit trade. For instance the Trinidad and Tobago Customs Act states that it is prohibited to import: "...extracts, essences or other concentrations of tobacco, or any admixture of the same, tobacco stalks and tobacco-stalk flour, except under such conditions as the Comptroller may with the approval of the President, either generally or in any particular case allow"(Ministry of the Attorney General and Legal Affairs, 2015b: 43). Moreover, it is against the law to import "tobacco, cigars, cigarillos and cigarettes, unless specifically reported as such and unless in aircraft, or in ships of thirty tonnes burden at least, and unless in whole and complete packages, each containing not less than nine kilogrammes net weight of tobacco, cigars, cigarillos and cigarettes" (Ministry of the Attorney General and Legal Affairs, 2015b: 44).

4.2 Key Institutions and Administrative Mechanisms for Enforcement

Customs controls. Broadly speaking, the issue of prevention of illicit tobacco trade is covered by various Customs Acts in the Caribbean. Specifically, any person caught smuggling tobacco products on board an aircraft or ship may face a fine, and all goods are forfeited. Caribbean Ministries of Health have taken the leadership role in driving tobacco control measures in Caribbean countries, which have led to control laws and legislation in some cases. Again, the emphasis is on tobacco control rather than the illicit trade of tobacco per se.

Within the region, the customs divisions usually carry out random checks of persons entering the countries. In the case of Grenada, random checks are also carried out on persons coming in from Carriacou. Custom officers rely heavily on coast guards to regularize the smuggling of products across the borders. However, informants admitted that there is a lack of communication between the two law-enforcement groups.

The importance of “track-and-trace”: recognized in theory. The WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products recognized the need to eliminate all forms of illicit trade in tobacco and to take measures to control the supply chain and to cooperate internationally (WHO 2013). The main mechanism through which the trade is to be monitored and controlled is referred to as a “track-and-trace system.” The WHO (n.d) reported that industry self-assessment⁶ and physical controls are the least effective control measures. Tax stamps without monitoring are partly effective, and automated monitoring using secure digital stamps is the most effective control measure.

Table 7 summarizes the status of control and enforcement measures in Antigua and Barbuda (A&B), Dominica (DOM), Grenada (GRE), St. Kitts Nevis (SKN), St. Lucia (STL), St. Vincent and the Grenadines (SVG), and Trinidad and Tobago (TT).

As Table 7 shows, St. Lucia and Trinidad and Tobago require markings on all packaging to indicate the origin of the product. They have also established rules for the destruction of confiscated equipment and tobacco products. Both Grenada and Trinidad and Tobago have enacted legislation to curtail illicit tobacco trading, adopted measures to monitor and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties, and have instituted licensing or other actions to prevent illicit trading.

Track-and-trace implementation in the region: a key shortfall. With the exception of Trinidad and Tobago, there are as yet no indications of countries’ developing practical tracking and tracing regimes to address the illicit tobacco trade. This system speaks to supply chain management (monitoring and control) of tobacco products from the point of manufacture to the point of sale through the use of secure and unique identifiers. According to Sharma (2018), the reports to the WHO FCTC for Trinidad and Tobago should state that,

⁶ Declarations by tobacco industry/manufacturers of production.

Table 7. Selected Measures to Reduce the Supply of Illicit Tobacco Products in the Caribbean

SELECTED MEASURE/DESCRIPTION	A&B	DOM	GRE	SKN	STL	SVG	TT
Developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade?	No	No	No	No	No	No	Yes
Requiring marking of all unit packets and packages of tobacco products and any outside packaging of such products to assist in determining the origin of the product?	No	No	No	No	Yes	No	Yes
Requiring marking of all unit packets and packages of tobacco products and any outside packaging of such products to assist in determining whether the product is legally sold on the domestic market?	No	No	No	No	No	No	Yes
Requiring that unit packets and packages of tobacco products for retail and wholesale use that are sold on the domestic market carry the statement: "Sales only allowed in ..." or carry any other effective marking indicating the final destination of the product?	No	No	No	No	No	No	Yes
Requiring the monitoring and collection of data on cross-border trade in tobacco products, including illicit trade?	No	No	No	No	No	No	Yes
Facilitating the exchange of this information among customs, tax and other authorities, as appropriate, and in accordance with national law and applicable bilateral and multilateral agreements?	No	No	No	No	No	N/A	Yes
Enacting or strengthening legislation, with appropriate penalties and remedies, against illicit trade in tobacco products, including counterfeit and contraband cigarettes?	No	No	Yes	No	No	N/A	Yes
Requiring that confiscated manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products derived from illicit trade be destroyed, using environment-friendly methods where possible, or disposed of in accordance with national law?	No	No	No	No	Yes	N/A	Yes
Adopting and implementing measures to monitor, document, and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties?	No	No	Yes	No	No	N/A	Yes
Licensing or other actions to control or regulate production and distribution in order to prevent illicit trade?	No	No	Yes	No	No	N/A	Yes

Source: Compiled from the WHO Core Questionnaire of the Reporting Instrument of the WHO FCTC 2018 for: Grenada, St. Lucia, and Trinidad and Tobago; from the WHO Core Questionnaire of the Reporting Instrument of the WHO FCTC 2016 for: Antigua & Barbuda and Dominica; from the WHO Reporting Instrument of the WHO FCTC 2012 for St. Kitts & Nevis; and from the WHO Reporting Instrument of the WHO FCTC 2010 for St. Vincent and the Grenadines.

while the country's Tobacco Control Act (2009) requires tracking and tracing measures, implementation and enforcement have yet to occur. Among relevant measures, penalties and licenses are the only enforceable stipulations that have been and can be executed (Sharma 2018). Penalties and liabilities for non-compliance with Tobacco Controls Act Sections 36(1)(c)(ii) and 36(1)(c)(vi) apply to tobacco products: (a) which are not properly

packaged or labelled; (b) where taxes and duties have not been paid; and (c) which have not entered the jurisdiction legally. Other penalties and sanctions are identified in the Act and include fines and loss of licenses, as well as criminal sanctions.

Enforcement of these control measures is fulfilled through the services of the Customs Division, the Police Service, and the Tobacco Control Unit of the Ministry of Health and its authorized officers. Enforcement is executed under the following:

- » Proceeds of Crime Act;
- » Protection Against Unfair Competition Act;
- » Trade Marks Act;
- » Customs Act;
- » Trade Description Act;
- » Excise (General Provision) Act; and
- » Tobacco Control Act 2009 (TCA).

In terms of physical control measures, the Government of Trinidad and Tobago ensures control of the storage of taxed and untaxed products on the premises of the manufacturers. These products are overseen by an Officer of the Customs and Excise Division of the Ministry of Finance who is located onsite and, in the case of imports, who relies upon issued licenses to importers in order to monitor the cross-border movement of tobacco products (cigarettes).

Enforcement gaps. However, there are challenges with consistency in the strength of implementation. The issues concern resource constraints. For example, at the time of this study, personnel contracts for the Tobacco Control Unit were pending renewal and, as such, the division was effectively without staff. Additionally, key informants from the public sector indicated that, while licenses are required for the importation of tobacco products, small traders who are granted these licenses tend to utilize these for the importation and distribution of brands different from those for which the licenses were granted, usually without penalty because of gaps in monitoring. Similar shortcomings exist where unique identifiers stipulated in the legislation have not been implemented.

Grenada's WHO FCTC report (2016) indicated that comprehensive multi-sectoral national tobacco control strategies, plans, and programs have not been implemented, although a focal point and national coordinating mechanism have been established. However, Draft Tobacco Control legislation has been developed. Grenada also has a negative list, issued by the Ministry of Trade. The negative list requires importers to apply for a trade license to import cigarettes from extra-regional countries into Grenada. St. Kitts and Nevis, as well as St. Vincent and the Grenadines, have no national coordinating mechanisms.

5. Cigarette Smuggling: Multiple Routes and Few Seizures

Customs and excise departments in OECS countries and Trinidad and Tobago report that seizure of contraband cigarettes and other tobacco products has been minimal to date, and in many instances non-existent. This is supported by data from the WHO Framework Convention on Tobacco Control Reporting Instrument (2010-2018), which indicate that there have been no reported seizures in Antigua and Barbuda, Dominica, St. Kitts and Nevis, or St. Lucia over the period. Grenada (2013) and Trinidad and Tobago (2012), reported seizures of 10,000 and 81,400 illicit sticks of tobacco, respectively.

Anecdotal evidence indicates that potential smugglers may opt for one of the many informal entry points that exist along the island coastlines, as the route through which contraband tobacco products are imported. This possibility speaks to the need for stronger monitoring of the countries' territorial waters and coastlines. The virtual absence of tobacco seizures in the region underscores the need to improve detection. Resources and technical support from international partners may prove invaluable.

6. Innovative and Technological Enforcement Solutions

The WHO (n.d.) assesses the effectiveness of control measures as reflected in Table 8.

Table 8. Effectiveness of Control Measures

LEAST EFFECTIVE	PARTLY EFFECTIVE	MOST EFFECTIVE
<p>Industry self-assessment: relying on declarations of production by the manufacturers is highly vulnerable to tax evasion.</p>	<p>Tax stamps (without monitoring): Stamps ordered from the Ministry of Finance (MOF) and placed on packs by manufacturers. These stamps (even new digital versions) can be counterfeited. The MOF can check the market for illegal sales, but can't determine their origin.</p>	<p>Automated monitoring: digital stamps placed on packs by special machines affixed in manufacturing facilities. The machines record production and this data is sent to a central MOF database. These types of measures minimize tax evasion.</p>
<p>Physical control: MOF officials monitor/clear production on-site. Still vulnerable to tax evasion and industry capture of officials.</p>		

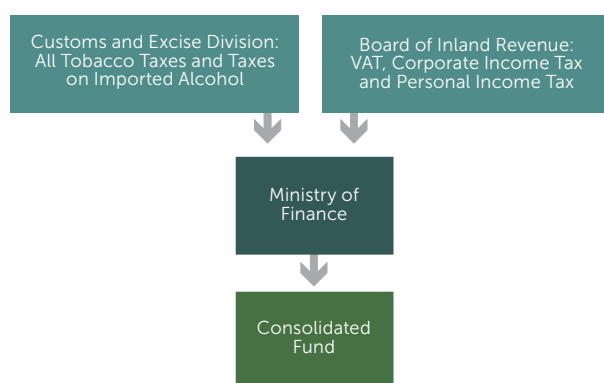
Source: Compiled from WHO (n.d)

Closing technology gaps: what role for industry? With regard to innovative and technological enforcement solutions adopted to fight forgery and counterfeiting in the OECS and Trinidad and Tobago, WITCO (2018) indicates that, as a manufacturer of some products sold in CARICOM markets, the company recently acquired the INEXTO technology, which performs digital encoding of tobacco packs and ancillary packaging. This system will be operationalized in 2018 in the WITCO facility (Padgett 2018). The INEXTO technology, formerly “Coidentify”, developed by PMI, is seen by critics as de facto perpetuating industry, rather than government, control of “track and trace.”

In the English-speaking Caribbean, apart from the systems acquired by the tobacco industry, there is a general lack of anti-counterfeiting technology, tracking and tracing systems, and fiscal marks as enforcement mechanisms.

Excise tax stamps. Generally, the various arms of the Ministries of Finance and/or Customs and Excise Departments throughout the region are responsible for collecting taxes on tobacco. Revenues collected usually flow into a pooled government fund (consolidated fund). Figure 2 illustrates the cases of Grenada and Trinidad and Tobago, which show similarities to other countries in the region.

Figure 2. Alcohol and Tobacco Industry Tax Collection System: Grenada and Trinidad and Tobago



Neither the OECS countries nor Trinidad and Tobago have implemented an excise tax stamp regime, although for Trinidad and Tobago, the existing regulations and legislation commit the country to this approach, as Table 7 indicates. In the wider CARICOM region, the Guyana Revenue Authority (GRA) Customs, Excise and Trade Operations (CE&TO) introduced excise stamps on imported alcohol and tobacco products in November 2017. The GRA collaborated with the Canadian Bank Note Company, which designed and produced the stamps (Guyana Revenue Authority 2017). In March 2016, the Jamaica Customs Agency (JCA) signaled its intention to introduce the use of excise stamps for tobacco and alcohol products (Jamaica Observer 2016).

In the absence of excise stamps in the case countries, importers or their agents/brokers normally complete an import declaration form, on which they indicate the type, quantity, and value of the good being imported. This form is normally accompanied by invoices and other relevant shipping documents, licenses, and permits. The taxes are then applied. Manufacturers also pay excise and other taxes on their products.

Advancing “track-and-trace”: seizing a key opportunity. WHO FCTC’s Illicit Trade Protocol specifies the minimum data needed for tracking and tracing. The track-and-trace system was designed to verify the quantity produced or imported, verify correct tax payments, track products through the supply chain, trace products back to their sources, and ensure product authenticity (WHO 2013). The data required for effective tracking and tracing are brand names of cigarettes; trademark holders; harmonized tariff schedule numbers; customs duties and payment records; taxes paid and payment records; and information as to whether the goods were previously reported stolen, destroyed, seized, or returned to the manufacturer. Tracking-and-tracing systems are non-intrusive and require minor adjustments to production lines.⁷ There are a number of countries where the implementation of the track-and-trace system increased tax revenues and reduced illicit trade. In Turkey, for example, the implementation of the track-and-trace system led to an increase in tax revenues of 31 percent with no rise in tax rates. Other countries where this system has been implemented are Brazil, Canada, Kenya, Malaysia, Panama, the Philippines, and the United States. Although, as reported in Table 8, Trinidad and Tobago responded “Yes” to the question of whether the country is developing a practical tracking and tracing regime, to date, none of the English-speaking Caribbean countries—including Trinidad and Tobago—has implemented the track-and-trace system.

7. Recommendations and Conclusions

The importance of independent data. This chapter has examined illicit tobacco trade in the OECS countries and Trinidad and Tobago. Although industry data were available and are generally the source of information used to discuss illicit trade in the region, this study opted not to utilize such data. This choice reflects the consensus in the international literature that industry data tend to have an upward bias (see e.g. Liberman et al. 2011). Within the English-speaking Caribbean region, as elsewhere, tobacco industry spokespersons highlight the illicit tobacco trade in urging policy makers to renounce or scale back tobacco control measures, including excise tax increases and other reforms. To counter this strategy, a sub-regional effort is needed to provide independent data on tobacco, including illicit flows.

Progress through political leadership. Caribbean countries can act as both sources and destinations of illicit tobacco, based on their licit and illicit trading activities. For example, for

⁷ WHO (2014) Secretariat study of the basic requirements of the tracking and tracing regime to be established in accordance with Article 8 of the Protocol to eliminate illicit trade in tobacco products, cited in Ross (2015).

St. Vincent and the Grenadines, the 2010 FCTC Report indicated that, even though tobacco is grown in that jurisdiction (WHO 2010), the country also imports manufactured tobacco products (cigarettes) from Trinidad and Tobago.⁸ According to Marquez et al. (2018: 6), *“By far, the largest share (61 percent) of the cigarettes sold in the sub-region is supplied by Caribbean and CARICOM countries; of that total, Trinidad and Tobago accounts for 91.9 percent, followed by the Dominican Republic (5 percent).”* In source countries, such as Trinidad and Tobago, the flows of illicit tobacco may be facilitated by the lack of political will and the attendant lack of institutional capacity to counter the illicit activity. The same holds for destination countries, particularly the smaller Eastern Caribbean States, in which the illicit trade in tobacco is also facilitated by, inter alia, low law enforcement focus. This lack of prioritization may be linked to cultural acceptance of the illegal products.

Resource gaps call for international support. In developing countries, including those in the Caribbean, there is no question that resource restrictions have also limited efforts to control the illicit trade of tobacco and tobacco products (HCC 2016). A major challenge identified by Joossens and Raw (2012: 233) is the *“difference in technical capacity between customs and enforcement authorities in different regions of the world.”* There is a case here for international support to standardize the measures taken to counteract illicit tobacco trade.

This report’s first recommendation in addressing illicit trade is to acknowledge the paucity of relevant and reliable data within the Caribbean and commit to strengthening the information-gathering platform. If the region’s leaders do not realize the true dimensions of the illicit tobacco trade, they will not be in a position to control it. Lecours and Hallen (2016: 202) emphasize that, *“[t]he lack of specific country information has been an important barrier to policy adoption.”* This underscores that, while technology can help law enforcement, the manner in which the law is to be enforced is itself dependent on the extent of data capture.

To successfully combat the illicit trade in tobacco products in the Caribbean, law enforcement authorities must take the lead on data systems, surveillance, and corrective action, including civil and criminal prosecution. Those involved in legitimate import, export, production, storage, and movement of tobacco products, whatever their scope, should work together to address the problem constructively and provide authorities with information and assistance on specified key elements. Further, legitimate market actors should be receptive to the introduction of reporting mechanisms as well as close collaboration to ensure that tracking and tracing systems are in place. Linked to the need for better information are the policy commitments and legislative frameworks required to modernize countries’ technological control capacities.

The evidence is very clear that effective control measures work hand in hand with taxation. While it cannot be said that the Caribbean has not adopted any measures whatsoever, there is

⁸ In many cases, countries can be considered to be in more than one category: source, transit, and destination (WHO 2018a). For example, Trinidad and Tobago can be classified as a source, transit, and destination country, while St. Vincent and the Grenadines functions as a source and destination country for tobacco products.

no question that the areas of coding, verification, tracking and tracing of tobacco products and tax stamps have not been developed to a degree where positive results could be expected.

This leads to the second recommendation of the present study: the need to adequately train personnel and acquire the equipment and systems required to mount an effective technological response to the illicit trade. In this respect, the region stands to benefit from the experience of countries like Brazil, which have had success on this front.

Illicit tobacco trade is affected by both demand and supply considerations: demand by smokers for cheaper or specific tobacco products and the supply of tobacco products by legal and illegal manufacturers looking for more profit (Joossens and Raw 2012). Of course, industry collusion is a means of tax evasion whereby tobacco products are diverted into the illicit market, where sales are tax-free and profit margins on illicit operations are considerably larger.

To reduce illicit trade in tobacco products, it is also critical to secure the legitimate supply chain. This will require that participants in the supply chain take measures to prevent diversion of tobacco products and machinery into illicit trade channels. These measures are intended to promote responsible business conduct that must apply equally to all participants, regardless of size.

Another key component of securing the supply chain involves, as stated earlier, tracking and tracing systems for different commodities. Added to this is the need to properly institute controls on the supply of key components used to manufacture cigarettes. This provides a targeted and powerful mechanism for restricting and ultimately eliminating the production of counterfeit and "illicit white" cigarettes.

In the English-speaking Caribbean, tobacco producers have argued that, *"Over the years, they [governments] have increased taxes so much that they have created a smuggler's paradise. The difference between legal product and illegal product is so huge from a profit standpoint, that people are willing to take that risk, once that remains you will always have smuggling."*⁹ Contradicting this argument is analysis presented by the World Bank, which shows that high levels of illicit tobacco products are linked more closely to corruption and tolerance of contraband sales (Merriman, Yurekli and Chaloupka 2000), as opposed to higher taxes. As a matter of fact, Joossens and Raw (2012) pointed out that illicit tobacco trade occurs in both low- and high-tax jurisdictions and occurs primarily as a result of a lack of control on cigarette manufacturing and the movement of cigarettes across borders. Research in Central and Eastern Africa also highlighted that, while varying tax levels among countries were a factor in cigarette smuggling, even more important contributors were high levels of corruption, weak state capacity to monitor and enforce, and the activities of rebel groups (Titeca, Joossens and Raw 2011). Interestingly, Joossens and Raw (2012) further pointed out that cigarette smuggling is more prevalent in low-income countries than in

⁹ See Illicit Trade a Big Problem (Retrieved from, <http://www.guardian.co.tt/business/2018-04-07/illicit-trade-big-problem>)

high-income countries. *Tobacco Tax Reform: at the Crossroads of Health and Development* (World Bank 2017) reinforces the arguments in these earlier studies.

The situation facing the Caribbean is one where a purposeful, strategic attack on illicit tobacco trade is necessary. Most of all, this calls for political commitment at the highest level, a commitment to adopt the available technology, and a commitment to significantly improve the data situation. The capacity of the tobacco industry to confuse the picture is directly linked to the low data-capture level that now prevails. If the region is to reduce exposure to the heavy price in preventable death and disease as well as the heavy drain on health expenditure caused by tobacco consumption, steps will have to be taken to limit the consumption of illicit tobacco. These steps are not unknown to us and are certainly not beyond the ken of the customs and tax officials in the different countries. The important point is that something substantial needs to be done. To do nothing would be to settle for the fact that tobacco will continue to kill almost half of those who use it and to impose a heavy economic burden on our countries.

The truth is that dealing with the illicit trade problem is well within the capacity of this region. At the country level in the Caribbean, the main enforcement bodies are usually customs authorities, with the possibility of creating specialized police units. However, since proper enforcement presumes that professionals will carry out their responsibilities with integrity, measures will be needed to ensure that this integrity is not compromised. **This means that the third recommendation is for steps to be taken to reduce or eliminate corruption in the sphere of illicit tobacco trade.**

In summary, this study calls for action in three critical areas:

1. **Data systems.** A major upgrade in the quality of current intelligence and information provided to enforcement officials about smuggling and domestic illicit production methods/players. Simple practical guidance will also be helpful, and this must be kept up-to-date to reflect trends, developments, and players in the illicit trade.
2. **Technology and skills.** Training personnel and adopting technology to facilitate coding practices and the latest anti-counterfeit techniques, and to help customs officials detect false compartments even when scanners are not available.
3. **The corruption fight.** A determination to reduce corruption, which remains a major enabler of illicit tobacco trade. To this end, if the culture of corruption that might be present is to be stamped out, there will have to be a willingness in the Caribbean to demonstrate visionary leadership and efficient management, as well as a preparedness to arrange appropriate remuneration and ethics training of personnel involved in the monitoring of the illicit tobacco trade.

To date, Caribbean countries have focused substantial tobacco control efforts on legislation. But good laws, while crucial, are not enough. The need now is to take the fight to another level—one where effective measures are implemented to deal with the illicit tobacco trade.

The FCTC Protocol seeks to eliminate all forms of illicit trade in tobacco products through a suite of measures to be taken by countries acting in cooperation. It offers a global solution to a global problem. The time has come for the Caribbean to make a significant contribution to this global solution.

References

Drope, Jeffrey and Neil W. Schluger, eds. 2018. *The Tobacco Atlas: Sixth Edition*. Atlanta: American Cancer Society.

Guyana Revenue Authority. 2017. Anti-Smuggling campaign continues with the introduction of the Excise Tax Stamp. Accessed April 6, 2018. <http://www.gra.gov.gy/publications/press-releases/702-anti-smuggling-campaign-continues-with-the-introduction-of-the-excise-tax-stamp>.

Healthy Caribbean Coalition. 2016. *Civil Society Led Tobacco Control Advocacy in the Caribbean*. Experiences from the Jamaica Coalition for Tobacco Control. Healthy Caribbean Coalition.

HEU, Centre for Health Economics. 2017. Survey on "Cigarette Prices in the Organisation of eastern Caribbean States." The University of the West Indies, November. Unpublished.

Jamaica Observer. 2016. "Customs to Implement Tax Stamp System for Alcohol, Cigarettes." *Jamaica Observer* March 30, 2016. <http://www.jamaicaobserver.com/news/Customs-to-implement-tax-stamp-system-for-alcohol--cigarettes>.

Joossens, Luk, David Merriman, Hana Ross and Martin Raw M. 2009. *How Eliminating the Global Illicit Cigarette Trade Would Increase Tax Revenue and Save Lives*. Paris: International Union Against Tuberculosis and Lung Disease.

Joossens, Luk, and Martin Raw. 2012. "From Cigarette Smuggling to Illicit Tobacco Trade-Strategic Directions and Emerging Issues in Tobacco Control." *Tobacco Control* 21: 230-234.

Lecours, Natacha and Glen Hallen. 2016. "Addressing the Evidence Gap to Stimulate Tobacco Control in Latin America and the Caribbean." *Rev Panam Salud Publica* 40(4):202-3.

Lieberman Jonathan, Evan Blecher, Alejandro Ramos Carbajales and Fishburn Burke. 2011. "Opportunities and Risks of the Proposed FCTC Protocol on Illicit Trade." *Tobacco Control* 20:6.

Marquez, Patricio et al. 2018. *Advancing Action on the Implementation of Tobacco Tax Harmonization in the Organisation of Eastern Caribbean States (OECS) Countries*. Port of Spain Trinidad and Tobago and Washington D.C.: The World Bank Group.

Merriman, David, Ayda Yurekli and Frank J. Chaloupka. 2000. "How big is the worldwide cigarette smuggling problem?" In *Tobacco Control in Developing Countries*, edited by Prabhat Jha and Frank Chaloupka, 365-392. Oxford: Oxford University Press.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

Ministry of the Attorney General and Legal Affairs. 2015a. *Laws of Trinidad and Tobago, Tobacco Control Act of 2009: Amended by 12 of 2012*. Accessed March 2, 2018.

http://rgd.legalaffairs.gov.tt/laws2/alphabetical_list/lawspdfs/30.04.pdf

Ministry of the Attorney General and Legal Affairs. 2015b. *Laws of Trinidad and Tobago, Customs Act Chapter 78:01: Act 22 of 1938: Amended and Updated to December 31st 2015*. Accessed March 2, 2018. <http://laws.gov.tt/ttdll-web/revision/list?offset=130&q=¤tid=600#email-content>

Padgett, John. 2018. Interview by Malini Maharaj with Caribbean External Affairs Manager, Legal and External Affairs, British American Tobacco. February 20, 2018.

Pan American Health Organization (PAHO) and World Health Organization (WHO). 2016a. Report on Tobacco Control of the Region of the Americas. *WHO Framework Convention on Tobacco Control: 10 Years Later*. Washington D.C.: PAHO.

Pan American Health Organization (PAHO) and World Health Organization (WHO). 2016b. *PAHO/WHO Strategy for Technical Cooperation with the United Kingdom Overseas Territories (UKOTs) in the Caribbean 2016-2022*. July.

Ross, Hana. 2015. *Measures to Control Illicit Tobacco Trade – Draft*. University of Cape Town and Institute for Health Research and Policy, University of Chicago. June 14.

Sharma, Karmesh. 2018. Interview by Malini Maharaj with Epidemiologist and former Manager, Tobacco Control Unit, Trinidad and Tobago, Ministry of Health, Trinidad and Tobago. February 22, 2018.

Titeca, Kristof, Luk Joossens, and Martin Raw. 2011. "Blood Cigarettes: Cigarette Smuggling and War Economies in Central and Eastern Africa." *Tobacco Control* 20:226-232.

West Indian Tobacco Company (WITCO). 2018. Interview by Malini Maharaj with Head of Legal and External Affairs, West Indian Tobacco Company. February 21, 2018.

World Health Organization. (n.d.). *Illicit Trade in Tobacco: A Summary of the Evidence and Country Responses*. Accessed February 15, 2018. <http://www.who.int/tobacco/economics/illicittrade.pdf>

..... 2018a. *The Protocol to Eliminate Illicit Trade in Tobacco Products: Questions and Answers*. *WHO Framework Convention on Tobacco Control*. World Health Organization. Accessed June 25, 2018. <http://www.who.int/fctc/protocol/faq/en/index1.html>

..... 2018b. *Core Questionnaire of the Reporting Instrument of the WHO Framework Convention on Tobacco Control: Grenada*. World Health Organization. Accessed June 20, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/Grenada_2018_report.pdf

..... 2018c. *Core Questionnaire of the Reporting Instrument of the WHO Framework Convention on Tobacco Control: St. Lucia*. World Health Organization. Accessed June 20, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/Saint_Lucia_2018_report.pdf

..... 2018d. *Core Questionnaire of the Reporting Instrument of the WHO Framework Convention on Tobacco Control: Trinidad and Tobago*. World Health Organization. Accessed June 20, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/Trinidad_and_Tobago_2018_report.pdf

..... 2017. *WHO Report on the Global Tobacco Epidemic: Monitoring Tobacco Use and Prevention Policies*. Geneva: World Health Organization.

..... 2016. *Core Questionnaire of the Reporting Instrument of the WHO FCTC: Antigua and Barbuda*. World Health Organization. Accessed January 7, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/reports/Antigua_and_Barbuda_2016_report.pdf

..... 2016. *Core Questionnaire of the Reporting Instrument of the WHO Framework Convention on Tobacco Control: Dominica*. World Health Organization. Accessed January 5, 2018 http://untobaccocontrol.org/impldb/wp-content/uploads/reports/dominica_2016_report.pdf

..... 2012. *Reporting Instrument of the WHO Framework Convention on Tobacco Control: St. Kitts and Nevis*. World Health Organization. Accessed January 5, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/reports/st_kitts_and_nevis_2012_report.pdf

..... 2015. *WHO Global Report on Trends in Prevalence of Tobacco Smoking 2015*. Geneva: World Health Organization.

..... 2013. *Protocol to Eliminate Illicit Trade in Tobacco Products: Framework Convention on Tobacco Control*. Geneva: World Health Organization.

..... 2010. *Reporting Instrument of the WHO Framework Convention on Tobacco Control: St. Vincent and the Grenadines*. Accessed January 5, 2018. http://untobaccocontrol.org/impldb/wp-content/uploads/reports/st_vincent_grenadines_2012_report_final.pdf

Annex

Taxes on the Most-Sold Brand of Cigarettes for CARICOM Countries

COUNTRY	YEAR	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - SPECIFIC EXCISE	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - AD VALOREM EXCISE	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - IMPORT DUTIES	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - VALUE ADDED TAX	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - OTHER TAXES	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - TOTAL TAX	TOBACCO EXCISE TAXES INCREASED 2008-2016
	2016	0	0	0	13.04	2.43	15.47	
	2014	0	0	0	13.04	1.59	14.63	
Antigua and Barbuda	2012	0	0	0	13.04	1.95	15.00	NA
	2010	0	0	0	13.04	1.72	14.77	
	2008	0	0	0	13.04	1.72	14.77	
	2016	11.26	0	0	13.04	0	24.30	
	2014	10.35	0	0	13.04	0	23.40	
Dominica	2012	10.35	0	0	13.04	0	23.40	No
	2010	12.57	0	0	13.04	0	25.61	
	2008	12.57	0	0	13.04	0	25.61	
	2016	0	31.80	0	13.04	1.89	46.73	
	2014	0	32.76	0	13.04	1.95	47.76	
Grenada	2012	...	...	...	...	...	...	No
	2010	0	34.70	0	13.04	1.74	49.48	
	2008	0	0	40.50	0	0	40.50	
	2016	28.27	0	0	14.16	2.05	44.48	No
	2014	26.25	0	0	14.16	2.52	42.94	
Jamaica	2012	31.82	0	0	14.16	0.08	46.06	(2016 tax rate lower than 2008 despite intermittent increases)
	2010	36.21	0	0	14.89	0.08	51.18	
	2008	29.63	0	0	14.16	0.09	43.88	

COUNTRY	YEAR	MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE		MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - AD VALOREM EXCISE		MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - IMPORT DUTIES		MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - VALUE ADDED TAX		MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - OTHER TAXES		MOST SOLD BRAND OF CIGARETTES - TAXES AS A % OF PRICE - TOTAL TAX		TOBACCO EXCISE TAXES INCREASED 2008-2016
		- TAXES AS A % OF PRICE - SPECIFIC EXCISE	- TAXES AS A % OF PRICE - AD VALOREM EXCISE	- TAXES AS A % OF PRICE - IMPORT DUTIES	- TAXES AS A % OF PRICE - VALUE ADDED TAX	- TAXES AS A % OF PRICE - OTHER TAXES	- TAXES AS A % OF PRICE - TOTAL TAX							
Saint Kitts and Nevis	2016	0	4.03	0	14.53	1.21	19.76							
	2014	0	4.03	0	14.53	1.21	19.76							
	2012	0	4.18	0	14.53	1.25	19.96							No
	2010	0	5.01	0	7.10	1.89	14.00							
	2008	0	6.52	0	9.23	2.46	18.20							
Saint Lucia	2016	39.11	0	0	13.04	0.93	53.09							
	2014	48.55	0	0	13.04	1.29	62.88							
	2012	28.71	0	0	0	1.20	29.91							Yes
	2010	0	24.92	0	0	1.62	26.54							
	2008	0	28.25	0	0	1.84	30.08							
Saint Vincent and the Grenadines	2016	5.17	2.48	0	13.04	0	20.69							
	2014	2.2	1.52	0	13.04	0	16.76							
	2012	1.83	1.08	0	13.04	0	15.96							Yes
	2010	1.67	1.28	0	13.04	0	15.99							
	2008	1.67	1.44	0	13.04	0	16.15							
Trinidad and Tobago	2016	14.65	0	0	11.11	0	25.76							
	2014	16.57	0	0	13.04	0	29.61							
	2012	19.54	0	0	13.04	0	32.58							No
	2010	20.69	0	0	13.04	0	33.73							
	2008	23.64	0	0	13.04	0	36.69							

Source: WHO Report on the Global Tobacco Epidemic 2017, Appendix IX, Table 9.1

CHILE

9

CHILE:

Tackling the Illicit Tobacco Trade

Guillermo Paraje¹

Chapter Summary

Although smoking prevalence in Chile has reduced over the past decade, consumption of tobacco products remains very high. Chile's tobacco taxation levels have been increasing since 2010 and currently represent about 70-75 percent of the price of the most sold brand. Cigarette real prices have been increasing well above such tax increases. Data on cigarette tax-paying sales over this period confirm that, as cigarette price increased, sales of cigarettes decreased. A recent survey in the metropolitan area of Santiago found that the prevalence of illicit cigarette among smokers was 10.9 percent, in contrast to industry estimates of 24 percent.

Chile ratified the WHO's FCTC in June 2005. Although Chile has not ratified the Protocol to Eliminate Illicit Trade in Tobacco Products, it soon plans to implement Track and Trace systems, which would give the Inland Revenue Service a rapid means of distinguishing illicit cigarette packs. In addition to this forthcoming system, it is recommended that Chile implements a comprehensive, integral policy to curb illicit trade, including the ratification of the Protocol and coordination with neighboring countries on tobacco illicit trade.

There is also an urgent need to produce independent information on the extent of tobacco illicit trade, its characteristics and its implications on Chile's internal tobacco market. It is also

¹ Universidad Adolfo Ibáñez

recommended that penalties for the illicit trade of tobacco products be increased, in parallel with greater enforcement of these measures. Other suggested steps include adopting stronger measures to address the entry of tobacco products via the duty-free zone of Iquique (close to the Bolivian and Peruvian borders), and greater controls on Chile's sizable duty-free allowances, which include no limitations on the number of trips per day (or month).

1. Tobacco Consumption and Regulation

Consumption of Tobacco

The average per capita consumption of tobacco products in Chile is among the highest in the world. This health epidemic has a high toll in human lives and economic resources. Tobacco is directly responsible for more than 16,000 annual deaths in Chile, equivalent to more than 18 percent of all deaths (Pichón-Riviere et al. 2014). Treating tobacco-related diseases implies a financial burden on the health system of more than Ch\$1 trillion (roughly US\$1.8 billion). Tobacco consumption also accounts for at least 285,000 lost disability-adjusted life years, 19 percent of the annual total.² Studies in numerous countries show that, among people who die in middle age (ages 30–69), smokers die an average of 10 years earlier, while, overall, smokers lose an average of 20 years of life with respect to nonsmokers (Jha and Peto 2014).

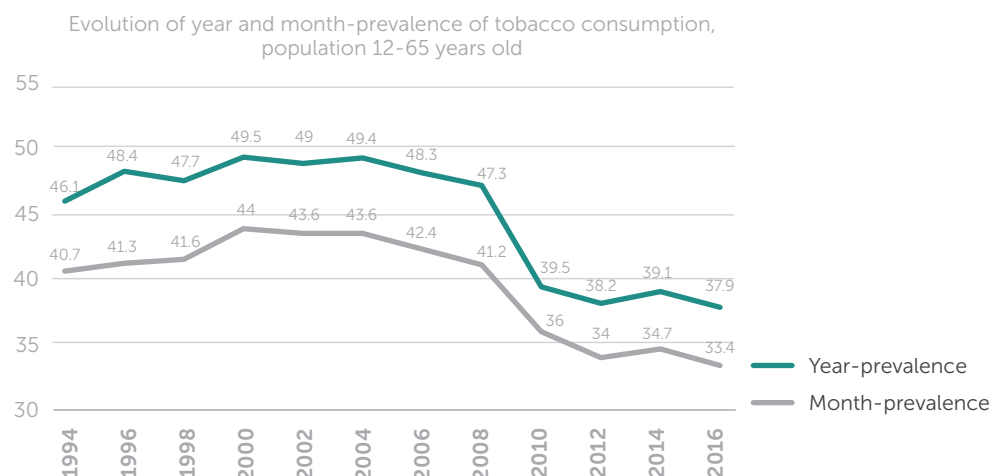
Until 2006, the share of the population aged 12–65 who reported they had smoked during the previous year was high and stable, at around 48 percent (Figure 1). The share among this age-group who reported they had smoked during the previous month was also high and stable, at around 43 percent. Consumption was concentrated in manufactured cigarettes, more than 90 percent of total consumption; the rest represented roll-your-own tobacco.³ After 2006, trends in both past-month and past-year smoking showed a clear declining trend, though the trends seemed to have stabilized since 2012. Past-year prevalence had fallen to 38 percent by 2016 (a decrease of 10 percentage points in 10 years). Past-month prevalence had fallen to 33 percent, also a decrease of 10 percentage points in a decade.

The progress in the reduction of tobacco use has been substantial, but the current levels of use are still elevated among high-income countries, a category Chile joined about a half-decade ago, but also among the countries in the region. Chile is only second to Bolivia in the Americas in smoking prevalence, more than twice the regional average and well above the global average (Table 1).

² See GBD Results Tool (database), Global Burden of Disease Study 2016, Global Health Data Exchange, Institute for Health Metrics and Evaluation, Seattle, <http://ghdx.healthdata.org/gbd-results-tool>.

³ See Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

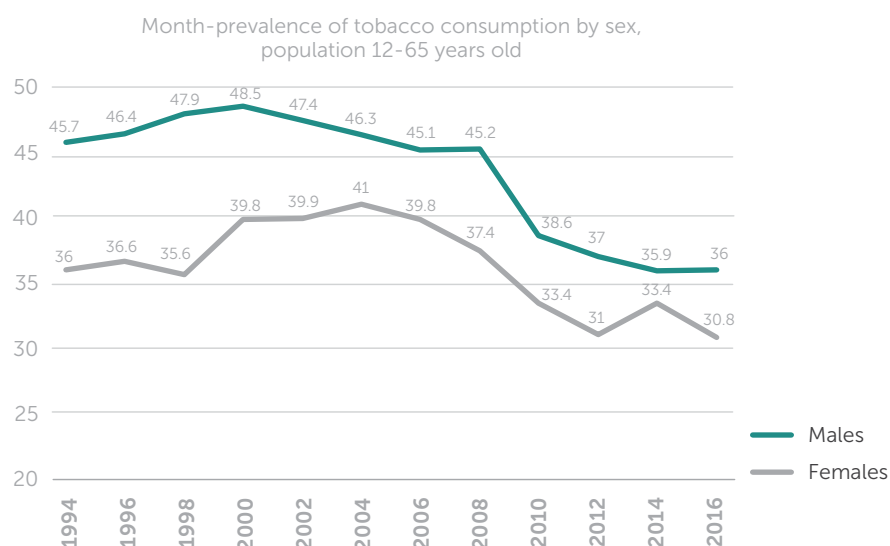
Figure 1. Trends in the Prevalence of Tobacco Consumption, Ages 12–65, Chile, 1994–2015



Source: Calculations based on Use of Drugs in General Population Surveys in Chile; see Observatorio Chileno de Drogas 2017.

Note: Month-prevalence refers to the share of the age-group that reported they had smoked during the previous month. Year-prevalence is the corresponding share with reference to the previous year.

Figure 2. Past-Month Tobacco Consumption, by Sex, Ages 12–65, Chile, 1994–2015



Source: Calculations based on Use of Drugs in General Population Surveys in Chile; see Observatorio Chileno de Drogas 2017.

Table 1. Age-Standardized Smoking Prevalence, Ages 15 and Over, Americas, Circa 2016

COUNTRY	VALUE
Bolivia (Plurinational State of)	38.9
Chile	37.9
Cuba	35.2
Suriname	25.2
Argentina	22.0
United States of America	21.9
Jamaica	17.0
Uruguay	17.0
Canada	14.3
Mexico	14.2
Brazil	14.0
Dominican Republic	13.8
Paraguay	13.3
Haiti	13.0
Costa Rica	11.9
Bahamas	11.8
El Salvador	10.7
Colombia	9.1
Barbados	8.2
Saint Kitts and Nevis	8.0
Ecuador	7.2
Panama	6.2
Regional average	16.9
Global average	21.9

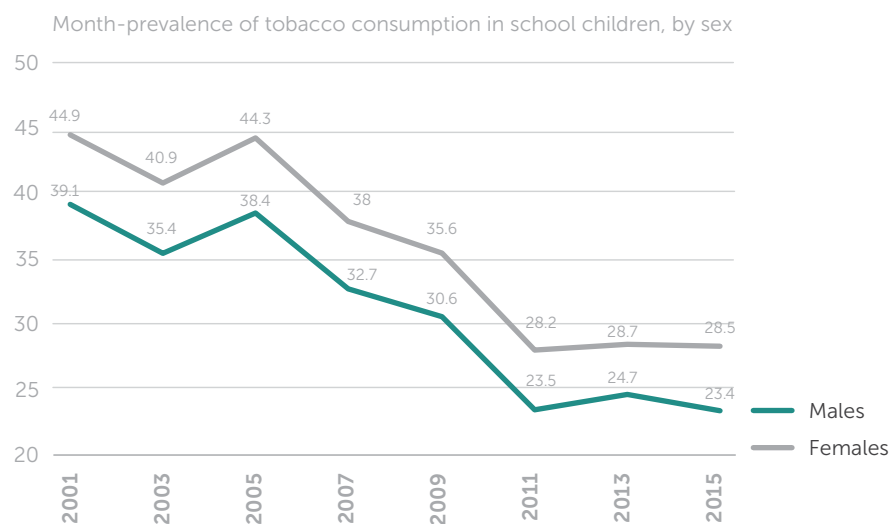
Source: Calculations based on data of "Maternal Mortality Country Profiles," GHO (Global Health Observatory) (database), World Health Organization, Geneva, http://www.who.int/gho/maternal_health/countries/en/.

One of the more striking characteristics in the Chilean case is the high prevalence of smoking among women, the highest in the region (Drope and Schluger 2018). Currently at 31 percent, the rate shows the same trend as the prevalence among men, that is, high and stable until 2006 and then declining. The gap in smoking between the sexes has decreased considerably (Figure 2).

No single explanation exists for the high prevalence of smoking among women. The reasons often given are linked to women’s empowerment, such as greater female participation in the labor market—still one of the lowest such participation rates in the region—and the associated rise in disposable incomes. However, no study has yet been conducted to probe this issue.

The high smoking prevalence is even more striking among young women. Data on smoking among children ages 12–17 indicate that, although rates have been decreasing since 2005, the past-month prevalence of smoking is consistently greater among girls than among boys (Figure 3). In 2015, the prevalence was 28.5 percent versus 23.4 percent, respectively. This pattern of consumption is rare in developing or developed countries (Drope and Schluger 2018).

Figure 3. Past-Month Tobacco Consumption, by Sex, Ages 12–17, Chile, 2001–15

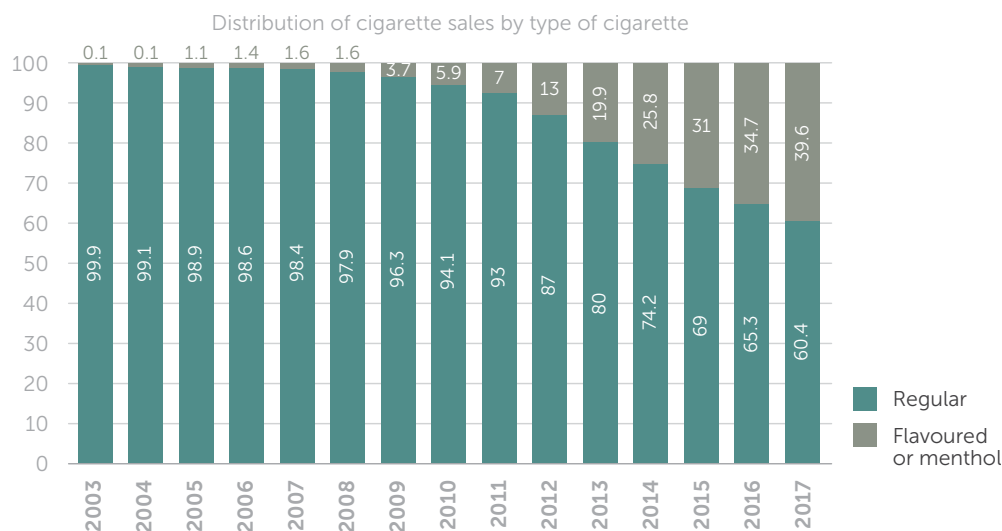


Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

This pattern of consumption has likewise not been thoroughly studied, and there are no clear explanations. One possible contributory factor might be the introduction of products that are targeted mostly at young women, such as flavored and scented cigarettes. These products represented only 6 percent of the cigarette market in 2010, but account for almost 40 percent today (Figure 4). A recent study finds that the consumption of flavored cigarettes is inversely associated with age and significantly more likely among women, even if the prices of these products are substantially higher than the prices of more standard products (Paraje and Araya 2017).

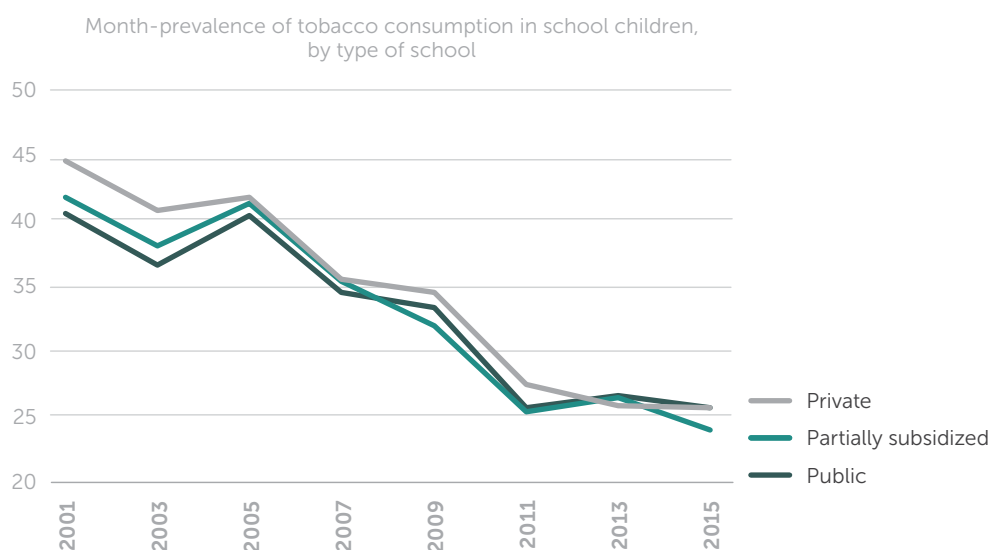
The fact that the market share of flavored cigarettes has been expanding rapidly despite the relatively higher prices also points to a singular feature of the Chilean market: smoking prevalence is at least as considerable among better-off groups as among the less well off. This can be investigated through smoking among school-age children, for example. In Chile,

Figure 4. Distribution of Cigarette Sales, by Type of Cigarette, Chile, 2003–17



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Figure 5. Past-Month Tobacco Consumption, by School Type, Ages 12–17, Chile, 2001–15



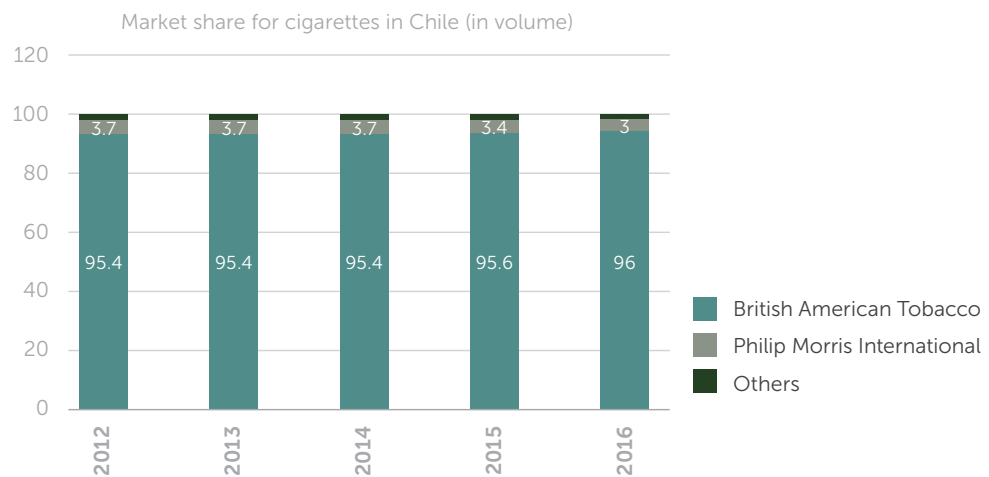
Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

socioeconomic status can be approximated by the type of school attended. Students at public schools are typically from low- and lower-middle income households, while students at partially subsidized schools are often from middle-income households, and students at private schools are usually from high-income households. During most years in 2001–15, smoking prevalence among children ages 12–17 at private schools was as high as or higher than the rates among the corresponding children in public schools (Figure 5). This is different from the situation in, for instance, neighboring Argentina, which is at a similar per capita income, or in the United Kingdom, where children from less affluent backgrounds exhibit higher smoking rates (Linetzky et al. 2012; Taylor-Robinson et al. 2017).

Market Structure

The only sources of information on the market structure of tobacco products in Chile are international consulting firms. One such firm is Euromonitor International, which provides a detailed account of the market structure among companies selling taxed cigarettes in Chile (Figure 6). This market is completely dominated by British American Tobacco (BAT), which enjoys a market share that is above 95 percent by volume. The second most important player is Philip Morris International, with no more than 4 percent of the taxed market, while the rest is distributed among minuscule players.

Figure 6. Cigarette Market Shares, by Volume, Chile, 2012–16

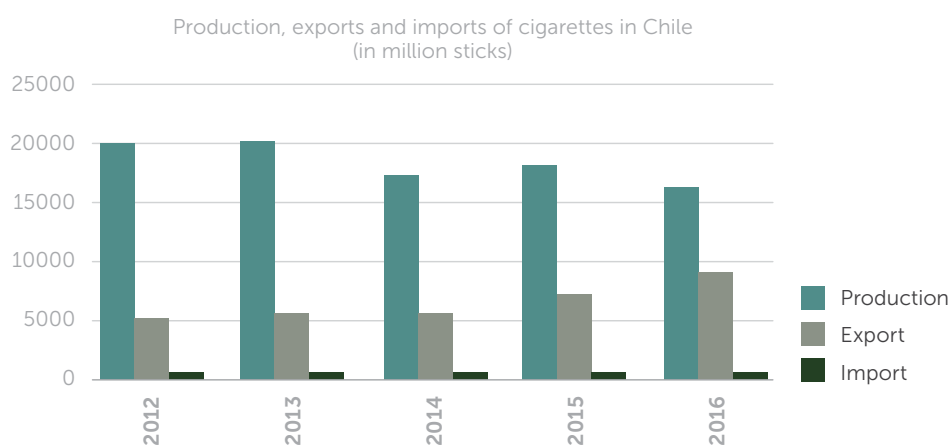


Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

BAT Chile produces for the internal market and also exports more than half of its domestic production. It shows a clear trend of shrinking production and expanding exports, which represented only 25 percent of total production in 2012 (Figure 7). In 2015, BAT Chile exported cigarettes to 17 countries, including Argentina, Colombia, Peru, the United States, Uruguay, and República Bolivariana de Venezuela.

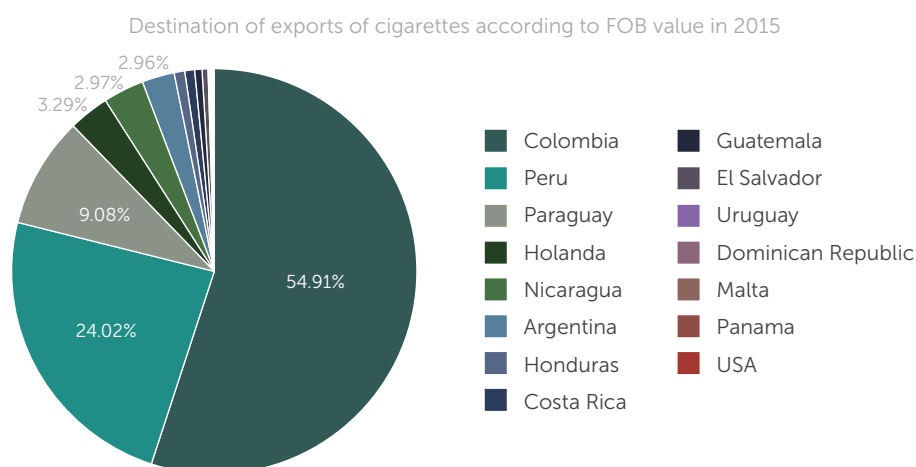
“All of the company’s cigarettes that are sold in duty-free outlets in Latin America and the majority of its cigarettes sold in duty-free outlets in Europe are produced in Chile,” affirms Euromonitor International.⁴

Figure 7. Production, Exports, and Imports, Cigarettes, Chile, 2012–16



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Figure 8. Export Destinations, Cigarettes, by Free on Board Value, Chile, 2015



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

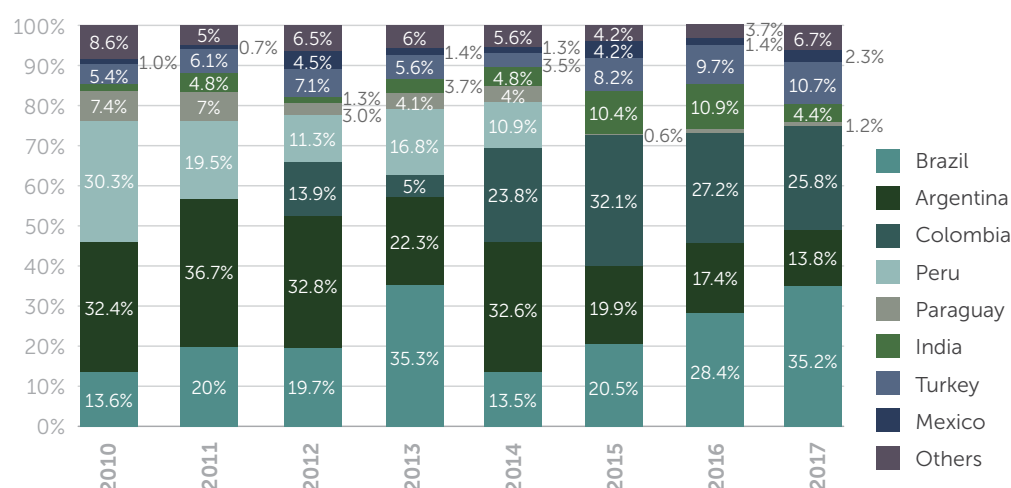
⁴ See “British American Tobacco Chile SA,” Tobacco (Chile), Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Among the main destinations in 2015, more than half the cigarette exports of Chile went to Colombia, while almost a quarter went to Peru (Figure 8). More than 95 percent of total exports went to only five countries, including Paraguay, which produces sufficient tobacco to supply its own domestic market and which is often indicated as a source of illegal cigarettes. All the exports are produced by BAT Chile.

In 2015, almost 84 percent of all imported cigarettes, including cost, insurance, and freight documentation, were imported by Philip Morris International, presumably to supply the internal market, of which Philip Morris International accounts for only 4 percent, while 16 percent were imported by BAT.

Several countries account for the imports of tobacco products, of which cigarettes represent an average of about 30 percent. More than 90 percent of annual imports are provided by eight countries, most of them within Latin America (Figure 9). Argentina and Brazil have traditionally been the main sources. Both countries are among the top 19 growers of tobacco, with no less than 40 percent of total imports into Chile in 2015 and a peak of 58 percent in 2013. Among the other countries, there has been a visible change in the share of imports. For instance, Peru was an important exporter to Chile until 2014 (an average import share of 18 percent), but its share in imports fell to almost zero beginning in 2014. Meanwhile, imports from Colombia started expanding rapidly in 2014. Countries outside the region, such as India and Turkey, have raised their shares recently, especially after 2014. There is no obvious explanation for any of these changes.

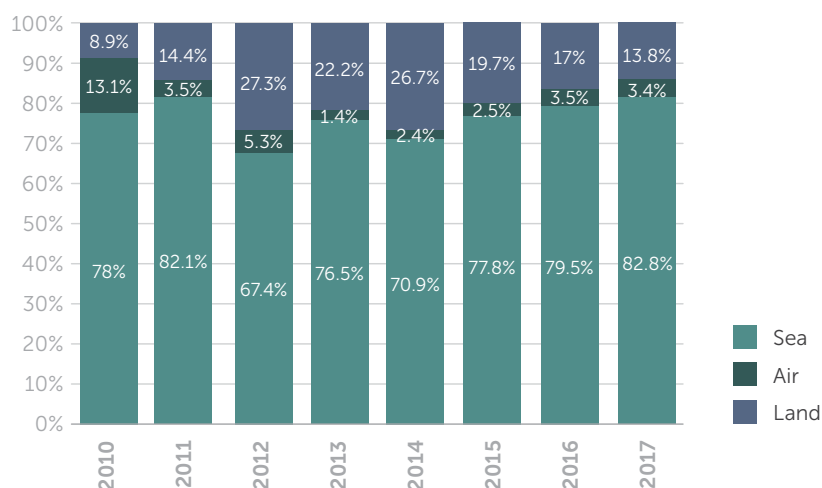
Figure 9. Imports of Tobacco Products, by Country of Origin, Chile, 2010–17



Source: Calculations based on data of the National Customs Service.
 Notes: Import valuation includes cost, insurance, and freight.

In the distribution of imports of tobacco products by means of transport, sea transport is by far the most important, representing from around 65 percent to 83 percent of all imports by

Figure 10. Imports of Tobacco Products, by Means of Transport, Chile, 2010–17



Source: Calculations based on data of National Customs Service.

Notes: Import valuation includes cost, insurance, and freight.

value (Figure 10). Land transport, mostly from Argentina, Brazil, and Paraguay, accounted for between 9 percent and 27 percent of imports by value.

Regulatory Context

Chile signed the Framework Convention on Tobacco Control (FCTC) of the World Health Organization (WHO) in September 2003 and ratified it in June 2005. The ratification of the FCTC implied a clear change in the regulation of tobacco products in the country.

The earliest legislation on tobacco products dates to Decree-Law 828 in 1974, which lays out the conditions under which tobacco should be grown and commercialized. The legislation assigned the Servicio de Impuestos Internos (Internal Revenue Service, SII) the mandate to monitor and raise revenue on sales of tobacco products. Law 19,419 of October 1995 banned advertising for tobacco products that targets minors (aged under 18), introduced health warnings on cigarette packaging, and prohibited smoking in closed spaces, such as elevators, classrooms, and public offices. In addition, restaurants, hotels, bars, and other such establishments, though they were not required to have them, were to indicate clearly any smoking and nonsmoking areas they might have.

After the ratification of the FCTC, Law 20,105 was enacted in May 2006 to adapt Chilean legislation to certain provisions of the convention. In particular, the law barred all tobacco advertising in the media, including radio, television, and newspapers, except at points of sale, which, moreover, were required to be of a type and dimensions defined by the Ministry of Health. All sales and promotions among minors were forbidden, as was the sale of tobacco products within 100 meters of primary and secondary schools. The sale of cigarettes in

packs of fewer than 10 cigarettes or of loose cigarettes was also prohibited. The Ministry of Health designed health warnings that were required to cover at least 50 percent of cigarette packs. The law likewise forbade the use of terms such as light, soft, and low tar on tobacco packaging. The law tightened regulations on smoking in educational institutions, public buildings, buses, airports, and so on. Public places such as restaurants, casinos, and bars were now required to provide separate areas for smokers.

Law 20,660 of February 2014 prohibits tobacco advertising targeted indirectly at children, such as the exhibition of smoking on television during hours when children's programs are being aired. The law also extends the definition of nonsmoking area to cover, for instance, patios with temporary roofs and similar structures, and it forbids smoking in any closed area, including those that would have been allowed as designated smoking areas under the previous law. The new law requires tobacco companies to issue public notification of any expenditures by agreement with other public or private companies. Tobacco companies must likewise provide detailed information about meetings and activities of any kind with public officials.

Parliament is considering a modification of the new law that would completely ban additives, such as menthol, chocolate, vanilla, and so on, prohibit advertising at the point of sale, impose a health warning that would cover 100 percent of the cigarette pack, and ban smoking in locations in which children are likely to be present, such as public parks and beaches. The new initiative has already been approved by the Senate. Though the Lower Chamber has been delaying debate, and the government has not introduced the legislation as a priority, the Health Commission of the Lower Chamber has unanimously recommended that the bill be taken up.

Licensing

Two government entities are charged with authorizing the sale of tobacco products for the domestic market. The first is the Ministry of Health, which must be informed by tobacco producers (or importers) about the components and additives included in tobacco products to be sold on the domestic market. The producers and importers must notify the ministry about the quantity and quality of ingredients and substances used in the treatment of tobacco products (Law 20,660). In practice, the Division of Healthy Public Policies and Health Promotion of the Ministry of Health is the licensing authority for tobacco products.

The second government entity that authorizes the sale of tobacco products is the SII, which collects tobacco tax revenue. Producers and importers of tobacco products must register with the SII to be able to sell their products in the domestic market (Decree Law 828 of 1974). Though tobacco growers do not have to pay the taxes on tobacco, they must supply regular information on planted area and harvests.

Because tobacco taxes are paid to the SII directly by the tobacco producers or importers, there is no licensing requirement among retailers.

Taxes on Tobacco Products

Tobacco taxes have been collected in Chile at least since 1974, when an ad valorem tax was imposed on packs of cigarettes (at a rate of 57 percent), cigars (40 percent), and loose tobacco (40 percent). The tax base was the retail price, including the tax. In practice, this means that tobacco companies have to notify the SII on the prices at which they will sell tobacco products to final consumers and that these prices will be the same throughout the country. The rates were subsequently changed frequently (Table 2). The change in the rate in 1998 was the last one before the ratification of the FCTC. It was also the first under a democratic government and therefore had to be approved by Parliament. The previous rates had been fixed under the dictatorship of Pinochet.

Table 2. Ad Valorem Tax Rates on Tobacco, Chile, 1974–2014

Percentage of retail price, plus the tax

YEAR	CIGARETTES, PER PACK OF 20	CIGARS	LOOSE TOBACCO
1974	57.0	40.0	40.0
1975	62.0	40.0	62.0
1977	57.0	40.0	57.0
1978	26.0	42.9	42.9
1982	52.9	26.0	52.9
1995	55.4	46.0	52.9
1998	50.4	51.0	47.9
2010	62.3	52.6	59.7
2012	60.5	52.6	59.7
2014	30.0	52.6	59.7

In 2010, four years after the ratification of the FCTC and with the stated purpose of funding the reconstruction of part of the country that had been devastated by a severe earthquake, Parliament approved an increase in the tobacco tax rate, and, for the first time, introduced a specific tax on individual cigarettes. Such specific taxes are automatically indexed in Chile to the projected monthly inflation rate, which is fixed by the SII. The value of the specific tax was set at 0.0000675 monthly tax units per cigarette, which was Ch\$2.5, around US\$0.005, at the exchange rate at the time.⁵ In 2012, when the tobacco tax was again changed by Parliament, aside from the new tax rate on packs of cigarettes, the specific tax on individual cigarettes was doubled to 0.0001288 monthly tax units, about Ch\$5.1, or US\$0.01. In 2014, though the ad valorem tax on packs of cigarettes was cut appreciably, the specific tax was

⁵ Monthly tax units are units of value defined in real terms for tax purposes. They are changed according to expected inflation, as projected

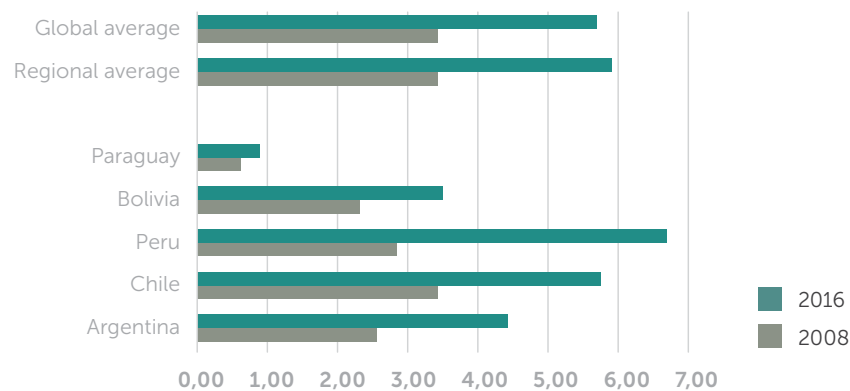
raised by a factor of more than 8, to 0.00103 monthly tax units, about Ch\$43.7, or US\$0.074, the equivalent of US\$1.48 a pack, at the exchange rate at the time.⁶ The reliance on specific rather than value added excises, the increases in real taxes, and the indexation of the taxation to inflation, if not to affordability to take account of increases in per capita income as well, are all consistent with current international best practice distilled by the World Bank (Marquez and Moreno-Dodson 2017).

The price of a pack of 20 cigarettes of the most widely sold brand jumped in real terms in Chile between 2008 and 2016, but not above the average increase in the WHO region of the Americas (Figure 11). Indeed, the price was also similar to the global real price estimated by WHO. Around 2008, the most widely sold brand of cigarettes in Chile was more expensive than the corresponding brands in neighboring countries, plus Paraguay. By 2016, the brand in Chile was the second most expensive behind the top brand in Peru.

While the tax share of the most widely sold brand in Chile was well above the regional and global averages in 2008 and 2016, it never reached the 75 percent threshold suggested by WHO as a minimum tax share for tobacco (Figure 12). Indeed, in both years, the second largest corresponding tax share after Argentina was in Chile, though the real prices in Argentina were lower.

Figure 11. Most Widely Sold Brand, by Price, Chile and Neighbors, 2008 and 2016

U.S. purchasing power parity (PPP) dollars per pack of 20



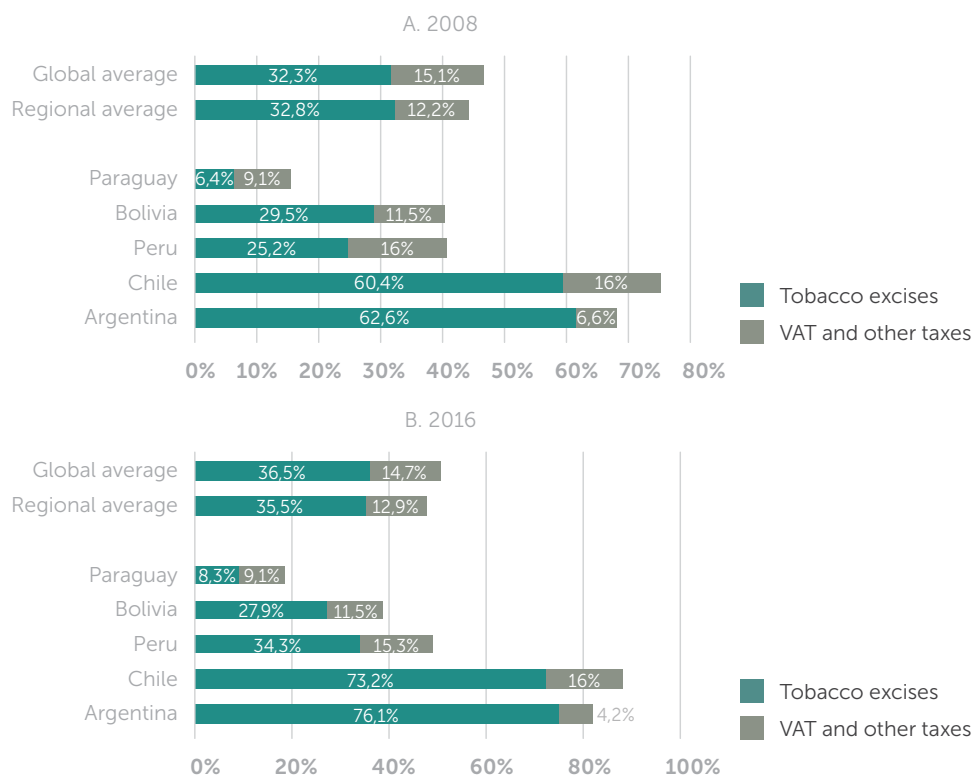
Source: Calculations based on data of TFI (Tobacco Free Initiative) (database): Taxation, World Health Organization, Geneva, <http://www.who.int/tobacco/economics/taxation/en/index1.html>.

Consequences of Regulatory and Tax Changes

Figure 13 depicts the changes in regulations and taxes since 1990, when democracy was restored and Parliament began once more to debate bills. The pace of the changes in regulations and taxes sped up after Chile ratified the FCTC in June 2005. According to

⁶ The value of the monthly tax unit at the time of the tax change was Ch\$42,431.

Figure 12. Most Widely Sold Brand, by Tax Share, Chile and Neighbors, 2008 and 2016



pack of 20, percent

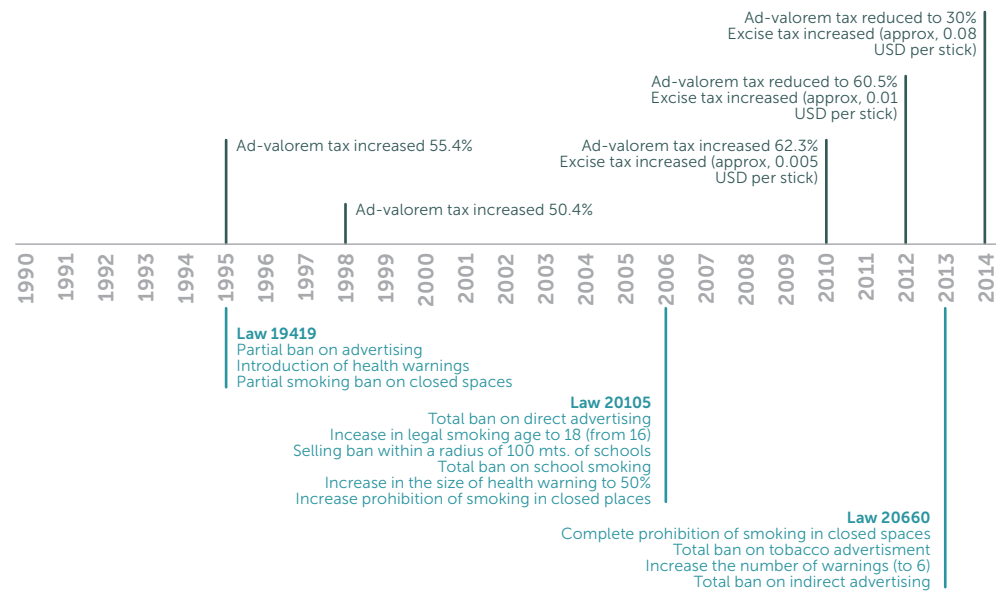
Source: Calculations based on data of TFI (Tobacco Free Initiative) (database): Taxation, World Health Organization, Geneva, <http://www.who.int/tobacco/economics/taxation/en/index1.html>.

WHO, through these changes, the government of Chile is fulfilling most dimensions of the MPOWER measures, except for the O (policies aiding in quitting smoking), on which the country is considered not to have progressed much, and the E (enforcement of bans on tobacco advertising, promotion, and sponsorship), on which it is considered to have achieved intermediate progress, mainly because it has not prohibited advertising at the point of sale (PAHO 2016).⁷

It is clear from Figure 13 that a number of policies were implemented in a short time, which renders an econometric assessment of the impact of these policies almost impossible. At least one study has attempted to measure the effect of the 2006 smoking ban in schools (Feigl et al. 2015). It finds that the ban was effective in reducing smoking prevalence among students, though it did not affect smoking intensity among the smokers. These results must be taken

⁷ MPOWER = M)onitor tobacco use and prevention policies. (P)rotect people from tobacco smoke. (O)ffer help to quit tobacco use. (W)arn about the dangers of tobacco. (E)nforce bans on tobacco advertising, promotion, and sponsorship. (R)aise taxes on tobacco. See TFI (Tobacco Free Initiative) (database): MPOWER, World Health Organization, Geneva, <http://www.who.int/tobacco/mpower/en/>.

Figure 13. Changes in Tobacco Regulation and Taxation, Chile, 1990–2014



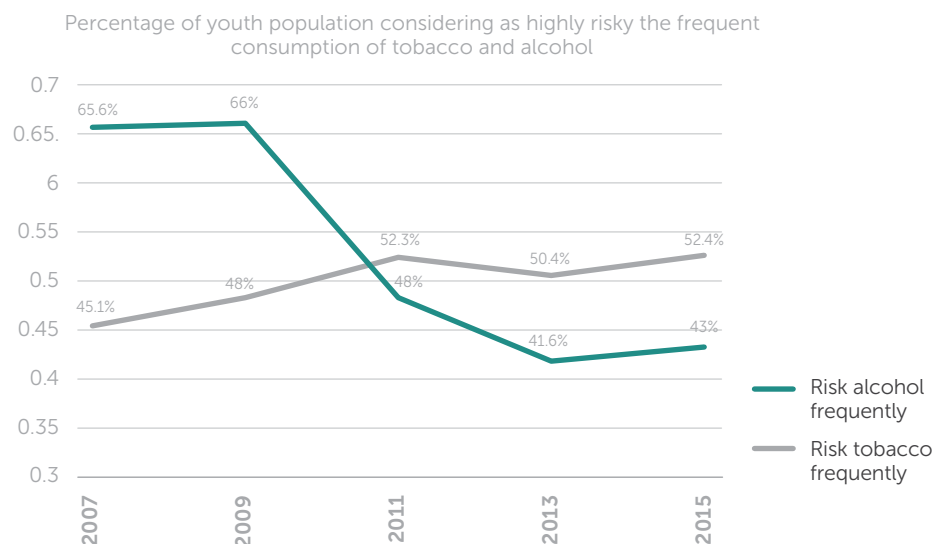
with extreme care, however, because the study does not consider changes in taxes and prices during the period of analysis. It is quite likely that the effect of the ban is overestimated.

There are other, indirect indicators of the effectiveness of these policies on the population, especially youth. One such indicator is the perception that there is a health risk associated with the frequent consumption of certain substances. Figure 14 shows trends in the perceptions among school children of a high risk to health from tobacco and alcohol, the two most frequently consumed harmful substances. It highlights that, while the incidence of the perception that consuming alcohol represents a health risk declined, the corresponding incidence of the perception about tobacco increased by 7 percentage points between 2007 and 2011. The increase has been constant at around 52 percent since then. This is a cause for real concern, given that tobacco kills about half of the confirmed users. Meanwhile, alcohol control policies are mild in Chile; apart from restrictions on sales to minors, there is little regulation.

Figure 15 shows trends in the real price of cigarettes and cigarette affordability. The real price is estimated as the ratio of the cigarette component of the consumer price index and the overall consumer price index. Affordability is the ratio between the general nominal wage index and the cigarette component of the consumer price index. These data are compiled monthly by the National Statistics Institute.

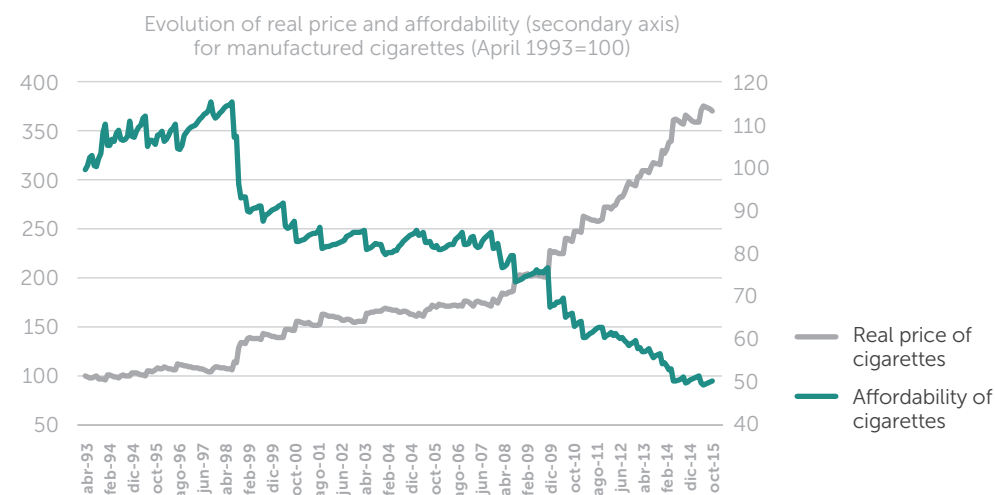
The real price of cigarettes rose by more than 280 percent between April 1993 and December 2017. Attributing this huge increase only to increases in the tobacco tax would be a mistake. Between April 1993 and May 2010, when the first substantial rise in the tobacco

Figure 14. Youth Who Say Use of Tobacco or Alcohol Is Risky, Chile, 2007–15



Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

Figure 15. Price and Affordability, Manufactured Cigarettes, Chile, 1993–2015



April 1993 = 100

Source: Calculations based on data of the National Statistics Institute.

tax in decades was implemented to finance reconstruction in the country, the real price of cigarettes increased by 100 percent. This was entirely the result of a profit-maximization decision by the monopolist producer, BAT Chile, and, during this time, there was no mention by the company of the illicit trade in cigarettes.

Between May 2010 and December 2017, the real price of cigarettes rose by 91 percent. During this time, BAT Chile pointed out repeatedly that the increase in the tobacco tax was responsible for the expansion in the market for contraband cigarettes (BAT Chile 2014). It is untenable to claim that only tax-driven price increases are responsible for contraband, while profit-maximizing price increases bear no responsibility.

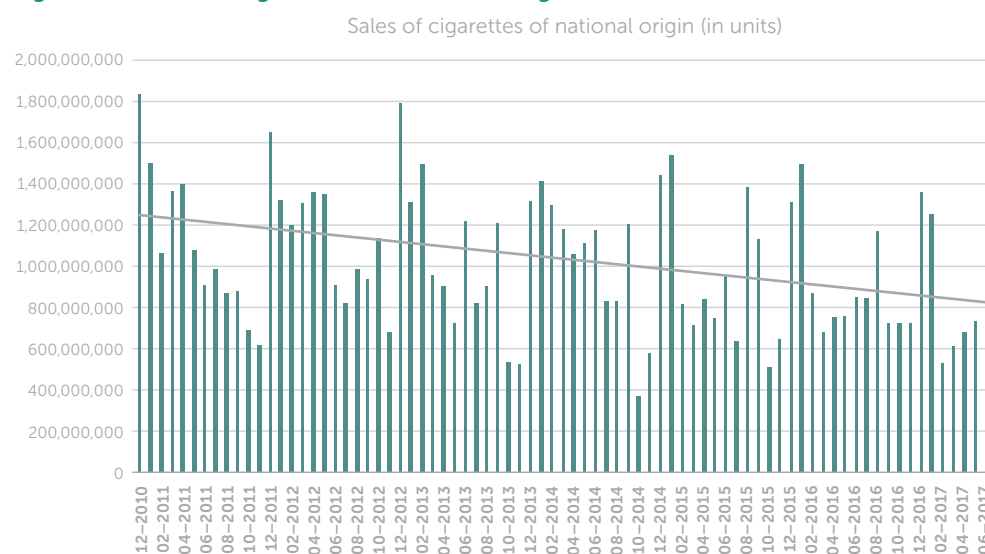
Figure 15 also shows that cigarette affordability decreased steeply during the period, especially beginning in mid-1998 with the onset of the Asian crisis. Thus, affordability fell by 23 percent between April 1993 and May 2010 and by 33 percent from May 2010 to December 2017.

Though no econometric analysis has been conducted on the impact that price changes had on consumption, these changes, plus the changes in regulation, are most likely behind the fall in smoking prevalence among school children and across the general population. Evidence on Latin America shows that a 10 percent rise in prices is associated with a decline in consumption of about 3 percent, which increases to 4 percent over the long run (Guindon, Paraje, and Chaloupka 2015). These results are similar to elasticities reported on Chile, though the study presenting them has econometric limitations (Debrott Sánchez 2006).

Data on cigarette sales that are taxed confirm that, as cigarette prices rise, legal sales of cigarettes decline. Figure 16 shows a clearly declining trend in such sales since the end of 2010. (No government data on cigarette sales existed before then).

Figure 17 shows trends in tobacco tax revenues in real terms in 1993–2017. The figure shows that tobacco tax revenue increased steadily until 2015, but then declined slightly in 2016–17. The rise in the ad valorem tax and the real price of tobacco were behind the increase in revenues (see Figure 15). That revenues fell in 2016–17 is more surprising. This may be attributed

Figure 16. Sales of Cigarettes of National Origin, Units, Chile, 2010–17

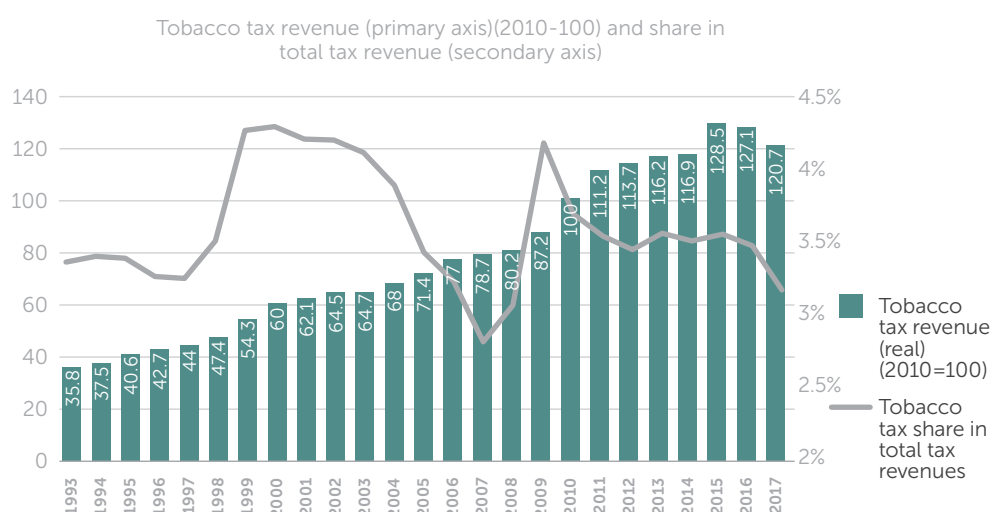


Source: Calculations based on data of the SII.

to shrinkage in cigarette consumption (consistent with the data in Figure 16), to an expansion in the illicit trade in cigarettes, or to a combination of both (see below). It is clear in any case that, despite the decline in legal sales in 2010–17, tobacco tax revenues generally rose.

In terms of relative revenue, Figure 17 shows that, despite recent increases, tobacco taxes have fluctuated between 3 percent and 4 percent of total tax revenue. Even the jump in the specific tax on individual cigarettes in 2014, which implied a nominal price increase of about 15 percent-20 percent, did not alter this pattern.

Figure 17. Share of Tobacco Tax Revenue in Total Taxes, Chile, 1993–2017



Source: Calculations based on data of the SII.

2. The Illicit Trade in Tobacco Products

Context

Chile extends over more than 4,200 kilometers from north to south and shares, with Argentina, one of the longest borders in the world. Nonetheless, the country is relatively isolated by natural barriers. In the east, the Andes, the tallest mountain range in the world outside Asia, covers much of the interior. The west is bounded by the Pacific Ocean. In the north, one of the driest deserts in the world abuts Bolivia and Peru. The south is broken up by numerous lakes and rivers and extends into frigid Antarctica. These natural barriers restrict travel and commerce and mean that the points of entry into the country are relatively few.

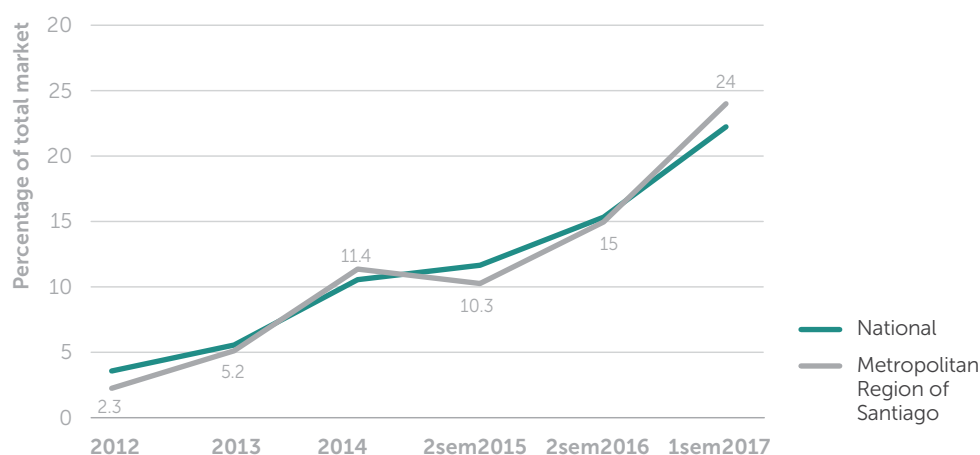
By the nature of the phenomenon, relatively little is known about the illicit trade across the borders of Chile, including the illicit trade in cigarettes, the main tobacco product involved. Until recently, the debate has been dominated by the data produced by the tobacco

industry, especially BAT Chile. BAT Chile has linked a presumably explosive increase in the illicit trade in cigarettes to the rise in the tax on tobacco (see above). Yet, the truly impressive rise in the real price of cigarettes in recent years has been dominated by the decision of BAT Chile to raise its prices, which preceded any appreciable tax increase. As is usual in monopolistic markets, BAT Chile has raised its prices at a pace to outstrip the rise in prices associated with the tax increase. Indeed, the average pass-through of the tax increase was 1.12 between 2010 and 2017 (Delipalla and O'Donnell 2001; Paraje, Araya, and Drope 2018).

According to BAT Chile, the market share of illicit cigarettes expanded by a factor of more than six from 2012 to the first half of 2017, from 3.6 percent to 22.3 percent (Figure 18). BAT Chile claims that, in the Metropolitan Region of Santiago (where about 40 percent of the total population of the country lives), the penetration of the illicit trade in cigarettes grew from 2.3 percent in 2012 to 24.0 percent in the first half of 2017. It also claims that the illicit trade in cigarettes accounts for tax evasion to the tune of US\$500 million a year.⁸

The claim made by BAT Chile that the tax increase is behind the rise in the illicit trade is untenable, because the real price of cigarettes started to climb rapidly at least as early as 1999, almost 10 years before of the main change in the tobacco tax (see Table 2). Despite the obvious inconsistency, the debate in the press has been dominated by the data of BAT Chile, which regularly publishes reports—widely reproduced in the media—about the role

Figure 18. BAT Chile: Penetration of the Illicit Cigarette Trade, Chile, 2012–17



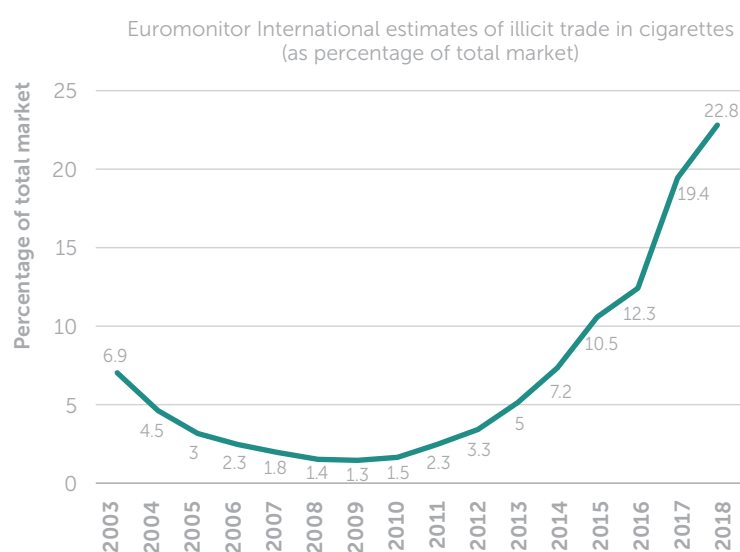
Source: Calculations based on data in “Informes por Industria,” Observatorio de Comercio Ilícito, Cámara Nacional de Comercio, Santiago, Chile. <http://www.observatoriocomercioilicito.cl/estudios/informes-por-industria/#1484577459575-1ef5d87e-6715>.

⁸ See “Informes por Industria,” Observatorio de Comercio Ilícito, Cámara Nacional de Comercio, Santiago, Chile. <http://www.observatoriocomercioilicito.cl/estudios/informes-por-industria/#1484577459575-1ef5d87e-6715>.

of the tax on tobacco in the expansion in the illicit trade.⁹ International consultancy firms also repeat the unfounded claims, which feeds into the debate in the press. The most important example is Euromonitor International, which has produced annual estimates of the penetration of the illicit trade in cigarettes at least since 2003 (Figure 19).¹⁰ According to these estimates, the illicit trade shrank from 6.9 percent to 1.3 percent of the total market in 2003–09 before expanding to 19.4 percent in 2017 and a projected 22.8 percent in 2018.

Euromonitor International explicitly states that “successive increases in tobacco tax, and the resultant increases in the price of cigarettes, remain the main drivers of growth in the illicit trade in cigarettes in Chile.”¹¹ However, between 2003 and 2010, the real price of cigarettes jumped by 43 percent, while affordability declined by 18 percent. Yet, Euromonitor International claims that the illicit trade shrank at this time. This type of inconsistency and the fact that Euromonitor International explicitly acknowledges that its main source of information is the tobacco industry means that Euromonitor International is not a neutral, credible analyst of illicit trade; this is also demonstrated in the case of other countries (Blecher et al. 2015).

Figure 19. Euromonitor International: Illicit Trade in Cigarettes, Chile, 2003–18



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

⁹ See Pérez-Cueto (2017); “Aumenta contrabando de cigarros en nuestro país,” 24horas.cl (November 8, 2013), <http://www.24horas.cl/nacional/aumenta-contrabando-de-cigarros-en-nuestro-pais-927199>; “Comercio ilegal de cigarrillos en Chile creció un 386% en cinco años,” La Tercera (February 1, 2017), Las Condes, Santiago, Chile, <http://www2.latercera.com/noticia/comercio-ilegal-cigarrillos-chile-crecio-386-cinco-anos/.also>.

¹⁰ See Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

¹¹ “Cigarettes in Chile 2016,” Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

More disturbing than the Euromonitor International estimates is the behavior of the government agencies in charge of combating the illicit trade, such as customs, that use BAT Chile estimates in analyses and that echo tobacco industry arguments that higher taxes might be behind the expansion in the illicit trade (National Customs Service 2016).

Studies on the Illicit Trade in Cigarettes in Chile

Independent studies are scarce, though, in the last couple of years, more effort has been undertaken to evaluate trends in the illicit trade in cigarettes. The first study of the illicit trade relied on sales data of BAT Chile (at the time, Chiletobacos SA) for 2002 and compared these data with reported consumption from the 2002 National Survey on Drug Use in the General Population (Debrott Sánchez 2006). The author attributed the gap between the two sets of consumption data to the consumption of illicit cigarettes and estimated the size of the gap at 4.2 percent of the total market. However, it is well known that this type of gap analysis is not appropriate for estimating the size of an illicit market, but only for evaluating trends. The shortcoming arises mainly because user surveys tend to underestimate true consumption (Ross 2015).

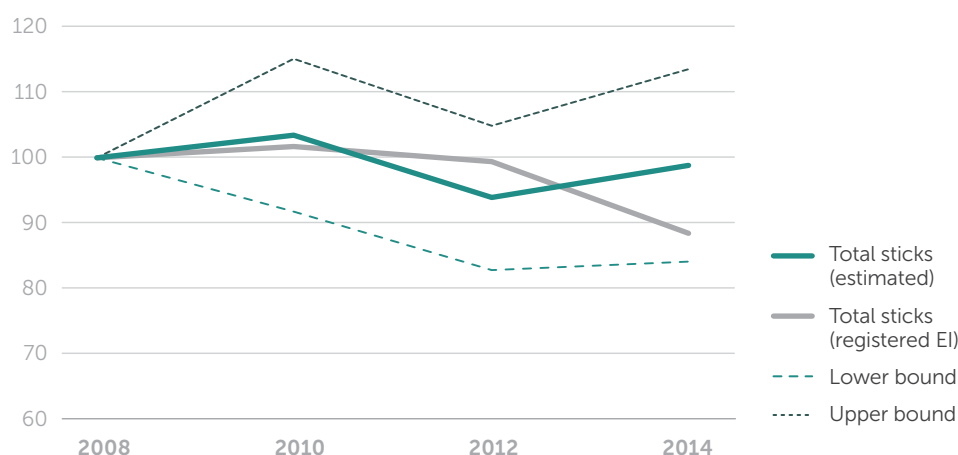
Using a private household survey, another study estimated the extent, in 2011, of the evasion of the tobacco tax, which represents a concept that is related to, but different from illicit trade because tax evasion may also involve undeclared and illegal domestic production (Jorratt 2012). The study found that the evasion of the tobacco tax reached 17 percent of the total tax base, that is, total cigarette consumption. No estimate was offered of the market share of the cigarettes entering the country illicitly from abroad.

A more recent study uses gap analysis to estimate trends in the illicit trade in cigarettes between 2008–14 (Paraje 2018). The study also considers the consumption reported in four waves of the National Survey on Drug Use in the General Population and compares these data with reported cigarette sales (Figure 20). As often occurs in gap analysis, the study assumes that the underreporting of cigarette consumption in surveys is constant across time. It concludes that the trends in the reported consumption are not statistically different—at a 99 percent confidence level—from the trends in the reported sales and that the illicit trade in cigarettes therefore did not change in proportion to the total market over the period. This contradicts the BAT Chile and the Euromonitor International data.

The gap analysis does not supply any information on the size of the illicit market - it cannot distinguish between tax avoidance and tax evasion and cannot determine whether illicit cigarette are counterfeit or contraband.¹² As a result, it is primarily used to detect deviations from the trend, not to estimate the scope of tax avoidance/evasion. However, if the initial estimates of Euromonitor International (indicating that the illicit trade of foreign origin in 2010 represented only 1.5 percent of the total market) are correct, then the illicit market for

¹² Ross, Hana (2015). Understanding and measuring tax avoidance and evasion: A methodological guide

Figure 20. Gap Analysis, Chile, 2008–14



Source: Paraje 2018.

cigarettes in 2014 was not statistically different from that share. Another option is that the true share of the illicit market of both domestic and international origin in 2010 was close to 17 percent. Keeping this share statistically constant for 2014 might imply that the market share of illicit cigarettes of domestic origin is a sizable, about 15.5 percent, if the Euromonitor International estimates are considered accurate.

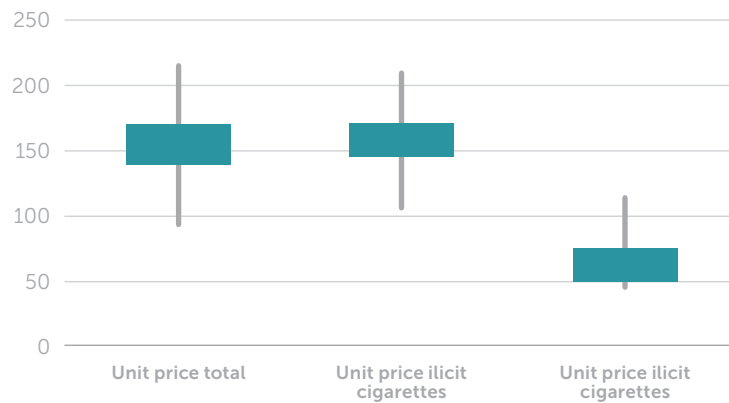
A recent study conducted independently of the tobacco industry included a survey among smokers (810 respondents) in the Santiago Metropolitan Area in May–June 2017 (Paraje and Araya 2017). It finds the share of illicit cigarettes among the consumption of these smokers is at 10.9 percent, in contrast to the contemporary estimates of BAT Chile of 24 percent (see Figure 18). The study also finds that illicit cigarettes are, on average, cheaper than licit cigarettes, though there are infrequent cases in which licit cigarettes are cheaper than illicit cigarettes (Figure 21).

In addition, the study finds that illicit cigarettes are mostly consumed by men, youth of school age, adults ages 60 or older, the less well educated, and the unemployed or economically inactive (Figure 22). This suggests that illicit cigarettes are mostly consumed by people at relatively lower income. This and the fact that illicit cigarettes are relatively cheaper than licit ones indicate that illicit cigarettes mostly compete in the lower-price segment of the cigarette market.

Characteristics of the Illicit Cigarette Trade

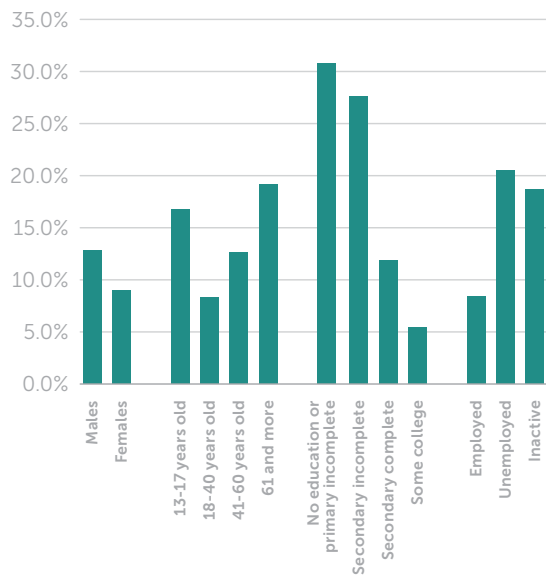
The most comprehensive, up-to-date, government analysis of the illicit trade cigarette has been produced by the National Customs Service (2016). The report includes a thorough description of the main routes and methods used in the illicit trade, though it acknowledges that there are no official estimates on the size of the illicit market and that government

Figure 21. Unit Cigarette Price, by Type of Cigarette, Chile



Source: Based on data of Paraje, Araya, and Drope 2018.

Figure 22. Sociodemographic Characteristics of Illicit-Cigarette Smokers, Santiago, Chile



Source: Based on data of Paraje, Araya, and Drope 2018.

agencies do not possess studies independent of the tobacco industry. Thus, the report relies on BAT Chile estimates and provides an alternative way of estimating the market that is, however, based on a wrongly applied gap analysis.

The illicit trade in northern Chile originates mainly in Bolivia and Peru. Part of the trade involves the fraudulent use of the legal allowance of up to two cartons of cigarettes per overland trip per adult. The report states that, at the Chile-Peru border, people, mostly women, cross the border several times a day and use the legal allowance each time.

In addition to this petty “ant smuggling” (a term used to describe tax avoidance and tax evasion), clandestine illegal crossings, mostly at the border with Bolivia, involve the large-scale

transport of contraband. At the border with Bolivia, 116 such crossings were recently counted, while there were 50 more at the border with Peru. A 140-year-old rift with Bolivia over the border is responsible for frequent tensions in the relationship between the two countries and makes collaboration on any matter difficult. For instance, Bolivia and Chile do not exchange ambassadors.

Another source of illegal trade is the duty-free zone at Iquique, one of the main ports of Chile. This zone is used as a port of entry for cigarettes, mostly from Asia, that are then re-exported to Bolivia and Peru. The cigarettes never reach those countries, but are redirected into the national market. The same method is used with a share of the cigarettes produced in Chile for export. Free of tobacco excise taxes or value added taxes, these cigarettes are re-transported into Chile using illegal crossings, or they never leave Chile, but are sold illegally on the domestic market.

In central Chile, a small-scale illicit trade likewise involves reliance on the two-carton allowance per adult per trip. In this case, there are no Argentine cities close to the border, and, hence, the number of cigarettes entering using this method is limited. In the case of air travel, the duty-free allowance is an extremely high seven cartons of cigarettes, which facilitates the commercialization of foreign cigarettes. Santiago International Airport is, by far, the main recipient of international travelers, and the number of passengers arriving in Chile by air rose 117 percent in 2001–17. Illicit cigarettes also enter into the country through the main seaports, on board ships mostly from Panama and the United States via the Dominican Republic. By sea, contraband is mostly brought in by concealing the illicit cigarettes in other goods shipments, such as clothing, or by falsifying import declarations, that is, by declaring that shipments contain other goods when, in reality, they contain cigarettes. That this large-scale smuggling is possible simply by misreporting the type of goods that are imported reveals the limited capacity to control imports effectively.

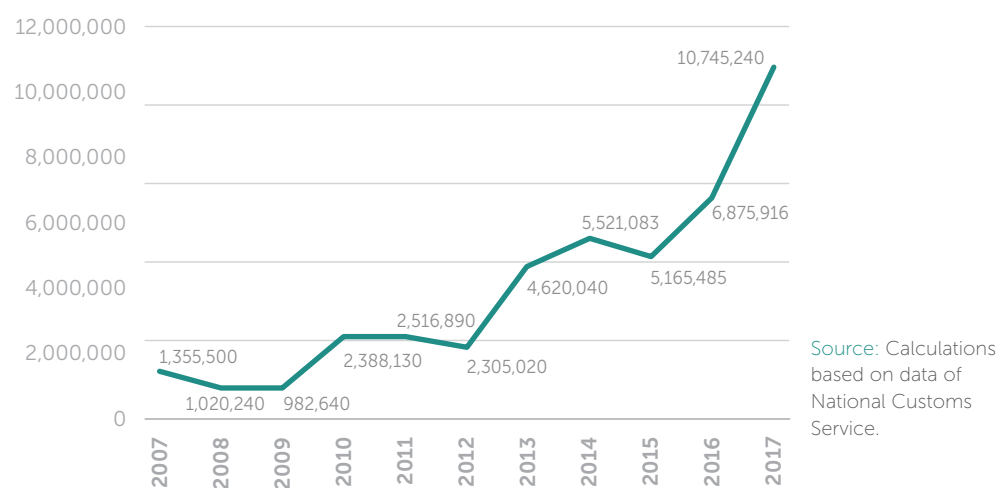
In southern Chile, Argentine cities are much closer, and the main source of illegal cigarettes is small-scale contraband involving the concealment of cigarettes in cars, buses, and clothing. In addition, ant smuggling also occurs.

Annex 1A shows summary tables of the main entry points for illicit cigarettes into Chile, along with information on brands and smuggling methods as reported by the National Customs Service (2016).

Figure 23 illustrates trends in illicit cigarette seizures in Chile. The seizures began to increase rapidly after 2012, growing by more than 500 percent in 2012–17. Though international experts warn against the practice, data on seizures have been used as a proxy for the trends in illicit trade and presented as evidence of expanding illicit trade.¹³ However, seizures of illicit

¹³ "Comercio ilegal." British American Tobacco, Argentina, Córdoba, Argentina (accessed December 27, 2017), http://www.batargentina.com/group/sites/BAT_9YXKEP.nsf/vwPagesWebLive/DO9T5K4G, but see NCI and WHO (2016).

Figure 23. Number of Packs of Cigarettes Seized by Customs, Chile, 2007–17



cigarettes have recently grown at least at a similar rate as seizures of other goods, which points to more effective control at borders, rather than to an increase in the volume of illicit trade (National Customs Service 2017).

The study by the National Customs Service (2016) makes clear a worrying fact: the lack of the technical capacity or the resources to produce independent government studies on contraband, which leads to a reliance on tobacco industry estimates without the ability to gauge accuracy or be critical of analysis. Moreover, it is clear that government agencies in charge of overseeing cigarette markets do not communicate or collaborate together sufficiently, at least on the production of official information.

The lack of technical capacity is clear not only in official reports, but in media reports, where officials repeat tobacco industry estimates, and also from the alliances between public entities and private associations in which the tobacco industry has a prominent role (National Customs Service 2016).¹⁴ Government studies on the illicit trade in cigarettes almost invariably begin by quoting tobacco industry estimates, even though they acknowledge there is no clarity about methodology or the way such estimates are produced.

The lack of technical capacity is made clear by the gap analysis produced by customs to estimate the illicit trade in cigarettes. First, customs uses data on sales provided by BAT Chile, even if official SII data exist on taxed sales (see Figure 16). BAT Chile estimates for 2015 are 3.2 percent lower than the official figures, a bias that would tend to raise the estimates of the illicit trade. Second, customs estimates a theoretical consumption of cigarettes using

¹⁴ One of these is the Illicit Trade Observatory (Observatorio del Comercio Ilícito; website: <http://www.observatoriocomercioilicito.cl/>), which maintains alliances with customs, several branches of the police, the Public Prosecutor's Office, the SII, and so on.

a methodology with no theoretical or empirical validity, given that it assumes arbitrarily the impact several policies, such as a tax increase and smoke-free areas, would have had on consumption. Using theoretical and observed consumption, customs concludes that the illicit trade accounted for 10.4 percent of the market in 2015, close to the BAT Chile estimates. This estimate lacks any validity also because a well-developed gap analysis, not one that is flawed such as the one produced in the customs report, requires at least two points in time to predict trends, not levels, of illicit trade. The report concludes that seized cigarettes constitute 7.7 percent of the illicit market, though seized cigarettes are not part of the market because they were seized, not consumed. Customs estimates the total tax evasion produced by this contraband at US\$220 million. Because the estimates of contraband are flawed, the estimate of tax evasion lacks any validity, though it is close to the BAT Chile estimate of the taxes evaded because of contraband, though BAT Chile provides no information on methodology.

3. Tackling the Illicit Trade in Tobacco Products

International experience shows that it is the quality and enforcement of tax administration, not tobacco taxation, that is the major driver of success in controlling illicit trade (Marquez and Moreno-Dodson 2017; NCI and WHO 2016). The first step to strengthening the quality and enforcement of tax administration is to implement a successful policy to control the illicit trade, that is, to possess a comprehensive national strategy that addresses this issue systematically. This is missing in Chile. Various agencies have distinct approaches, means, and priorities, and there seems to be no substantial coordination among them, apart from some recent efforts to share information. Illicit cigarettes can be purchased in known places around large cities and even on the Internet on well-known trading sites.¹⁵ Investigative journalists have denounced publicly cases of collusion between contrabandists and customs officials who are behind the illegal commercialization of large quantities of cigarettes (Carvajal and Jara 2016).

Though the methods of contrabandists are well known, the activity continues to this day (see Annex 1A). Some efforts have been undertaken by the authorities. In the case of the National Customs Service, an integrated smuggling plan (Plan Integral de Fiscalización) was developed for cigarettes, along with 10 other sectors, groups, or problem areas (mining products, intellectual property, public health, drugs, and so on). The plan has involved the establishment of a network of actors and responsibilities within customs and the formation of working groups among several agencies with shared action plans.

The program has brought about an increase in communication among customs offices on important information obtained during seizures of cigarettes. An initial report is filed within 24 hours of a seizure, and then, within 48 hours, a final report is filed containing

¹⁵ For instance, see Mercado Libre Chile, at <https://www.mercadolibre.cl/>.

all information relating to the incident. Reports are sent to a central office where they are processed, and then they are sent to nearby customs offices. This central office regularly generates a spreadsheet that consolidates all seizure information across customs offices and incorporates data on the most relevant seizures carried out by the other agencies (the National Police and the Investigation Police). This spreadsheet is sent to customs offices on a regular basis to ensure that the entire organization is informed of incidents occurring in various parts of the country.

For inspection and control operations, the plan relies on a handful of regional customs offices in the most highly affected areas, the National Police Force, and the Investigative Police for work outside the customs perimeter. It has established the Organization of Cigarette Smuggling–Integrated Smuggling Plan Technical Meeting to promote the work of the customs departments involved in the program.

The Control Directorate of the National Customs Service uses a suite of risk analysis tools. Risk filters refer to selection criteria or parameters based on risk indicators and involve the review of documents, cargo scanning, and physical examinations to identify risk characteristics. Customs uses these filters to select operations automatically or manually for documentary review, evaluation, or physical examination and to generate customs alerts. This is a dynamic process that requires constant review of the effectiveness of the filters to determine whether they should be maintained or modified.

One central topic in controlling contraband is the penalty associated with, for example, smuggling. It is a basic economic premise that, for certain crimes, such as smuggling, if the expected cost of committing the crime (which depends on probability of detection, probability of conviction, fines, and length of conviction) is smaller than the expected benefits (which depends on the probability of detection and the economic gain associated with the crime), there is an incentive to commit the crime.

In Chile, the penalties associated with smuggling are relatively mild. Currently, an individual smuggling fewer than 25 monthly tax units (about US\$1,850) in goods is punished by the seizure of the goods and a fine from one to five times the value of the goods. If the value of the goods exceeds 25 monthly tax units apart from the seizure and fine (one to five times the value of the goods), the individual may receive up to 40 days in prison. Usually, the time in prison is not effective unless individuals have committed serious crimes before.

The Protocol to Eliminate the Illicit Trade in Tobacco Products

Though the government of Chile ratified WHO's FCTC early, it has not ratified the Protocol to Eliminate Illicit Trade in Tobacco Products. Indeed, the government has not even signed the protocol, despite the fact that many Latin American countries that have cigarette trade with Chile, such as Colombia, Panama, and Uruguay, have either signed or already ratified the protocol.

There is no clear indication about when the protocol will be signed and ratified in Chile, and there is currently no information available on which government department is analyzing any future implementation of the protocol. There are no Parliamentary initiatives nor political discussions regarding the ratification of the protocol despite the constant claims by the tobacco industry about a growing illicit trade.

The Track-and-Trace System

Despite the lack of progress on the protocol, Chilean authorities have decided to implement a track-and-trace system (TTS). However, the reason to implement such a system is related to tighter fiscal control over the tobacco industry with respect to the collection of the tobacco tax rather than to the effective control of illicit trade, as explicitly stated in the laws and regulations on this matter. In other words, the stress is on domestic tax evasion, not smuggling.

The TTS was approved by Parliament during discussions on general tax reform in 2014. The reform substantially raised the specific tax on cigarettes, and lawmakers supported it by extending the supervisory power of the SII over the tobacco industry and by approving the TTS (see Figure 13). Until then, though the SII was generally believed to be one of the most effective tax collection agencies in Latin America, it was informally assumed by SII officials that the capacity they have to audit the tobacco industry's tax declarations was limited (Serra 2003).

The TTS system was approved in September 2014 through Law 20780, on general tax reform, which explicitly stated that the reason for the adoption of the system was to enhance fiscal control over the excise taxes on tobacco. It also stipulated that the Minister of Finance should issue a regulation defining the characteristics of the system. The regulation was published in Decree 19 of the Minister of Finance in January 2015. It defines the TTS as an integral platform housing information on the production, importation, distribution, commercialization, and so on of taxed tobacco products. In addition, it provided that the system should be enabled to identify, mark, and trace taxed tobacco products. According to the regulation, the firm providing the TTS platform could not be associated with the tobacco industry, though the definition of the prohibited relationship was not sufficient to prevent firms connected to the tobacco industry from installing a systems technology developed by the tobacco industry, such as Philip Morris International's Codentify TTS software.

Civil society pressure caused Parliament to amend Law 20780 through Law 20899 (February 2016), which mandated that the Minister of Finance introduce regulations preventing the direct participation of the tobacco industry in the TTS. The main regulation was issued at the end of December 2016 (Decree 1027) and established that the TTS would necessarily have to include devices installed on production lines that would compile information on product types, dates of production, production lines, the quantities produced, and so on. It was left as an option of the SII to tag products with seals, stamps, or other tracking material. Though there was no requirement on the independence of the TTS provider relative to the tobacco industry, there was a public agreement that the firm operating the TTS would be independent.

In March 2017, the SII issued a public tender on the TTS. Contrary to the agreement, there was no provision on the independence of TTS providers from the tobacco industry, and the tender gave 93 percent of the total weighting of bids to economic aspects, and only 7 percent to technical aspects. However, only firms qualifying on the technical aspects would be assessed on the economic aspects.

In August 2017, three firms presented bids. Two had ties with the tobacco industry. One was ATOS, one of the developers of the Codentify software; the other was a firm that provided printing products to the tobacco industry. Civil society and political pressure exerted by some parliamentarians led the SII to reject the bids of these two firms and award the contract to SICPA, a firm not related to the tobacco industry (SII 2018).¹⁶ Because of legal challenges and the lack of the necessary legal authorization for the entire process, no TTS has yet been implemented, though it has been estimated that one should be established by April 2019.

There is no objective evidence that the tobacco industry was involved in the changes, delays, and attempts to interfere in the implementation of the TTS. However, a system that should have been in place by the end of 2015, at the latest, is still being legally challenged. A former director of the SII estimated that delaying the TTS meant a loss of US\$500 million a year in extra revenue and that officials at the Ministry of Finance were not willing or able to overcome the tobacco industry's resistance to the system (Alonso 2017).

The TTS that will be implemented will allow the SII to count the cigarettes produced in the country. It will permit an accounting of the cigarettes sold domestically. This information is available today only through the tax declarations provided by the tobacco industry, and there is currently little capacity to audit these declarations properly. The TTS will also allow the SII to monitor the quantities of cigarettes that are exported and thus not liable for local taxes.

The TTS will consist of a printed seal similar to a QR code on the pack. It will include information on the production line, the date and time of production, the brand, and so on. Cigarettes that are destined for the international market will not be marked, and no information on these will be collected apart from the number produced. This means that round-tripping, whereby the cigarettes end up on the domestic market, will still be possible. The information contained in the printed seal will only be readable using the special devices that will be supplied to SII officials.

One of the main limitations of this method of product identification is that it can be replicated by simply printing a counterfeit code on packs. The only way to discover if seals are being counterfeited is to check each one using the special code readers. Unlike the methods adopted by other countries in the region, such as Argentina, Brazil, Ecuador, and others, this method does not involve stamps of different colors or seals with special inks allowing

¹⁶ See "Trazabilidad a las tabacaleras: El gato cuidando la carnicería," GuidoGirardi website, <http://guidogirardi.cl/tag/trazabilidad/>.

a rapid, bare-eye inspection to check if the product is licit or illicit. In this respect, Chile has chosen a method that, while allowing the collection of information useful in monitoring tax evasion by producers, may fall short in the goal of identifying contraband cigarettes.

4. Challenges and Recommendations in Tackling the Illicit Trade

Chile faces several challenges to tackling the illicit trade successfully. First, the country needs an integrated set of laws and regulations designed to curb the illicit trade in cigarettes. Ratifying the Protocol to Eliminate Illicit Trade in Tobacco Products is certainly a first step in this direction. New legislation improving the policing capabilities of the agencies involved in reducing the illicit trade can be built on the framework provided by the protocol, especially in coordinating with agencies in other countries. The difficult relationship between Bolivia and Chile represents an extra challenge, but the protocol may also facilitate collaboration with countries trading tobacco products with Bolivia.

Second, there is an urgent need to produce more information, independent of the tobacco industry, on the extent of the illicit trade in tobacco, its characteristics, and the related implications for the internal tobacco market. The public discussion on the illicit trade cannot be dominated by the data of the tobacco industry, with no account taken of how these data are produced or that the data tendentiously link trends in the illicit trade with taxes. Public authorities echo these data and misleading conclusions. Independent estimates, whether produced by public entities or commissioned to third parties, should be available regularly to assess the extent of the illicit market and trends in the trade. No serious political effort to tackle the illicit trade can be undertaken without knowledge of the scope of the problem or with misleading ideas about the problem.

Third, the influence of the tobacco industry on policy makers should be contained, as set out in the FCTC. The tobacco industry or private associations and other organizations in which the tobacco industry is prominent maintain regular contacts with government agencies on illicit trade issues. This helps the tobacco industry propagate its questionable data and discourse on the illicit trade across the public sector. There are frequent meetings between tobacco industry executives and government officials; and, as a consequence, important initiatives, such as the implementation of the TTS, were stopped, altered, or delayed.

Fourth, the penalties for illicitly marketing cigarettes and other tobacco products should be drastically augmented. A successful campaign against the illicit trade depends on effectiveness in detecting the illicit act, but also on the penalties for those people who are found guilty. In Chile, the penalties are relatively light. The cost of engaging in smuggling must be raised, not only by increasing the ability of government agencies to detect the illicit trade, but also in punishing illicit traders meaningfully.

Thus, the recommendations for tackling the future development of the illicit trade in cigarettes include the following: to sign and ratify the Protocol to Eliminate Illicit Trade in Tobacco Products; to enforce related policies and initiatives; to reduce the influence of the tobacco industry on policy makers and other officials; to produce independent and verifiable information on the extent of and trends in the illicit trade in cigarettes; and to augment the amount of fines and imprisonment for people convicted of trading in contraband.

Other measures could also be adopted that would have a significant effect on the illicit market for cigarettes:

- » The existence of a duty-free zone in Iquique, one of the main ports of Chile and close to the Bolivian border, is a threat to any meaningful policy aimed at tackling the illicit trade in cigarettes. The zone has often been justified as a tool to foster economic development in a relatively poor area of the country.¹⁷ Even if such an ambition were achievable through a duty-free zone, it is not credible that the cigarette trade would contribute to such a goal. There are no meaningful economic reasons to allow cigarettes to enter the Iquique free zone untaxed.
- » Duty-free allowances should be limited or eliminated. Though duty-free allowances might be justified by the lack of capacity to check every person entering the country or because it is more cost-effective to allow individuals to enter the country with a small amount of certain goods, the allowance could be greatly reduced or eliminated. Permitting a duty-free allowance of up to seven cartons for international air travelers seems excessive, especially because passengers entering the country at the main airport, Santiago International Airport, are extensively checked by the Agriculture Service to block them from bringing in fruits and vegetables. The x-ray scanners used for this purpose at every international airport and even at some land crossings could easily be used to check for larger quantities of cigarettes. The allowance at land crossings—up to two cartons per trip—could be more effectively enforced by limiting the number of times a person can use the cigarette allowance to, for instance, once a month.
- » A regional political approach toward the illicit trade should be considered. Latin American countries with which Chile has regular trade relations, such as Bolivia and Paraguay, are sources of smuggled cigarettes. A successful policy for the control of contraband would be incomplete if it focuses only on the recipient country, especially if the source of these products is known. The relationship with Bolivia is often difficult, and, in the case of Paraguay, the contraband and the counterfeiting industry (not only in cigarettes) are well established and often enjoy substantial political protection. It has even been suggested that a cigarette manufacturing facility owned by a former president of Paraguay may be a source of the illicit trade in cigarettes in other countries (Risatti 2017). High-level meetings in multilateral regional forums, such as the Southern Cone Common Market, could

¹⁷ See "Nuestra Historia," ZOFRI, Zona Franca de Iquique, Iquique, Chile, <https://www.zofri.cl/es-cl/Nosotros/Paginas/Historia.aspx>.

encompass discussions on how to limit or control the illicit trade in all goods, including cigarettes. A more extreme initiative would be to forbid cigarette exports from Chile to countries suspected of not contributing appropriately to controlling the illicit trade, such as Bolivia or Paraguay. The use of the Iquique free-trade zone to re-export foreign cigarettes to these countries could be prohibited given that these cigarettes are often illegally re-transported into Chile or never cross the border at all.

Smoking prevalence rates, including among young people, are so high as to constitute a severe public health epidemic and to merit a more vigorous response. Chileans who continue to smoke will die an average of 20 years prematurely. So, Chile should not allow self-interested and exaggerated underestimates of the illicit trade to stop it from strengthening its tobacco control program.

Annex

Annex A. Illicit Entry of Cigarettes into Chile

Table A.1. Modus Operandi of the Illicit Entry of Cigarettes, Northern Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Chacalluta customs post	Entry of cigarettes at Arica through the misuse of the international traveler allowance, for subsequent collection and sale in Arica or shipment to southern Chile	Cigarettes primarily of Bolivian origin (Bolivian National Customs stamp), involving brands not authorized for sale in Chile	Mainly Carnival, Fox, Jaisalmer, Mensfield, and Pine
Unauthorized border crossings in the Arica and Parinacota Region (XV)	Entry of cigarettes hidden in vehicles		
Colchane border crossing	Entry of cigarettes in the Tarapacá Region through misuse of the international traveler allowance, for subsequent collection and sale in Iquique or shipment to southern Chile	Cigarettes primarily of Bolivian origin (Bolivian National Customs stamp), involving brands not authorized for sale in Chile	
Unauthorized border crossings in Tarapacá Region (I)	Entry of cigarettes by ship, mules (transporters), and cargo trucks, 4x4s, and so on	Counterfeit cigarettes of Paraguayan origin, which enter Bolivia through unauthorized border crossings and subsequently enter Chile in the same way	
Around the Quillagüa internal control point	Entry of cigarettes hidden in vehicles, primarily buses		
	Breach of the Quillagüa internal control point by means of detours and alternate routes		
	Reshipment processes in which the goods are not reported to the exit customs office and remain in the country illegally		

Source: Calculations based on data of National Customs Service 2016.

Table A.2. Modus Operandi of the Illicit Entry of Cigarettes, Central Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Port of San Antonio	<p>Small number of packs or cartons are hidden among imports of other goods, such as clothing or miscellaneous small items</p> <p>Entry of contraband involving importers bringing in full containers of counterfeit cigarettes</p>	<p>Cigarettes primarily of Chinese origin and Chinese brands presumably for personal consumption</p> <p>Cigarettes primarily from China, Curaçao, Jamaica, Panama, and the United States; unauthorized brands intended for sale in Chile (cigarettes that cannot be identified as counterfeit) and counterfeit cigarettes have been found</p>	Mainly Belmont, Bronco, Cumbia, Derby, Golden, Jaisalmer, Lucky Strike, Marlboro, Montreal, Pocker, Rich, Seneca, Walden
By land, via the Los Libertadores customs post, Andes Customs	<p>Entry via small-scale smuggling, by means of the misuse of passenger allowances</p> <p>Entry by various means of transport, particularly buses, trucks, and passenger vehicles</p>	Various manufacturer brands; authentic cigarettes, with or without authorization for sale in Chile; counterfeit cigarettes	Mainly 357, Blue Point, Brass, Bronco Ultra, Carnival, Eston, Euro, Fox, Lucky Strike, Pall Mall, Rodeo
By land, on trucks to locations in the outskirts of Santiago	From other regions and countries; stored for later distribution and sale in shops not authorized by the SII	Brands authorized for sale in Chile and unauthorized brands have been seized; the former includes some counterfeit cigarettes, whereas the latter involves only authentic cigarettes	Mainly 51, Blue Point, Bronco, Carnival, CJ, Fox, Golden, Hilton, Jaisalmer, Laredo, Marlboro, Melbour, Mensfield, Montreal, Nirvana, Pall Mall, Philip Morris, Pine, Rodeo, Starlite, V8, You
By sea, from Panama and the United States, the latter with transit through the Dominican Republic	Cartons or packs are hidden among imports of other types of goods, such as vehicle roof racks and television antennas	Seized cigarettes not authorized for sale in Chile, mainly of Indian origin	Cumbia, Gold City, Hongmei, Huang Shan, Jaisalmer, Shuangxi
By land, from northern Chile	Trucks loaded with cigarettes from northern Chile, such as Arica and Coquimbo, involving counterfeit cigarettes; the transit return method is used with cigarettes produced in Bolivia	Seized cigarettes not authorized for sale in Chile, mainly of Indian, Korean, and Paraguayan origin	Carnival, Fox, Jaisalmer, Laredo, Nirvana

Table A.2. Modus Operandi of the Illicit Entry of Cigarettes, Central Chile, Cont.

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Seized outside the customs perimeter	Sales in commercial warehouses	Seized cigarettes not authorized for sale in Chile and counterfeit cigarettes	Counterfeit: Belmont, Pall Mall, Viceroy; not authorized for sale: Carnival, Esse, Jalsaimer, Pine Blue
	Clandestine trade	Seized cigarettes that are or are not authorized for sale in Chile, primarily of Argentine, Bolivian, Korean, and Paraguayan origin	Belmont, Blue Point, Carlile, Carnival, Cigar Mojito, Esse Black, Esse Blue, Esse Change, Fox, Hilton, Jalsaimer, Marlboro, Mustang, Pall Mall, Philip Morris, Pine Blue, Pine Green, President, Viceroy

Source: Calculations based on data of National Customs Service 2016.

Table A.3. Modus Operandi of the Illicit Entry of Cigarettes, Southern Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Border crossings: Dorotea, Casas Viejas, Monte Aymond, San Sebastián	Entry of cigarettes in the Magallanes and Chilean Antarctic regions through misuse of international traveler allowances (small scale); cigarettes hidden in vehicle compartments (caletas); cigarettes hidden in luggage and clothing; the goods are stored and shipped to northern Chile	Cigarettes primarily of Argentine origin, both brands that are authorized for sale in Chile and those that are not.	Mostly 357, Belmont, Blue Point, Camel, Lucky Strike, Marlboro, Pall Mall, Philip Morris, Red Point, Viceroy
Unauthorized border crossings: Última Esperanza Province (Puente Lincoman), Tierra del Fuego Province (Las Bandurrias, adjacent estancias)			
Ports of Puerto Montt (for example, Oxxean, Empormontt) and Cardenal Samoré border crossings	Entry at Punta Arenas of cigarettes of Argentine origin that are subsequently transported to the Lakes Region and the rest of the country; storage of Argentine cigarettes in Puerto Natales; direct entry of trucks with cigarettes from Argentina	Cigarettes primarily of Argentine origin, both authorized and unauthorized for sale in Chile	Mostly 357, Baltimore, Belmont, Blue Point, Derby, Melbo, Pall Mall
Futaleufú and Río Encuentro border crossings	Entry of cigarettes of Argentine origin in the Lakes Region for later transport to the rest of the country		

Source: Calculations based on data of National Customs Service 2016.

References

- Alonso, Carlos. 2017. "Fisco deja de recibir US\$1.000 mills. por retraso en trazabilidad del tabaco." *La Tercera Pulso*, June 12. <http://www.pulso.cl/economia-dinero/fisco-deja-recibir-us1-000-mills-retraso-trazabilidad-del-tabaco/>.
- BAT Chile (British American Tobacco, Chile). 2014. "Impuestos más altos del mundo y regulaciones desproporcionadas favorecen contrabando y limitan libertades." September, BAT, Santiago, Chile.
- Blecher, Evan, Alex Liber, Hana Ross, and Johanna Birckmayer. 2015. "Euromonitor Data on the Illicit Trade in Cigarettes." *Tobacco Control* 24 (1): 100–01.
- Carvajal, Víctor, and Matías Jara. 2016. "La aguda crisis de Aduanas facilita evasión, contrabando y narcotráfico." March 23, Centro de Investigación Periodística, Santiago, Chile. <https://ciperchile.cl/2016/03/23/la-aguda-crisis-de-aduanas-facilita-evasion-contrabando-y-narcotrafico/>.
- Debrott Sánchez, David. 2006. "Economía del Control del Tabaco en los países del Mercosur y Estados Asociados: Chile." Pan American Health Organization, Washington, DC. <http://iris.paho.org/xmlui/handle/123456789/2811>.
- Delipalla, Sophia, and Owen O'Donnell. 2001. "Estimating Tax Incidence, Market Power, and Market Conduct: The European Cigarette Industry." *International Journal of Industrial Organization* 19 (6): 885–908.
- Drope, Jeffrey, and Neil W. Schluger, eds. 2018. "The Tobacco Atlas." 6th ed. With Zachary Cahn, Jacqui Drope, Stephen Hamill, Farhad Islami, Alex Liber, Nigar Nargis, and Michal Stoklosa. American Cancer Society, Atlanta.
- Feigl, Andrea B., Joshua A. Salomon, Goodarz Danaei, Eric L. Ding, and Esteban Calvo. 2015. "Teenage Smoking Behaviour Following a High-School Smoking Ban in Chile: Interrupted Time-Series Analysis." *Bulletin of the World Health Organization* 93 (7): 468–75.
- Guindon, G. Emmanuel, Guillermo R. Paraje, and Frank J. Chaloupka. 2015. "The Impact of Prices and Taxes on the Use of Tobacco Products in Latin America and the Caribbean." *American Journal of Public Health* 105 (3): e9–e19.
- Jha, Prabhat, and Richard Peto. 2014. "Global Effects of Smoking, of Quitting, and of Taxing Tobacco." *New England Journal of Medicine* 370 (1): 60–68.
- Jorratt, Michael. 2012. "Estimación de la evasión tributaria en los impuestos selectivos al consumo: el caso de Chile." *Revista de Administración Tributaria* 34 (December): 33–45.
- Linetzky, Bruno, Raúl Mejía, Daniel Ferrante, Fernando G. De Maio, and Ana V. Diez Roux. 2012. "Socioeconomic Status and Tobacco Consumption among Adolescents: A Multilevel Analysis of Argentina's Global Youth Tobacco Survey." *Nicotine and Tobacco Research* 14 (9): 1092–99.
- Marquez, Patricio V., and Blanca Moreno-Dodson. 2017. *Tobacco Tax Reform: At the Crossroads of Health and Development; A Multisectorial Perspective*. Washington, DC: World Bank.
- National Customs Service, Chile. 2016. "Estudio de cumplimiento tributario en las importaciones de cigarrillos." National Customs Service, Valparaíso, Chile.

———. 2017. "Cuenta Pública Gestión 2017." National Customs Service, Valparaíso, Chile. https://www.aduana.cl/aduana/site/artic/20180531/asocfile/20180531165417/cuenta_p_blica_director_nacional_de_aduanas_2017.pdf.

NCI (U.S. National Cancer Institute) and WHO (World Health Organization). 2016. *The Economics of Tobacco and Tobacco Control*. NCI Tobacco Control Monograph 21, NIH Publication 16-CA-8029A. Bethesda, MD: NCI, National Institutes of Health, U.S. Department of Health and Human Services; Geneva: WHO.

Observatorio Chileno de Drogas. 2016. "Décimo Primer Estudio Nacional de Drogas en Población General de Chile, 2015." December, Servicio Nacional para la Prevención y Rehabilitación del Consumo de Drogas, Santiago, Chile.

———. 2017. "Décimo Segundo Estudio Nacional de Drogas en Población General de Chile, 2016." December, Servicio Nacional para la Prevención y Rehabilitación del Consumo de Drogas, Santiago, Chile.

PAHO (Pan American Health Organization). 2016. *Informe sobre Control del Tabaco en la Región de las Américas: A 10 años del Convenio Marco de la Organización Mundial de la Salud para el Control del Tabaco*. Washington, DC: PAHO.

Paraje, Guillermo R. 2018. "Illicit Cigarette Trade in Five South American Countries: A Gap Analysis for Argentina, Brazil, Chile, Colombia, and Peru." *Nicotine and Tobacco Research* (May 15).

Paraje, Guillermo R., and Daniel Araya. 2017. "Estudio sobre hábitos de consumo de cigarrillos en el Gran Santiago." Informe Final (November), Universidad Adolfo Ibáñez and American Cancer Society, Santiago, Chile.

Paraje, Guillermo R., Daniel Araya, and Jeffrey Drope. 2018. "Illicit Cigarette Trade in the Metropolitan Santiago de Chile." Universidad Adolfo Ibáñez, Santiago, Chile.

Pérez-Cueto, Constanza. 2017. "CNC calcula en 22% el comercio ilícito de cigarrillos en el país." La Tercera, November 9. <http://www2.latercera.com/noticia/cnc-calcula-22-comercio-ilicito-cigarrillos-pais/>.

Pichón-Riviere, Andrés, Ariel Bardach, Joaquín Caporale, Andrea Alcaraz, Federico Augustovski, Francisco Caccavo, Carlos Vallejos, et al. 2014. "Carga de enfermedad atribuible al tabaquismo en Chile." Documento Técnico IECS 8 (April), Instituto de Efectividad Clínica y Sanitaria, Buenos Aires.

Risatti, Francisca. 2017. "El rey del tabaco paraguayo." *El País*, September 22. https://elpais.com/economia/2017/09/21/actualidad/1506014119_261889.html.

Ross, Hana. 2015. "Understanding and Measuring Cigarette Tax Avoidance and Evasion: A Methodological Guide." March, Economics of Tobacco Control Project, School of Economics, University of Cape Town, Cape Town; Tobacconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago, Chicago.

Serra, Pablo. 2003. "Measuring the Performance of Chile's Tax Administration." *National Tax Journal* 56 (2): 373–83.

SII (Internal Revenue Service, Chile). 2018. "Finalizó licitación de sistema de información para apoyar la trazabilidad fiscal para cigarrillos." *Noticias*, February 19. <http://www.sii.cl/noticias/2018/190218noti01er.htm>.

Taylor-Robinson, David C., Sophie Wickham, Melisa Campbell, Jude Robinson, Anna Pearce, and Ben Barr. 2017. "Are Social Inequalities in Early Childhood Smoking Initiation Explained by Exposure to Adult Smoking? Findings from the UK Millennium Cohort Study." *PLoS ONE* 12 (6): e0178633.

COLOMBIA

10

COLOMBIA:

Illicit Cigarette Trade

*Blanca Llorente and Norman Maldonado*¹

Chapter Summary

Colombia introduced a major tobacco tax hike in December 2016, raising the specific component of its tobacco excise from 700 Colombian pesos (COP\$) per 20-cigarette pack to COP\$ 1,400 in January 2017 and then COP\$ 2,100 (US\$ 0.74) in January 2018. Such recent measures have energized Colombia's tobacco control agenda. Meanwhile, however, reforms to tackle illicit tobacco in Colombia have not yet achieved the status of a functional public policy, i.e., one that integrates actions across sectors at the national level while establishing coordination with subnational authorities.

Estimates from an independent 2017 survey show a slight rise in illicit tobacco trade after Colombia's 2016 tax reform. However, the figures remain low, with 6.63 percent of cigarettes identified as illicit and 4.23 percent of smokers consuming illicit products. Illicit cigarette trade in Colombia mostly involves outright smuggling, that is, cigarettes that do not appear in any official records and on which no taxes are paid. In some cases, the merchandise enters the country through official border crossings with the complicity of public servants, while in other instances illicit products enter through any of the hundreds of paths along the Colombo-Venezuelan border. Criminal organizations maintain smuggling activities as a "portfolio" that includes cigarettes along with other goods. La Guajira is a region with a particularly weak presence of state institutions, where illegal armed groups have aimed to control both narcotraffic and smuggling activities.

¹ Fundación Anáas

Colombia does not currently have a track-and-trace system or tax stamps that facilitate identification of illicit cigarettes. The country's National Development Plan 2011–2014 foresaw the creation of a unified tracking and tracing system, dubbed SUNIR. However, as of 2018, the SUNIR initiative remains on hold. The information available to subnational tax administrations is fragmented and at times misleading. With the data currently available, it is difficult to prove noncompliance. Currently the tobacco industry is the only source of information used by the authorities to establish if a tobacco product is genuine.

This chapter presents policy options for national and subnational authorities to strengthen Colombia's illicit tobacco control. Specific recommendations include:

- » Implement a unified excise tax management system to reduce costs and improve efficiency, for example by rolling out the proposed SUNIR system.
- » Establish a national-level coordinating authority to manage all information about domestic tobacco production, international trade, tax revenues, prices, sales, and consumption trends.
- » Ensure that subnational authorities consult with the Ministry of Health to verify compliance with the Framework Convention on Tobacco Control (FCTC), when developing interventions related to tobacco taxation.
- » Establish formal mechanisms to ensure participation by the research community and civil society in institutional structures for policy debates on illicit trade.
- » Inform national and subnational stakeholders about tobacco-industry involvement in illicit trade activities and interference in policy processes. Programs against cigarette smuggling at the subnational level should not be funded or receive technical cooperation from the tobacco industry.
- » Continue to reinforce legal penalties for illicit tobacco trade, and publish complete information on the implementation of sanctions. Set fines such that wholesalers and retailers face penalties that are truly dissuasive, relative to their potential profits from illicit tobacco.

Introduction

Until December 2016, Colombia had the doubtful distinction of being one of the countries with the lowest cigarette prices in Latin America. Arguments against tax increases relied almost exclusively on the alleged direct link between high cigarette taxes and smuggling. In the early 1990s, in the face of local tobacco companies' claim that illicit trade represented between 50 and 80 percent of the country's tobacco market, Colombia's Congress cut the then-existing 100 percent ad valorem tobacco tax to a 55 percent rate.² In the following

² Law 223/1995 established the base for this tax in 1995 as the retail price of domestic cigarettes before tax, and the value of the cigarettes at custom point plus tariff and a 30 percent assumed profit margin, for imported cigarettes. The latter should not be less than the average tax paid by domestic cigarettes.

years, tobacco taxes and prices remained low, despite two modifications in tax design: first from ad valorem to specific in 2006, and then to a mixed system with a small ad valorem component in 2010.

A major tobacco tax increase took place in December 2016, when a tax reform boosted the specific component of the excise from 700 Colombian pesos (COP\$) per 20-cigarette pack to COP\$ 1,400 in January 2017 and COP\$ 2,100 in January 2018.³ In subsequent years, this value will be adjusted according to the inflation rate⁴ plus 4 additional points.

This tax measure resulted in consumption reduction and increased tax revenues, as expected. Illicit trade remained at moderate levels. That this success was possible under highly challenging border security conditions, and a resurgence of money laundering associated with drug trafficking, makes this a case worth studying.

The purpose of this chapter is to present the case of illicit cigarette trade (ICT) in Colombia.⁵ To do so, Section 1 describes the country's situation in terms of its tobacco epidemic, cigarette market, and illicit trade. Section 2 presents the institutional, legal, and administrative situation and efforts developed to control ICT. The chapter concludes with lessons learned and a set of policy recommendations in Section 3.

1. Situation Description

1.1 Current State of the Tobacco Epidemic

Colombia is a South American upper-middle income economy with an estimated population of 50 million as of 2018. Regarding consumption of tobacco products, the country has experienced a decrease in smoking prevalence. In 2013, the Survey of Consumption of Psychoactive Substances (SCPS) estimated a smoking prevalence of 13 percent, down from 17 percent in 2008 (MPS and DNE 2008; MinSalud and ODC 2013). Other surveys prior to 2008⁶ show the same trend. This decrease is likely explained by implementation of some FCTC measures by Law 1335/2009, including a comprehensive regulation on smoke-free areas, one of the strongest tobacco advertising, promotion, and sponsorship (TAPS) bans in the region, and to a lesser extent the introduction of health warnings.

SCPS is the most accurate source of information on Colombia's smokers because of the protocols it follows to minimize response bias; however, the survey has not been updated. For this reason, monitoring of the epidemic since 2016 relies on other sources that provide

³ According to the Central Bank of Colombia, the exchange rate between COP\$ and US dollars (USD\$) was COP\$ 3,053 = USD\$ 1 for 2016, COP\$ 2,951 for 2017 and the January-to-May monthly average for 2018 was COP\$ 2,841. Thus, the specific component of the excise tax was USD\$ 0.23 in 2016, USD\$ 0.47 in 2017, and USD\$ 0.74 in 2018.

⁴ The average inflation rate in the last six years reported by the Central Bank of Colombia was 4.29 percent and the average inflation target for the same period was 3 percent.

⁵ There is no record of illicit trade in other tobacco products in the country.

⁶ With methods that are not entirely comparable.

the minimum information needed to measure prevalence. One of those is the National Survey of Quality of Life (NSQL); it shows an ongoing decreasing trend over the past two years (DANE 2017; DANE 2018) and an estimated number of smokers of 2.85 million for 2017. Smoking prevalence in Colombia is similar between urban and rural areas.⁷ However, as a result of the urbanization process,⁸ smokers are mostly concentrated in urban areas. The most recent survey among university students indicates that this group still displays relatively high levels of consumption, with a month-prevalence of 17.2 percent in 2016 (UNODC 2017), down from 21.7 percent in 2009 (MIJ 2009). Subnational-level evidence shows that cigarettes are the most common type of tobacco product consumed, with 97.9 percent of smokers using cigarettes (Fundación Salutia 2018, p.94).

There are important differences in smoking patterns across regions. Elements behind these patterns include population size, age composition, and cultural issues. The biggest cities in terms of population, namely, Bogotá (the capital), Medellín, Barranquilla, Cali, and Cartagena, possess the highest concentration of smokers. Some medium-sized cities with high local prevalences include Cúcuta, Soacha, Villavicencio, Manizales, and Pereira. Some of these cities are near borders and coasts, potentially increasing their exposure to illicit trade.

Most smokers report daily consumption (Figure 1). According to NSQL-2017, 57.2 percent smoke every day, 26.23 percent smoke some days in the week, and only 14.44 percent smoke less than once a week. Similar proportions are reported in the Demand for Illicit Cigarettes Survey for Colombia (DEICS-COL). Figure 2 shows the distribution of smoking intensity, measured as number of cigarettes per day. For non-daily smokers, the number of cigarettes per month was calculated and then divided by 30 to provide a proxy of daily intensity. The figure shows that most smokers consume ten cigarettes per day (i.e., half a pack), followed by one cigarette and five cigarettes per day. This is consistent with a smoking epidemic concentrated in younger smokers, and relatively more people in an experimentation phase. Distribution of brands noted in DEICS-COL-2017 indicates that the most common brands are Rothmans (British American Tobacco, BAT) at 29 percent and Chesterfield (Philip Morris International, PMI) at 22 percent,⁹ followed by Marlboro (18.7 percent) and Lucky Strike (17.5 percent). Local brands like Pielroja have low participation in the portfolio (3.6 percent).

1.2 Production and Supply of Cigarettes

Traditionally, Colombia had two local companies controlling production and distribution of cigarettes: Compañía Colombiana de Tabaco (Coltabaco) and Productora Tabacalera de Colombia (Protabaco). That changed at the beginning of the 21st century, when PMI and

⁷ As reported by Fundación Salutia 2018, p.94, DANE 2017, p.20, DANE 2018, p.21 and estimations using microdata from the National Health Survey (MPS and Cendex 2009).

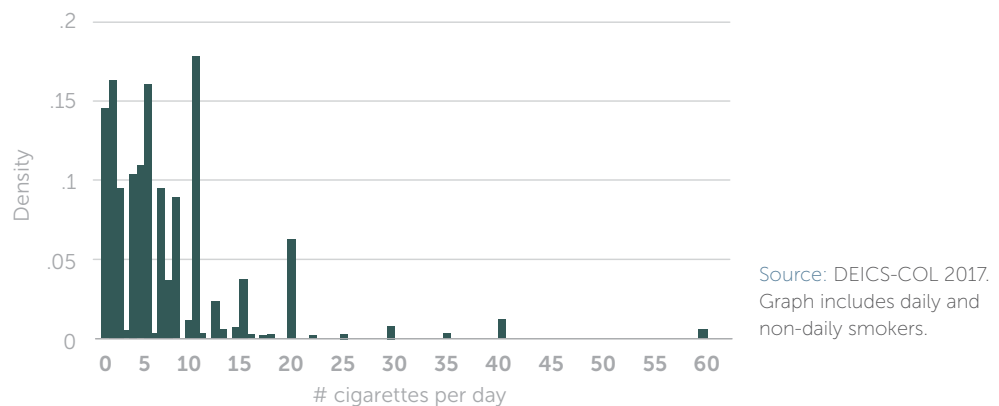
⁸ According to the World Development Indicators, the proportion of the population living in urban areas in Colombia increased from 45 percent in 1906 to 77 percent in 2016. Maldonado et al. 2018a, p.3.

⁹ In 2017 BAT started to replace Mustang and Belmont by Rothmans. Similarly, PMI replaced Boston and Green by Chesterfield.

BAT acquired Coltabaco in 2005 and Protabaco in 2011, respectively. By 2015, the market share was 51 percent for PMI and 48.9 percent for BAT (Forero 2015).

In Colombia, the most reliable source of information for production of manufactures such as cigarettes is the Annual Survey of Manufacturing - EAM. According to EAM, in 2016 Colombia produced 8,242.39 million cigarettes, equivalent to 412.12 million packs of 20 sticks, down from 626.57 million packs in 2013; most of the production goes to the local market, and filtered cigarettes represent around 95 percent of the total production. The decreasing trend in production (supply side) over time is consistent with the similar trend in smoking prevalence (demand side) shown above; this is a good signal for control of the tobacco epidemic, although the country is still far from the tobacco endgame (Thomson et al. 2012).

Figure 1. Smoking Intensity



Both smokers' access to cigarettes and the success of inspection, surveillance, and control activities are strongly determined by channels of distribution. To begin with, in Colombia there is no licensing that provides official authorization to buy or sell cigarettes. Informal distribution channels in the country play a crucial role in provision of cigarettes to consumers; according to DEICS-COL 2017, 55.7 percent of smokers purchase their cigarettes from street vendors, and 42.2 percent of cigarettes are sold through this channel. Ranked by proportion of smokers that use the distribution channel, street vendors are followed by small neighborhood grocery stores (26.7 percent) and liquor stores (11.2 percent). Informal distribution channels, especially street vendors, play a role in expanding the tobacco epidemic, because they are able to offer cigarettes¹⁰ anywhere at nil transport cost for the consumer, given their atomized structure and negligible costs of relocation.

¹⁰ Most of them offer sugar confectionery (chocolate, sugar candy, chewing gum), snacks, and cigarettes; the larger establishments also offer soft drinks, industrialized juice, and bottled water.

In terms of tobacco control policies, regulatory compliance and law enforcement are more difficult to achieve in informal distribution channels, because, as part of the informal sector, these businesses are harder to identify, locate, monitor, and penalize. At the same time, the lack of law enforcement makes street vendors more likely to get involved in illegal activities, such as sale of cigarettes to minors (banned by Law 1335/2009 Article 2), loose cigarettes (banned by Law 1335/2009, article 3), illicit cigarettes,¹¹ and engagement in promotion and advertising (banned by Law 1335/2009, article 15).

1.3 Tobacco Control

Colombia became a party to the Framework Convention on Tobacco Control (FCTC) in 2006, and ratified the FCTC in 2008. The specific tool developed within this agreement to act against illicit trade is the Protocol to Eliminate Illicit Trade in Tobacco Products (Protocol), which Colombia signed in 2013 but has not yet ratified. Colombia is mentioned among some of the key players in global illicit trade, because it is a transit country. As a destination country in the global context, Colombia's role has become less relevant, both because of the long-term downward trend in market size and because of Colombia's position, until 2016, as one of the countries with the cheapest cigarettes in the Americas (PAHO 2016).

Colombia has reached several milestones in the implementation of the FCTC through a set of policy, planning, and regulation tools. The planning instrument with the largest potential influence in policy making is the ten-year Public Health Plan (2012-2021) that sets goals to reach 100 percent enforcement of smoke-free areas and increase taxes considering affordability trends. The National Cancer Plan (MinSalud and INC 2012) for the same period includes the same tax goal and adds a commitment to increase health warning size from 30 percent of the pack surface to 70 percent by 2021. The current National Development Plan commits to develop a tracking and tracing system (SUNIR from its initials in Spanish) by 2018. However, this system is not yet in place.

NON-PRICE MEASURES

The most comprehensive regulatory development of FCTC commitments is Law 1335/2009, providing national guidelines for smoke-free areas, packing and labeling, prohibition of loose cigarette sales and sales to minors, and a total ban on tobacco advertising, promotion, and sponsorship (TAPS). It also considers education and cessation interventions, but these have advanced less rapidly than the other measures. Compliance with smoke-free areas is fairly high (particularly with respect to closed area) and Colombia is considered one of the leading countries in this policy in the region.

As for tobacco packaging, in order to comply with FCTC article 11, article 13 of Colombia's Law 1335/2009 established restrictions for cigarette pack design elements and defined general

¹¹ Even in high-income countries like Germany, street selling has been associated with distribution of illicit cigarettes (Lampe 2006, p.240).

guidelines for health warnings. Three years later, the Ministry of Health (MoH) created the Tobacco Packaging and Labeling Committee.¹² This committee is in charge of authorizing pack designs that can be sold in the national market, after studying tobacco companies' submissions.

Other general norms that interact with tobacco control regulation are the Consumer Protection Act (Law 1480/2011), the Anti-Smuggling Act (Law 1762/2015), the National Police Code (Law 1801/2016), and sanitary inspection, surveillance, and control norms, particularly the Administrative Act 1229/2013.¹³ A relevant aspect to determine institutional capacity to detect illegal activity, including illicit cigarette sales, is the regulation to protect consumers. It defines the general responsibilities for the Superintendence of Industry and Commerce (SIC) to ensure compliance with labeling and packaging norms and with TAPS ban observance at the point of sale. SIC can impose fines and other penalties when establishments sell merchandise that does not comply with legal requirements, including tobacco products.

Violation of packaging and labeling regulations is subject to fines between 200 and 400 times the value of the minimum wage per day.¹⁴ This is a significant amount for street vendors but not for larger retailers, wholesalers, or manufactures. Retailers and wholesalers not complying with the TAPS ban face fines so small they are inconsequential: between two and five times the value of the minimum wage per day. Other participants engaging in TAPS activities would pay higher penalties: up to 400 times the value of the minimum wage per day. Unfortunately, complaints of TAPS ban violations lodged by members of VCCT, a local coalition that oversees the implementation of the FCTC in Colombia, have increased. DEICS-COL 2017, a survey with a representative sample of smokers from the five cities with the largest number of smokers, found that one in five smokers reported having been offered free cigarette samples in the prior eight months.

The Police Code (articles 38 and 180) establishes sanctions on behaviors that could be related to the distribution of illicit cigarettes. Distribution, offering, selling, and instigation of consumption of cigarettes to minors are punished with the destruction of the merchandise and a fine equal to 32 times the value of the minimum wage per day (the equivalent of about USD\$ 293), the highest level of ordinary fines. Sanctions may take time to become effective, because the Code has been in force since January 2017, and it requires a gradual process to be fully implemented. Additionally, existing penalties are not sufficient to discourage such practices among organizations that can promote them on a large scale.

TOBACCO PRICE, TAXES AND TAX REVENUE

In Colombia, cigarettes are subject to Value-Added Tax (VAT) and excise tax. The general rate for VAT, currently 19 percent, applies to cigarettes. The excise tax has an ad valorem component (reintroduced for the first time since 2006) and a specific component. The ad

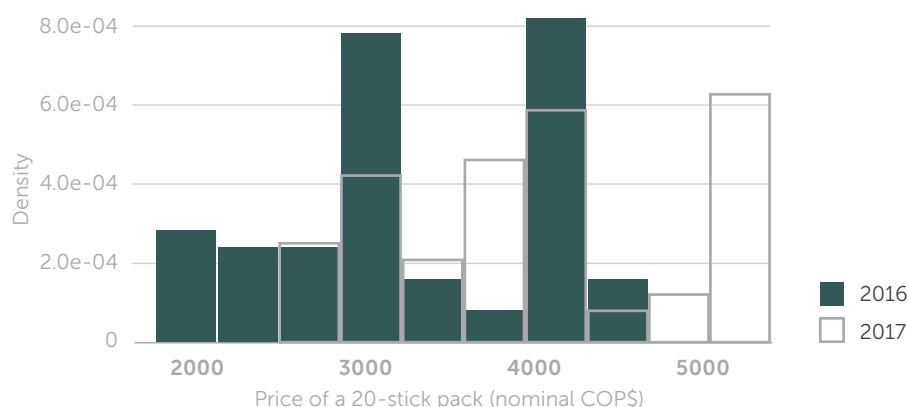
¹² Administrative decision 1309/2012.

¹³ For a comprehensive description of sanitary control mechanisms, consult the following MoH document: <https://www.minsalud.gov.co/sites/rid/Lists/BibliotecaDigital/RIDE/VS/PP/SA/ ivc-control-tabaco.pdf>.

¹⁴ Minimum wage per day for 2017 was COP\$ 24,590 (USD\$ 8.33) and for 2018 is COP\$ 26,041 (USD\$9.16).

valorem rate is 10 percent (Law 1393/2010, article 6), and for 2018 the specific tax is COP\$ 2,100 (USD\$0.74) per 20-stick pack. The Department of Statistics, once a year, must certify the cigarette price of a 20-stick pack for each brand variant to the Ministry of Finance for calculation of the ad-valorem component of the excise tax.¹⁵ Certified cigarette prices are based on retail price information,¹⁶ including VAT, and the formula discounts ad valorem taxes from the previous period and adjusts the result by the Consumer Price Index.¹⁷

Figure 2. Certified Prices of 20-Stick Packs (Supermarkets)



Source: DEICS-COL 2017. Graph includes daily and non-daily smokers.

Figure 2 shows the distribution of certified cigarette prices (nominal) in COP\$ for 2016 and 2017, and the vertical line in the figure shows the average price, which in 2016 was COP\$ 3,282 (USD\$ 1.07) and in 2017 was COP\$ 3,991 (USD\$ 1.35). There is a substantial dispersal of prices, with the cheapest brand in 2017 priced at COP\$ 2,500 (USD\$ 0.84) and the most expensive at COP\$ 5,400 (USD\$ 1.82). Also, the mean does not represent the behavior of the market. The distribution is usually bimodal, that is, most prices are concentrated around two values, making the average a statistical measure that does not accurately capture market realities. The bimodal distribution is explained by two market segments: the regular segment with affordable cigarettes (price \leq COP\$3,000 (USD\$ 1.01)) and the premium segment with fancy and expensive cigarettes (price \geq COP\$4,000 (USD\$ 1.35)).

A good indicator of the behavior of prices after the 2016 tax reform is the cigarette real price index calculated with the price index for cigarettes¹⁸ (included in the CPI basket) and

¹⁵ Decree 2427/2007 Article 3, Law 1819/2016 Article 348, Law 1393/2010 Article 6.

¹⁶ Article 6 of Law 1393/2010 establishes that retail price information must correspond to the price charged to the consumer in supermarkets.

¹⁷ The base calculation was simplified in 2016, and now uses only the average price of the previous year, without the discount.

¹⁸ This index provides information beyond the supermarket channel, although it is a limited representation of prices in the main distribution channels

the general CPI. This is the fastest price growth observed in the past three decades, but still below the accumulated rate between July 1997 and October 2001 (52.7 percent), which remains the period of most dynamic growth in Colombia's cigarette prices. It is worth noting that the price behavior during those years was not caused by taxes.

Department of Statistics published estimates by brand are reliable for prices in supermarkets. However, its sample underrepresents informal channels of distribution because it excludes prices of illicit cigarettes as well as those of loose cigarettes. This is a relevant issue for Colombia, where 68 percent of smokers bought sticks instead of packs for their last purchase, and 7 percent of purchases take place via supermarkets. By using information from smokers instead of retailers, DEICS-COL 2017 provides more reliable data on prices in both distribution channels. Distribution of prices and average price (thick line) from this source for 20-stick packs and for loose cigarettes is shown in Figures 4 and 5, respectively.

Figure 3 shows that, when all distribution channels are considered, dispersion of prices in the market for packs is wider than the one reported in formal distribution channels. The average price of a 20-stick pack is around COP\$ 5,200 (USD\$ 1.76). Packs on the far left of the distribution represent a public-health issue, because they are being offered at a price below the price consistent with current cigarette taxes, undermining the tobacco tax policy and providing affordable cigarettes to consumers.¹⁹ Figure 4 shows that the average price of a stick is around COP\$ 400 (USD\$ 0.13) and also confirms an important price spread in this segment of the market. In both markets, illicit cigarettes are found all across the price spectrum,²⁰ which partially explains the difference in average price between data from DEICS-COL 2017 and from the Department of Statistics. Comparison of both figures show that, overall, the price of a stick is lower in packs than in loose cigarettes. By brand, for instance, the average price of a Belmont stick in loose cigarettes is COP\$ 386.95 (USD\$ 0.13), while in 20-stick packs, it is COP\$ 289.79 (USD\$ 0.09). For Marlboro, the corresponding prices are COP \$ 489.03 (USD\$ 0.16) and COP\$ 278.6 (USD\$ 0.09), and for Lucky Strike COP\$ 484.11 (USD\$ 0.16) and COP\$ 365.39 (USD\$ 0.12). Even though a higher price of loose cigarettes has the potential to reduce consumption via price elasticity, it might actually increase consumption, because (i) indivisibility²¹ in formal channels makes loose cigarettes more affordable and (ii) small package sizes might not activate a self-control conflict (Coelho do Vale, Pieters, and Zeelenberg 2008).

At the end of 2016, Colombia had the second-lowest cigarette price in the Americas. The tax reform approved in December 2016 (Law 1819/2016) increased the specific component of the cigarette excise tax by 200 percent. The reform adopted a two-step annual

¹⁹ Colombian regulation does not establish a minimum price. Although this is usually not considered when the specific component is large, the price dispersion observed here suggests that additional price regulation measures could help increase the tax impact in this case and reduce possible cross subsidy across brands.

²⁰ Evidence of expensive illicit cigarettes, sold by pack or loose, is found in DEICS-COL 2016 and 2017, as well as in Fundación Anáas' active search for illicit brands through direct purchases in traditional distribution channels, such as San Andresitos.

²¹ In Colombia, it is illegal to sell packs of less than 10 sticks.

Figure 3. Cigarette Real Price Index

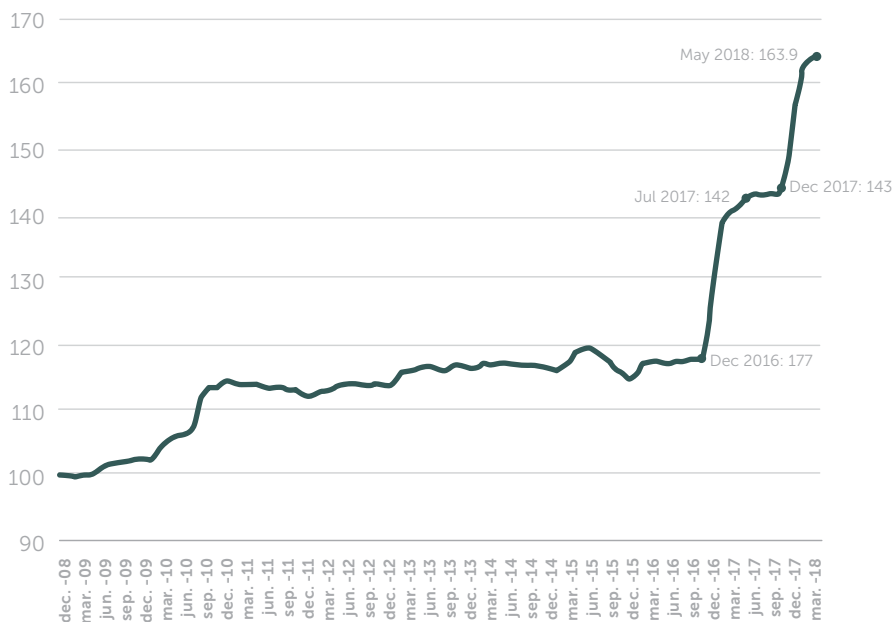


Figure 4. Prices of 20-Stick Packs in 2017

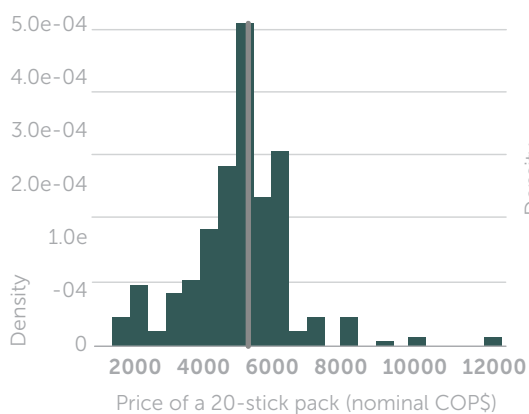


Figure 5. Prices of Loose Cigarettes in 2017

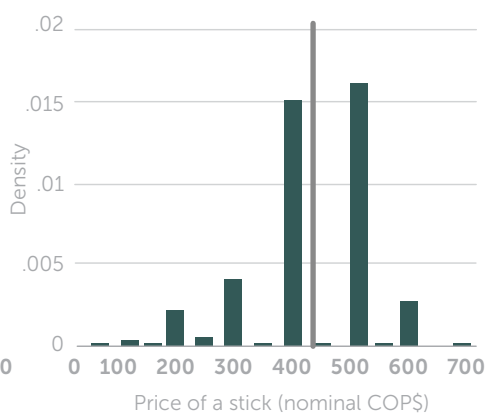
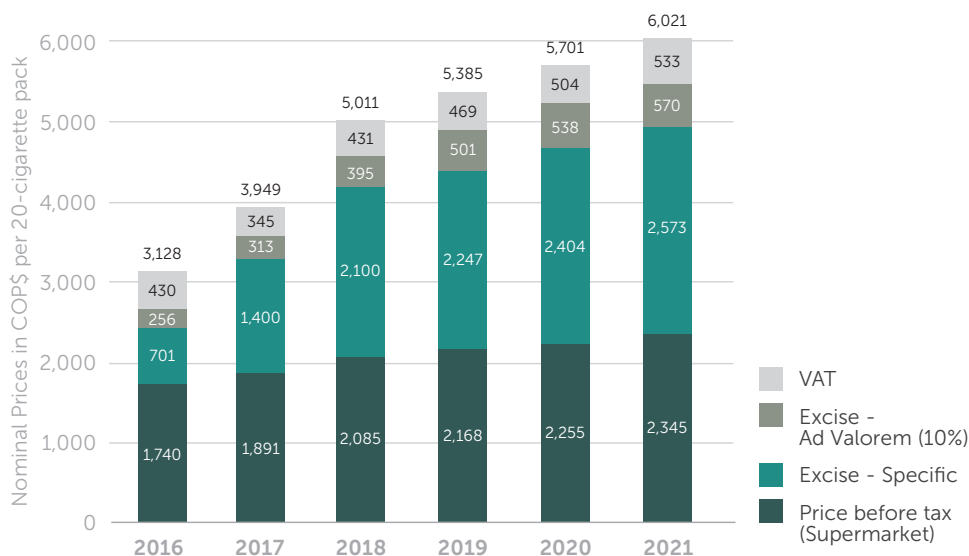


Figure 6. Structure of cigarette prices in Colombia



increase for the period 2017-2018 and subsequent annual adjustments by the inflation rate plus 4 percentage points, adjustment that takes place every January. The new legislation also established a small increase in the ad valorem component of the excise, keeping its 10 percent level while changing the procedure to calculate its reference price. The reform also raised the general VAT rate, applicable to cigarettes since 2000, from 16 percent to 19 percent. Figure 6 shows the current and expected structure of the price. Table 1 shows the evolution of tax burden as percentage of retail price, which is near 60 percent of retail price, and relies mostly on the specific component. In international dollars, the price of Colombian cigarettes is closing the gap with other countries in the region, but it is still relatively low compared to Chile, Ecuador, or Panama, and needs an extra tax hike to reach the benchmark of 75 percent suggested by WHO.

Figure 7 describes the behavior of affordability using minutes of labor required to purchase one pack. In the 1990s, the trend was driven by price volatility and a sharp tax cut in 1994-1995. Between 1998 and 2000, cigarettes became less affordable due to a rapid drop in household income. During most of the 2000-2016 period, cigarettes were cheaper as a result of a combination of household purchasing power improvement and stable prices. The 2010 tax reform produced only a minor rise. The effects of Law 1819/2016 are reflected in the surge observed in 2017 and 2018.

Figure 7. Affordability

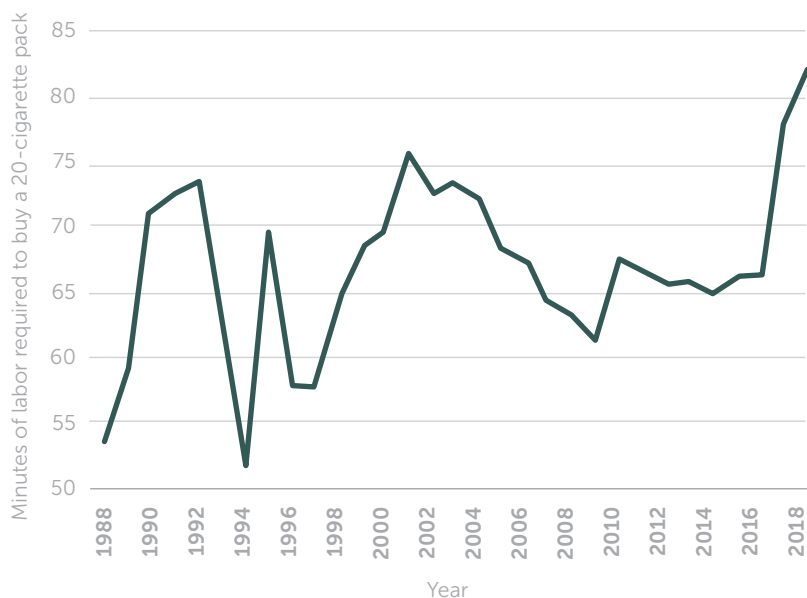


Table 1. Prices and tax burden for 20-cigarette pack

YEAR	CERTIFIED PRICE	EXCISE SPECIFIC (COP\$)	EXCISE AD VALOREM (COP\$)	VAT (COP\$)	TOTAL TAXES	PRICE INCREASE (%)	SPECIFIC TAX BURDEN (%)	TOTAL TAX BURDEN (%)	RETAIL PRICE IN PPP
2010	2,134	570.0	194.7	293.6	1,058		26.7	49.6	1.92
2011	2,168	584.8	200.2	298.2	1,083	1.6	27.0	50.0	1.87
2012	2,295	607.9	203.7	315.8	1,127	5.9	26.5	49.1	1.95
2013	2,433	624.8	215.6	334.8	1,175	6.0	25.7	48.3	2.06
2014	2,516	635.8	230.6	346.2	1,213	3.4	25.3	48.2	2.13
2015	2,718	659.0	236.3	373.9	1,269	8.0	24.2	46.7	2.26
2016	3,128	701.1	256.4	430.4	1,388	15.1	22.4	44.4	2.51
2017	3,949	1400.0	312.8	345.1	2,058	26.2	35.5	52.1	3.10
2018e	5,011	2100.0	394.9	430.7	2,926	26.9	41.9	58.4	3.90
2019e	5,385	2247.0	501.1	468.6	3,217	7.5	41.7	59.7	4.16
2020e	5,701	2404.3	538.5	503.6	3,446	5.9	42.2	60.4	4.36
2021e	6,021	2572.6	570.1	533.2	3,676	5.6	42.7	61.1	4.61

e: estimated

1.4 Illicit trade

Illicit cigarette trade (ICT) is a threat to tobacco-tax policy because it increases market size and expands the epidemic by offering affordable cigarettes. ICT also undermines other tobacco control measures, particularly packaging and labeling regulation. Finally, even if it is not the main policy concern, tax evasion associated with illicit cigarettes leads to revenue loss for the government.

From the demand side, for many years the only source of information available was the one provided by the Tobacco Industry (TI) through the Federación Nacional de Departamentos and, more recently, the national business association of Colombia - ANDI. This study is performed by Invamer, a private market research firm, with a survey of smokers aged 18 or older regarding smoking habits and information on last purchase.²² Results are presented as a set of slides (Invamer and ANDI 2017).²³ Using this survey, the TI estimated the market share of illegal cigarettes for 2017 at 18 percent, and the proportion of smokers consuming illegal cigarettes at 13 percent. In order to undermine the tobacco tax policy, TI studies emphasize the loss of tax revenue caused by ICT (Invamer and ANDI 2017: 21-23) and claim that higher tobacco taxes increase ICT (Portafolio 2018b). TI studies are positioned in public opinion through a strong media strategy. Every year, when Invamer's study is released, the results are widely covered by influential national media. Findings are also disseminated among top-level government officials.²⁴ This media strategy seeks to discourage tobacco tax increases and disparage tobacco taxes' contribution to public health. Since the first wave of the Invamer survey in 2011, Invamer's published estimates of illicit cigarette penetration fluctuate between 13 percent and 19 percent.²⁵

Illicit cigarette trade in Colombia mostly involves outright smuggling, that is, cigarettes that do not appear in any official records and on which no taxes are paid. In some cases, the merchandise enters through border crossings with the complicity of public servants, while in other instances the merchandise enters the country through any of the hundreds of paths ("trochas") along the Colombo-Venezuelan border. Tax avoidance associated with bootlegging easily takes place in cities like Maicao, Guajira, and Cucuta (Llorente and Díaz 2018). The magnitude of bootlegging in Colombia has not been established. However, due to the link between money laundering and illicit trade in Colombia (Cáceres-Corrales 2016), it is plausible that large-scale operations constitute the most important type of smuggling. This is consistent with the fact that the traditional smuggling routes used by criminal organizations in the 1990s remain operational, although criminal structures have evolved over the decades

²² The questionnaire of the survey is not publicly available, so the topics of the survey are deduced from the results.

²³ There is no report with all the technical information on the study.

²⁴ For example Vega 2018, Cigüenza 2018, La República 2018, Portafolio 2018a, El Tiempo 2018.

²⁵ As opposed to other global sources of illicit trade, the estimates produced by INVAMER through FND/ANDI have not been subject to retrospective revisions. For instance, the 2011 survey from INVAMER was published by the National Association of Retailers, FENALCO, showing the same estimates as those reported by ANDI in 2018 for 2011.

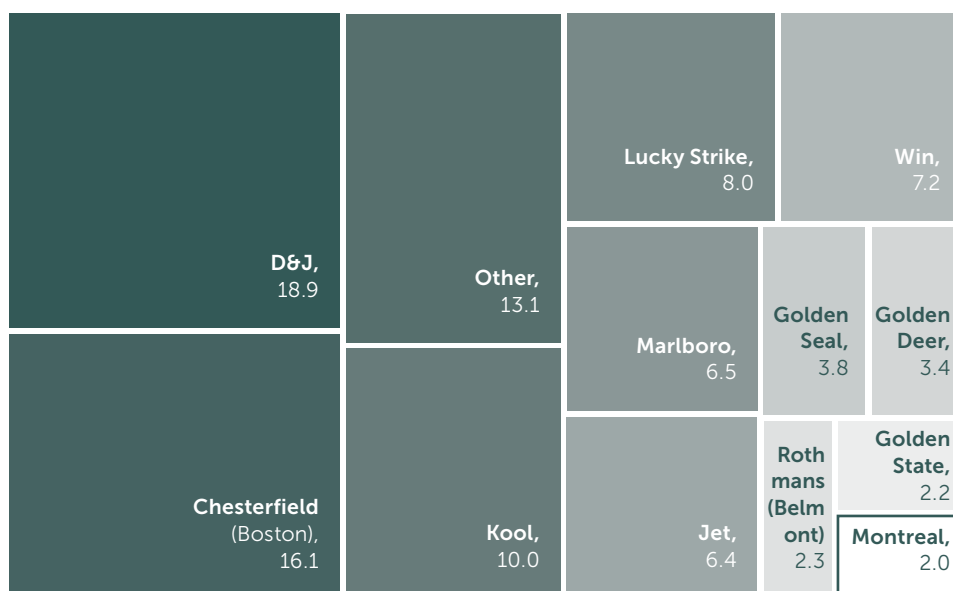
(Avila et al. 2012; Ochoa Sierra 2011), and new routes have also emerged. This recomposition maintains smuggling activities as a "portfolio" that includes cigarettes, among other goods. La Guajira is a region with a particularly weak presence of state institutions, where illegal armed groups have aimed to control both narcotraffic and smuggling activities (Quiroga-Angel 2018).

In 2016, an independent study on ICT, funded by the American Cancer Society, collected information for a representative sample of smokers in the five Colombian cities with the highest number of tobacco consumers, allowing researchers to draw inferences on 57.3 percent of this population in the country. The instrument used to collect information was the Demand for Illicit Cigarettes Survey (DEICS), with a questionnaire covering demographic variables, smoking behavior, characteristics of the last purchase, and socioeconomic information. The penetration of ICT based on DEICS-COL-2016 was estimated to be 3.46 percent of cigarettes and 3.35 percent of smokers (Maldonado et al. 2018a). Funded by PROACTT, a joint effort of the American Cancer Society and UK Cancer Research, a comparable study was conducted a year later, with the purpose of obtaining estimates after Colombia's tax reform (Maldonado et al. 2018b). Results were used as inputs for an impact evaluation of the tobacco tax increase on ICT (Gallego et al. 2018). Estimates from DEICS-COL 2017 show a slight increase of ICT after the tax reform but remain at a very low 6.63 percent of cigarettes identified as illicit and 4.23 percent of smokers consuming illicit products. These results coincide with a substantial body of independent studies finding consistently lower ICT penetration compared to TI-funded studies (Stoklosa and Ross 2014).

On the other hand, at subnational level there are important differences. Cucuta, a border city with Venezuela facing a 38 percent illicit tobacco penetration rate, is an extreme example of what can happen with smuggling when governance conditions are very challenging. On the other end of the spectrum is Bogotá, the country's main market for cigarettes, with only a 2 percent share of illicit cigarettes. In the capital city, the institutional strengths are explained by elements such as the capacity to coordinate efforts across government agencies, a very different situation with illegal armed groups, and a territory where the interaction between the state and communities is not dominated by repressive actions. This regional pattern has been observed in the analysis of criminal activities in other sectors. For instance, when comparing levels of violence in Colombia's banana-growing regions and in regions with flower production, distance to the capital city and the institutional conditions associated with this difference are features suggested as partially explaining more peaceful conditions (Nasi and Lozano 2018). In this sense, Colombia is a natural experiment that illustrates how regions with gaps in institutional structures, when subject to the same policy, respond differently in terms of illicit trade indicators.

Colombia does not have a track-and-trace system or tax stamps that facilitate identification of illicit cigarettes; therefore, identification must rely on characteristics of the pack/

Figure 8. Share of Illicit Cigarettes by Brand



stick. One such characteristic is the brand/presentation approved by the Ministry of Health.²⁶ This is not to say that every product from companies that have submitted requests for MoH approval complies with legal requirements; in fact, DEICSCOL and active search of brands clearly suggest that some cigarette brands enter the market without permission. Prominent cases include Camel (imported by JTI), sold during 2017 before the committee’s approval was sought, and Chesterfield, found in the market bearing the text “menthol with capsule” on the front of the pack, violating the committee’s rejection of PMI’s request for this presentation. In addition to brand, the other two criteria are current health warnings and price (Maldonado et al. 2018a).²⁷ Applying these criteria to DEICS-COL-2017 to identify illicit cigarettes among a representative sample of smokers, the brands constituting the highest share of illicit cigarettes are D&J and Chesterfield (Figure 8). D&J is mostly found in Cúcuta. Of note, there is a wider dispersion of brands in this illicit market than for the cigarette market as a whole.

²⁶ Details in Section 2.1.

²⁷ For price, the study defines a threshold to classify cigarettes as illicit, “based on the fact that the current tax scheme implicitly determines a minimum price... Any price under COP\$100 [USD\$ 0.03] for sticks, COP\$ 1,700 [USD\$0.57] for a 20-stick pack and COP\$20,000 [UDS\$ 6.77] for a carton was classified as illicit.” (Maldonado et al. 2018a, p.4).

2. Policy and reforms

Reforms of ICT control in Colombia can be described as a set of efforts that have not yet achieved the status of a functional public policy, i.e., a policy that integrates actions across sectors at the national level while establishing coordination with subnational authorities. Regarding the legal, institutional, and administrative dimensions of ICT control, the country shows encouraging achievements that still lack intersectoral coordination. The uneven pace of implementation is largely determined by highly disparate regional institutional conditions. The following sections describe the efforts deployed and the current challenges faced in each dimension. We summarize lessons learned that may help other countries in similar situations, as well as policy recommendations to further advance ICT policy in Colombia.

It is worth noting that, despite challenging circumstances, the Colombian government managed to adopt an ambitious cigarette tax hike, obtaining positive results in terms of consumption reduction and tax revenue increases. At the same time, overall illicit trade penetration remained at moderate levels, with exceptions due to the regional differences mentioned above, which require a differential policy response.

2.1 Institutional Context

The focal point for tobacco control policies is the MoH. In compliance with the FCTC, the MoH has adopted specific goals to raise tobacco taxes as the most cost-effective instrument to control the epidemic. However, any tax initiative must be submitted to Congress by the Ministry of Finance. Since 1990, Colombia has gone through 14 tax reforms, that is, an average of one tax reform every two years. Each one of these has created opportunities to discuss tobacco taxes. Sometimes the result was a sharp tax cut, as was the case in 1995. However, the latest reform, in 2016, took the opposite direction. Along with tax discussions, the MoH has worked to strengthen government-wide capacity to eliminate ICT. The MoH advocacy role includes providing technical advice to agencies in other sectors; training customs police (POLFA); and incorporating the verification of sanitary regulations (e.g., health warnings) into customs procedures, among other actions.

In addition to national institutions, subnational authorities play a key role, as they receive all the revenues from the tobacco tax based on reported sales in each region. Colombia is divided in 33 first-level subnational authorities—32 departments (departamentos) and one capital district—and each department is divided into a set of municipalities (the second level). Tobacco excise tax rents belong to departments.²⁸ This is a consequence of the decentralization process that allocated certain tax revenues to these entities. However, only the

²⁸ Article 2 Law 30/1971.

²⁹ Constitutional Court rulings C-246/95 on Decreto 1280/199 1994 <http://www.corteconstitucional.gov.co/relatoria/1995/C246-95.htm> and C-252/2010 and C-253/2010 on Decreto 4975/2009 <http://www.corteconstitucional.gov.co/RELATORIA/2010/C253-10.htm>

Colombian Congress has the authority to define the tax level and its composition. In addition, Congress is the only instance that can establish the taxable event, and name the agent responsible for its payment. Past attempts to modify tobacco taxes through administrative acts by the executive branch have been deemed unconstitutional.²⁹

Revenues from excise taxes of departments are partially earmarked for universal health coverage and sports.³⁰ This includes excises on tobacco products, liquor, beer, lotteries, and the registry (World Bank 2009, p.19).³¹ Consequently, tobacco taxes are part of the departments' revenue, and departments are responsible for decentralized tax collection and administration, including tax evasion controls (see Section 2.3). In order to coordinate efforts among departments, the Federación Nacional de Departamentos (FND) was created in 1998.³² In 2009, a Cooperation and Investment agreement was signed between PMI-Coltabaco, the Republic of Colombia, and the departments. It established commitments for the tobacco company to provide funds and technical cooperation for actions against the illicit cigarette trade. FND acts as the recipient of funds and is in charge of executive tasks.

Section 1.4, above, described the TI's skillful construction of a discourse linking tax increases with ICT and significantly overstating both the level of ICT and the impact of higher taxes on it. As a consequence, this argument is widely accepted within the government, media, and public opinion. The resulting misrepresentation of the impact of tobacco taxes and ICT on tax revenues discourages subnational authorities both at the local level (department governors) and the national level (members of Congress), making it difficult for Congress to substantially increase tobacco taxes.

Tobacco tax administration, enforcement, and penalties bring other institutions into play: in particular, the national customs authority (DIAN),³³ customs police (POLFA),³⁴ Financial Information and Analysis Unit (UIAF),³⁵ and the Superintendence of Industry and Commerce (SIC). DIAN is responsible for collecting the tobacco tax at borders. Also, in joint work with POLFA, they are in charge of ICT seizures all over the country. UIAF collects information to identify illegal flows of money and money laundering. At the end of the enforcement process is Colombia's Office of the Attorney General,³⁶ whose main role on ICT is to impose penalties on people and organizations involved in the illegal trade. At the MoF, the tax administration advisory division (DAF) oversees the tax administration performance of subnational

³⁰ Article 7 Law 1393/2010 and Article 211 Law 1819/2016.

³¹ For further details, see ruling C-958/99 by the Constitutional Court, República de Colombia.

³² Concept Note 5293, 2012 of the Office of the Inspector General of Colombia (Contraloría General de la Nación.)

³³ Dirección de impuestos y Aduanas Nacionales.

³⁴ Policía Fiscal y Aduanera.

³⁵ Unidad de Información y Análisis Financiero.

³⁶ Fiscalía General de la Nación.

authorities. Finally, the Ministry of Foreign Affairs is an important actor on ICT, because it is in charge of international treaties, including the FCTC. At present, this ministry has the pending task of submitting the Protocol to Congress to obtain its ratification.

2.2 Legal Framework

Colombia has benefited from a set of reforms that improve harmonization of customs management, including features such as a comprehensive risk management perspective, cooperation between the customs agency and sub-national authorities, non-intrusive inspection, infrastructure improvements, and coordinated actions across border areas,³⁷ as well as new regulations on procedures, sanctions, and institutional mechanisms. This section explains some relevant aspects of these reforms.

Law 1762/15 (also known as the Anti-Smuggling act) is the current legal framework in Colombia for illicit trade control. Its main contribution is to include smuggling activities within the legal framework for money laundering in Colombia. This law also boosted penalties for smuggling and strengthened institutions involved in the control of illicit trade, including POLFA, DIAN, and UIAF. The law also unified the sanctions imposed for evasion of the tobacco tax, overcoming previous limitations caused by the lack of coordination of penalties among departments. The law represents an important milestone for ICT, because it recognizes legal and institutional factors as the main drivers of illicit trade, and it provides tools for extending law enforcement activities in order to improve control of illicit trade in border areas.

Since 2014, another advance in the legal framework is Decree 2155/2014, which established the technical standards for non-intrusive inspection and created an intersectoral commission for implementation and monitoring of these procedures.³⁸ Although the foundation for non-intrusive inspections was laid out several years earlier with Decree 1520/2008, the adoption of technologies and standard procedures became a reality when the commission was put in place. The commission's responsibilities include the coordination and provision of guidelines for procurement activities and the non-intrusive inspection system. DIAN is responsible for the technical secretariat functions.³⁹ One of its accomplishments is the adoption of a manual with detailed procedures for international trade operations, including imports. This first manual covers inspections at sea ports. Later versions will address procedures in border posts and airports.⁴⁰ Ports in Colombia are managed through concession contracts. In some cases, such contracts already include an obligation to acquire non-intrusive inspection technology. In other cases, this is a voluntary option for the concessionaire.⁴¹

³⁷ The border act, law 191/1995 also set the general framework to establish cooperation with neighbor countries to fight illegal activities.

³⁸ <http://www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=59857>

³⁹ The operation of the commission is defined by Resolución 247/2014

⁴⁰ Resolución 84/2015

⁴¹ Circular externa 051/2017 from the Superintendencia of Ports and Transportation.

The most recent modification to the customs regulatory framework is Decree 349/2018. It modifies a previous norm, Decree 390/2016, and advances in a process that started with the Customs Act (Law 1606/2013) and that has consistently enhanced the capacity of government agencies responsible for control of international trade operations to act more strategically against the activities of criminal organizations.

Law 677/2001 established the regulatory framework for "Special Economic Export Zones." One of these, in La Guajira, plays a prominent role in the illicit trade of cigarettes directed to the domestic market, and possibly to neighboring countries, such as Ecuador. It is worth mentioning that, although the smoking population in La Guajira represents less than 6 percent of cigarette consumers in the country, a significant proportion of cigarette imports in official records declare this department as their destination. According to Bonilla et al. (2015): "The critical spot for smuggling is the Special Customs Zone in Maicao (Guajira) [...] More than 90 percent of smuggled cigarettes enter through this area." Article 18, Paragraph 2 of this law assigns departments full responsibility to control excise tax payments.

Maicao is not the only problem area. Both the departments of La Guajira and Norte de Santander face many difficult governance challenges that require a careful and better-informed approach. Recently, control agencies have identified Urabá as a new route for smuggled cigarettes. Identification of the driving forces of corruption and other institutional weaknesses in these territories is necessary to determine the path for a successful illicit trade policy.

Colombia's National Development Plan 2011-2014 foresaw a Unified Tracking and Tracing System (SUNIR),⁴² and in 2012, a policy document⁴³ supporting decree 602/2013 offered guidelines to develop SUNIR. The system was intended to improve coordination and efficiency in the management of excise taxes for alcohol and tobacco products. Unfortunately, despite attempts to develop the initiative, as of 2018 the country still does not have an information system with the technical specifications described in CONPES 3719 and in guidelines for implementation of the Protocol to Eliminate Illicit Trade of Tobacco Products. SUNIR was included as one of the strategies in the current National Development Plan, but without stating which entity would be responsible for it.

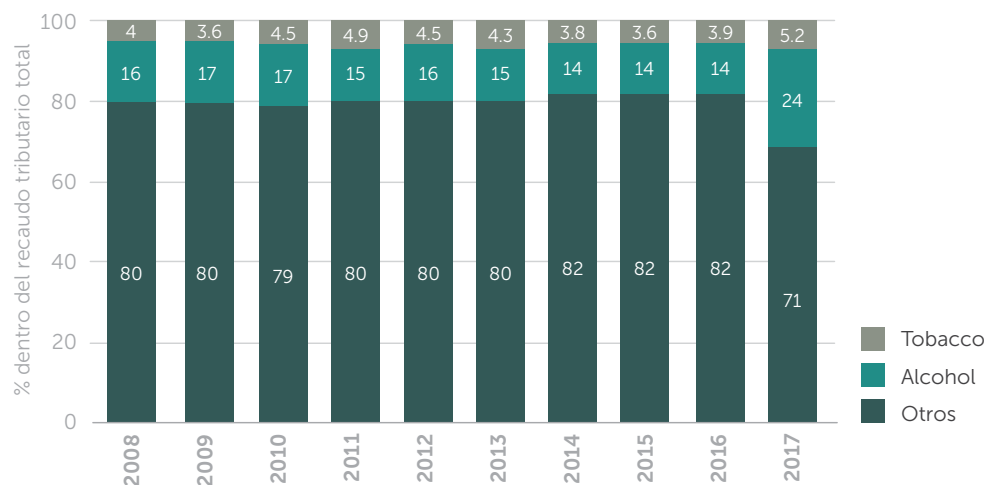
2.3 Administrative Mechanisms

Tobacco taxes represent a very small fraction of tax revenues for subnational entities, as shown in Figure 9. However, for some departments, especially those with the weakest tax structures, this is an important source of funds. Usually these are areas with relatively low smoking prevalence, thus the importance of tobacco taxes in such cases is better explained by the lack of alternative sources of revenue that are typically present in regions with a more developed economy. The institutional limitations are not unique to tobacco tax administration. In fact, the Expert Tax Commission appointed by the Santos administration to provide recommendations

⁴² Law 1450/2011.

⁴³ Conpes 3719/2012.

Figure 9. Tobacco Tax As a Share of Departments' Total Tax Revenues (2008-2017)



Source: based on subnational entities' reports to CHIP – the national accountancy information system.

for the recent tax reform reiterates the need to establish a unified tax act for the subnational entities to eliminate inefficiencies both for the authorities and for tax payers.

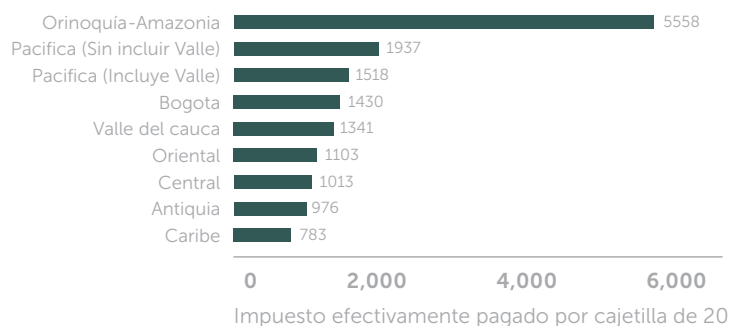
One indicator of the efficiency of tax collection is the effective revenue per pack. Figure 10 shows the results obtained from the ratio between tax revenues in 2016 and the number packs in each region.⁴⁴ Departamentos with border trade activity, like Amazonas, will have much larger revenue, probably from sales destined to the Brazilian market, where prices are higher. Setting aside that observation, it is clear that some regions are doing a better job than others. On average, a 20-stick cigarette pack would have yielded COP\$ 1000 (USD\$ 0.03) in revenue in 2016 (COP\$ 701 specific plus COP\$ 300 from the ad valorem). Regions with ratios below that reference value are Antioquia and Caribe, which are also regions with more frequent complaints about illicit trade of cigarettes and a history of other illegal activities related to organized crime.

Currently, the information system is administered by FND. This institution has sparked controversy regarding control of its activities and contracting procedures. FND manages taxes through the "Fondo Cuenta,"⁴⁵ administered by a fiduciary contract with the consortium FIMPROEX. This mechanism has been in place since January 2010. However, Fondo Cuenta covers only one part of the operations related to the tobacco product market.

⁴⁴ The number of packs is calculated based on the most comprehensive consumption survey, Encuesta de Calidad de Vida, that provides information on number of smokers per region and frequency of consumption. The consumption intensity indicators used are derived from a previous survey, the Psychoactive Consumption Study, 2013.

⁴⁵ This fund was created by article 224, Law 223/1995, to handle the revenues generated by excise taxes on imported goods, including tobacco products.

Figure 10. Effective Revenue per 20-Cigarette Pack by Region (2016)



Source: based on data from CHIP, Encuesta de Calidad de Vida 2016, Estudio de Sustancias Psicoactivas 2013.

Domestic cigarette sales must be reported directly to departments. In the past, this has been implemented through private suppliers that offer information systems to register sales of goods subject to excise taxes (including cigarettes). There is no obligation for departments to use the same system. The official documentation to prove the legality of merchandise is a certification (tornaguía), that declares point of origin and destination. It has been proposed to replace this certification by electronic invoicing, but this is not yet implemented. Currently, the dispersion of control mechanisms across departments, limited development of standards for inspection procedures, and the division between controls for imported and domestic cigarettes create inefficiencies and risks that can be exploited by those seeking to evade taxes.

TOBACCO INDUSTRY INTERFERENCE

The cooperation and investment agreement signed between PMIColtabaco, the Republic of Colombia, and the departments covers specific activities regarding illicit trade. These include:

1. Purchasing and maintaining equipment
2. Training personnel
3. Storing and destroying seized cigarettes
4. Developing educational campaigns
5. Providing financial resources for production control mechanisms.

Under the agreement, FND is required to present reports to PMI-Coltabaco. Worryingly, the arrangements give the company the opportunity to influence budget allocations and decisions relating to the control of ICT. Other aspects of the current situation also raise concerns. For example, in 2016, FND initiated a contracting process to implement a unified

information system. However, according to personal communications with tax authorities, even though a provider had been selected, the system is not yet operating.

It is clear that the current tools for tracking and tracing do not reflect best practices, at least in the following respects:

Data security and integrity: the information available to subnational tax administrations is fragmented and at times misleading. Most importantly, with the data currently available, it is difficult to prove noncompliance. For instance, fiscal authorities do not have clear information about the volume and place of origin of cigarettes. Cigarette packs are not labeled individually, and the codes used are those of the manufacturer.

Independent production controls. Existing information systems do not give relevant stakeholders enough information to establish the volume of tobacco products flowing from source to final destination. The controls are based on manual procedures, not machine-readable identifiers. They rely on the accuracy of information provided by the taxpayer.

Authentication mechanisms. Currently the tobacco industry is the only source of information used by the authorities to establish if a tobacco product is genuine. Also, the documentation to support the legality of the merchandise (tornaguías) in highway control posts is easy to reuse. Cases of such abuse have been reported, and an expert commission has recommended a change to newer technologies.

Such dependence on the tobacco industry in the identification of illicit products falls far short of the standards called for in the Protocol, which notably includes the following language:

Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law; [...]

[Parties must] be alert to any efforts by the tobacco industry to undermine or subvert strategies to combat illicit trade in tobacco products [...];

Obligations assigned to a Party shall not be performed by or delegated to the tobacco industry. Each Party shall ensure that its competent authorities, in participating in the tracking and tracing regime, interact with the tobacco industry and those representing the interests of the tobacco industry only to the extent strictly necessary in the implementation of this Article.

3. Conclusions and Recommendations

3.1 Lessons Learned

Colombia has recently increased its tobacco taxes substantially. The country's 2016 tax reform defied partisan warnings from the tobacco industry about spiking ICT and marked a historic step in the defense of the nation's public health. However, when compared to other countries in the region, Colombia's tobacco tax levels remain below average. Colombia is far

from having taxes high enough to control its tobacco epidemic. The country's health leaders continue to advance the anti-tobacco fight.

Among recent efforts on ICT by national and subnational institutions, three in particular appear pivotal. First, the modernization of customs regulation by DIAN is already paying off in terms of institutional capacity to confront the renewed force of criminal organizations using illicit trade as part of their operations. Second, a monitoring and evaluation initiative has been launched to provide authorities with reliable, impartial information on interactions among tax increases, tobacco consumption, and ICT. This initiative originated with Colombian civil society, generating evidence that was subsequently used by the MoH to shape policy.⁴⁶ More recently, the MoH has championed including a question on tobacco use prevalence in a national survey. This will provide annual nationwide data on trends in tobacco market size.⁴⁷

It is important to emphasize, based on the Colombian experience, that ICT monitoring and evaluation must not be limited to conventional indicators. An integrated approach incorporating different dimensions of tobacco control is required. That means monitoring consumption, supply, prices, violations to labeling and packaging regulations, characterization of distribution channels, and price information at different stages of the distribution chain. All this must be in addition to standard metrics on seizures. Because of the illegal nature of ICT activities, qualitative methods provide useful explanations and inform the analysis of the quantitative data, and should be included in the monitoring and evaluation strategy.

A third key point regarding Colombia's recent ICT control efforts is the following. Some subnational authorities demonstrate that it is possible to maintain low illicit trade penetration rates in the context of a significant tax increase. The asymmetries observed in this indicator reflect uneven institutional capacities across the national territory. Comparison of subnational results can be used to motivate and guide interventions to address these performance gaps.

3.2 The Way Forward: Action Steps

Looking ahead, a next key step for Colombia is to secure congressional approval of the Protocol, followed by ratification with the Treaty Section of the United Nations Secretariat. At the same time, it is necessary to develop national and subnational capacities for implementation. For the latter, issues related to tobacco tax policies per se must be understood as part of a larger conversation about the improvement of subnational tax management

⁴⁶ The MoH also rapidly disseminated this evidence to decision makers in other institutions and sectors. This has helped counteract TI attempts to misinform stakeholders and create the perception of a failed and unsustainable tax policy.

⁴⁷ That said, Colombia still badly needs more detailed measurement of its tobacco epidemic to better understand smokers' behavior and provide evidence for future policy design, including illicit trade control. For instance, since 2012, the MoH has planned the Global Adult Tobacco Survey (GATS), but the decision to perform the study remains stalled. Colombian authorities continue to rely heavily on TI data to assess tobacco consumption and ICT.

capacity. This involves governance challenges related to coordination between institutions at the national and subnational level and across sectors. The conversation should include government and non-governmental actors with responsibilities to promote transparency and improve governance, largely absent from tobacco control discussions in Colombia to date. Specific steps for Colombia to develop relevant capacities include the following:

1. Develop a strategy to promote a unified excise tax management system to reduce coordination costs and improve operational efficiency and transparency. One path already established is the commitment in the National Development Plan to adopt the SUNIR system. This pledge has not yet been fulfilled. It is imperative that, after ratification of the Protocol, the next administration appoint a national-level authority to develop and deliver SUNIR. Current discussions in Latin America about adoption and implementation of the Protocol provide the opportunity to exchange information with neighboring countries on the required technology and procedures. Emerging innovations may reduce contracting costs and institutional efforts, improving synergies for international cooperation.
2. Despite the inherent challenges of monitoring an illicit activity such as ICT, Colombia has started to generate ICT evidence through collection of better data, independent estimates, articulation of different sources of information, and preliminary evaluation exercises. The country should pursue this critical effort. Ultimately, Colombia's ICT policy should be based on evidence meeting the World Bank's minimum quality requirements for inputs to policy design (Ross 2015; Yurekli, Beyer, and Merriman 2001).
3. An important positive experience in Colombia is the improvement in independent information available to diagnose and analyze illicit trade. The government should reflect such independently generated knowledge in its routine policy monitoring. Leaders should plan and budget for activities and resources to further advance reliable monitoring and evaluation.
4. Establish formal mechanisms to ensure participation of legitimate representatives of the research community (academia) and civil society in institutional structures established for policy debates on illicit trade. These structures include the High Commission Against Illicit Trade. It is vital to tap into academic and civil society expertise in tobacco control and related illicit trade issues.
5. Even in a country with a history of TI involvement in illegal activities, including a well-established case of illicit trade in the 1990s, most stakeholders still tend to regard the TI as a partner and the first source of information and technical advice on ICT issues. Thus, significant efforts are needed to inform national and subnational stakeholders about international evidence on TI involvement in illicit trade activities. Improved communication is needed to raise awareness of the FCTC, the Protocol, and the need to prevent direct or indirect TI interference in policy processes. Moreover, Colombia's information system for tobacco-related data (including on topics other than ICT) must draw much more strongly on data that does not come from industry sources. Relevant institutions

must also strengthen their capacity to verify the reliability of any remaining data that continues to be derived from the TI.

6. Other procedures to counteract TI interference include requiring a comprehensive explanation of the methodology of TI-funded studies, when they are presented to the authorities.
7. Programs against cigarette smuggling at the subnational level should not be funded or receive technical cooperation from the TI. Some of the conditions in the current cooperation agreement between PMI-Coltabaco and various public-sector authorities provide PMI with influence over the use of resources for tobacco control, a circumstance that is not consistent with the commitments of the Colombian State under the FCTC (Article 5.3).
8. A national-level coordinating authority should be established to manage all information about domestic tobacco production, international trade, tax revenues, prices, sales, and consumption trends. This agency should also be in charge of outlining plans for international cooperation. It is not appropriate to maintain the current fragmentation of responsibilities in the strategic management of tobacco taxation and illicit trade. The role played so far by the FND does not fulfil the necessary conditions. It is also worth noting that the usual controls in place for public servants do not apply to FND, making it a liability in terms of governance conditions. The scope of FCTC 2030, which currently incorporates an objective related to establishment of a National Coordinating Mechanism, provide an opportunity to consider these issues in the discussions about specific institutional designs.
9. The MoH should continue its effort to offer training to agencies outside the health sector that bear responsibility for inspection activities, in particular, members of POLFA. Training should include relevant updates on sanitary regulations, specifically health warnings, the list of brands approved by the packaging and labeling committee, and guidelines for implementation of Article 5.3 to prevent tobacco industry interference.
10. Subnational authorities must undertake consultations with the MoH to verify FCTC compliance, when developing any intervention related to tobacco taxation.
11. Advances in the definition of legal penalties must be accompanied by publicly available information on performance indicators for the implementation of sanctions. A specific case that requires improvement in coordination and policy-objective harmonization is the engagement of the Superintendence of Industry and Commerce to improve point-of-sale controls and the imposition of penalties according to the law. The magnitude of fines (particularly in relation to the minimum wage) needs to be adjusted so that wholesalers and established retailers face penalties that are more than trivial in relation to their sales and profits from tobacco products.

12. Improving transparency on tax revenue may help identify the weakest areas of tax administration and focus authorities' efforts on those areas. Learning about tax-collection performance across regions may help in identifying champions and encourage information sharing about successful strategies.
13. Development policies under Agenda 2030 may identify local multisectoral interventions to optimally manage informal channels that distribute both licit and illicit cigarettes. This is a common situation in Colombia, as in other Latin American countries.

References

- Avila, Ariel et al. 2012. *La frontera caliente entre Colombia y Venezuela*. Corporación Nuevo Arco Iris, Random House Mondadori.
- Bonilla, Ricardo et al. 2015. "Comisión de expertos para la equidad y la competitividad tributaria. Informe Final al Ministro de Hacienda". In: URL: <http://www.repository.fedesarrollo.org.co/handle/11445/3284>.
- Cáceres-Corrales, Pablo. 2016. *Las formas cambiantes de la criminalidad en Colombia a finales del siglo XX*. Universidad Nacional de Colombia.
- Cigüenza, Noelia. 2018. "El contrabando de cigarrillos le costó al país más de \$229.000 millones en 2017". In: *La República*.
- Coelho do Vale, Rita, Rik Pieters, and Marcel Zeelenberg. 2008. "Flying under the Radar: Perverse Package Size Effects on Consumption Self-Regulation". In: *Journal of Consumer Research* 35.3, pp. 380–390. DOI: 10.1086/589564.
- DANE. 2017. *Boletín técnico Encuesta Nacional de Calidad de Vida ECV 2016*. Tech. rep. Departamento Administrativo Nacional de Estadística - República de Colombia (DANE).
- . 2018. *Boletín técnico Encuesta Nacional de Calidad de Vida ECV 2017*. Tech. rep. Departamento Administrativo Nacional de Estadística - República de Colombia (DANE).
- El Tiempo. 2018. "Vuelve a repuntar el contrabando de cigarrillos en el país". In: *El Tiempo*.
- Forero, Gabriel. 2015. "Coltabaco y BAT se disputan un negocio que factura hasta \$2,2 billones al año". In: *La República*.
- Fundación Salutia. 2018. *Encuesta de Riesgos Cardiovasculares - ERICA Risaralda 2017*. Fundación Salutia, Gobernación de Risaralda.
- Gallego, Juan Miguel et al. 2018. *Tobacco control and illicit trade in Colombia*. Tech. rep. Universidad del Rosario and Fundación Anáas. Working paper.
- INVAMER and ANDI. 2017. *Incidencia de cigarrillos ilegales en Colombia*. Tech. rep. Investigación y Asesoría de Mercado (INVAMER), Asociación Nacional de Empresarios de Colombia (ANDI).
- La República. 2018. "Contrabando de cigarrillos ha pasado de 13% a 18% en el último año". In: *La República*.
- Lampe, Klaus von. 2006. "The cigarette black market in Germany and in the United Kingdom". In: *Journal of Financial Crime* 13.2, pp. 235–254. DOI: 10.1108/13590790610660935.
- Llorente, Blanca and Diana Díaz. 2018. *Caracterización cualitativa de la cadena de distribución del contrabando de cigarrillo en Colombia con una perspectiva de Derechos Humanos*. Tech. rep. Fundación Anáas, Diversidad Rural.
- Maldonado, Norman et al. 2018a. "Measuring illicit cigarette trade in Colombia". In: *Tobacco Control*. DOI: 10.1136/tobaccocontrol-2017-053980.
- . 2018b. *Monitoring illicit cigarettes in Colombia to advance tobacco tax agenda*. Tech. rep. Fundación Anáas. Working paper.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

- Marquez, Patricio and Blanca Moreno-Dodson. 2017. *Tobacco Tax Reform at the Crossroads of Health and Development: A Multisectoral Perspective*. Tech. rep. World Bank, Report No. 39832-CO.
- MIJ. 2009. *Estudio epidemiológico andino sobre consumo de drogas sintéticas en la población universitaria, Informe Colombia 2009*. Tech. rep. Ministerio del Interior y Justicia (MIJ).
- MinSalud and INC. 2012. *Plan Decenal para el Control del Cáncer en Colombia 2012-2021*. Tech. rep. Ministerio de Salud y Protección Social (MinSalud) and Instituto Nacional de Cancerología (INC).
- MinSalud and ODC. 2013. *Estudio Nacional de Consumo de sustancias Psicoactivas en Colombia 2013*. Tech. rep. Ministerio de Salud y Protección Social - República de Colombia (MinSalud) and Observatorio Colombiano de Drogas (ODC).
- MPS and Cendex. 2009. *Encuesta Nacional de Salud 2007*. Tech. rep. Ministerio de la Protección Social de la República de Colombia (MPS), Cendex.
- MPS and DNE. 2008. *Estudio Nacional de Consumo de sustancias Psicoactivas en Colombia 2008*. Tech. rep. Ministerio de la Protección Social - República de Colombia (MPS) and Dirección Nacional de Estupefacientes (DNE).
- Nasi, Carlo and María del Pilar Lozano. 2018. "¿Diferentes recursos, conflictos distintos?" In: Angelica Rettberg et al. (eds). *La economía política del conflicto armado en Colombia: algunas hipótesis sobre el contraste entre los sectores bananero y floricultor*. Bogotá: Universidad de los Andes.
- Ochoa Sierra, María. 2011. *Horror sin nombre. Impacto de la entrada de los paramilitares en territorio Wayú*. Bogotá: Universidad de los Andes. ISBN: 978-958-695-637-6.
- PAHO. 2016. *Report on Tobacco Control for the Region of the Americas. WHO Framework Convention on Tobacco Control: 10 Years Later*, p. 148. ISBN: 9789275118863.
- Portafolio. 2018a. "Hueco por contrabando de cigarrillos superaría los \$300.000 millones". In: *Portafolio*.
- . 2018b. "¿Sirvió el impuesto al tabaco para reducir el contrabando?" In: *Portafolio*.
- Quiroga-Angel, Daniel. 2018. "¿Diferentes recursos, conflictos distintos?" In: ed. by Angelica Rettberg et al. Bogotá: Universidad de los Andes. Chap. Minería de carbón y guerra: una mirada a la economía política del conflicto armado en el Cesar y La Guajira.
- Ross, Hanna. 2015. *Understanding and measuring cigarette tax avoidance and evasion: a methodological guide*. Tech. rep. Tobacconomics.
- Stoklosa, Michal and Hana Ross. 2014. "Contrasting academic and tobacco industry estimates of illicit cigarette trade: evidence from Warsaw, Poland." In: *Tobacco control* 23.e1, e30–4. DOI: 10.1136/tobaccocontrol-2013-051099.
- Thomson, George et al. 2012. "What are the elements of the tobacco endgame?" In: *Tobacco Control* 21.2, pp. 293–295. DOI: 10.1136/tc.2010.040881.
- UNODC. 2017. *III Estudio epidemiológico andino sobre consumo de drogas en la población universitaria, Informe Regional, 2016*. Tech. rep. Oficina de las Naciones Unidas contra la Droga y el Delito (UNODC).
- Vega, Juan Pablo. 2018. "Contrabando de cigarrillo llega hasta 18% del total de ventas de la industria". In: *La República*.
- World Bank. 2009. *Colombia Decentralization: Options and Incentives for Efficiency, Volume I: Main Report*. Tech. rep. The World Bank, Report No. 39832-CO.

Yurekli, Ayda, Joy de Beyer, and David Merriman (2001). *Economics of tobacco toolkit*. Tech. rep. The Worldbank.

ECUADOR

11

ECUADOR:

Addressing Illicit Tobacco Trade

Santiago Trujillo¹

Chapter Summary

The chapter begins with a review of the smoking epidemic using global figures and data, followed by an examination of Ecuador's domestic epidemic. The chapter describes the advances and challenges associated with specific laws and regulations designed to combat tobacco consumption in Ecuador, such as the Tobacco Control Law and the country's signing and ratification of the Protocol to Eliminate Illicit Trade in Tobacco Products. The analysis highlights how Ecuador's government has promoted cultural and social change smoking-related attitudes and practices by means of measures such as the National Plan for Well-Being. A brief look is taken at the application of MPOWER measures recommended by the World Health Organization (WHO) as the most effective means to combat the smoking epidemic. This is followed by analysis of tobacco tax issues.

The chapter provides an extensive analysis of Ecuador's tax track-and-trace system (TTS) for domestically produced cigarettes, alcoholic beverages, and beer, known as the Identification, Marking, and Tracking System (Sistema de Identificación, Marcación y Rastreo, SIMAR). The system was implemented by Ecuador's Internal Revenue Service (SRI) in 2017. Topics related

¹ Servicio de Rentas Internas (SRI), Ecuador

to the technical and security characteristics of the physical features of the SIMAR system are discussed; these features are evidence of the robustness of the solution.

The implementation of the SIMAR system earned the SRI a 2017 award from WHO on World No Tobacco Day (which supported the theme “tobacco – a threat to development”). The first TTS to comply with the Protocol to Eliminate Illicit Trade in Tobacco Products, SIMAR has become a benchmark for other countries in the region as they begin to tackle these issues. The government of Ecuador has signed an international cooperation agreement with the Dominican Republic to establish a similar system, cooperated with various other countries in the region, and participated in a number of international forums to share its experiences: precisely the sort of international assistance called for under the Protocol.

The core of this study focuses on the illicit trade. Illicit trade in cigarettes has been widely discussed and is recognized as a policy issue of great importance. The collection of relevant data is especially critical in understanding the scope of the problem and whether illicit trade is expanding. Unfortunately, it is difficult to conduct a study of this type without adequate data on consumption within countries. This remains a challenge in Ecuador, which needs to periodically collect more reliable consumption statistics and compare them with data on sales and production to establish a robust assessment of the illicit trade. This would allow more effective targeting of public policy and facilitate intraregional comparisons and lessons.

The study presents additional evidence that may help in the further analysis of Ecuador’s illicit tobacco trade, such as the finding of a recent striking decline in the sales of the only authorized cigarette producer in the country. Seizures of illicit products are also discussed that highlight the effectiveness of Ecuador’s public policy and market surveillance. A key conclusion of the study is that, while the decline in legal cigarette sales has been associated with a fall in tobacco tax revenues, the current tobacco tax level in Ecuador is sustainable. The government appears to be adopting the appropriate response to the revenue reduction, which is strengthening tax administration.

The Smoking Epidemic: Background and Data

Tobacco consumption is the main factor in the death of 50 percent of smokers (WHO 2017). In Ecuador, an estimated 15.0 percent of women and 38.2 percent of men were current smokers in 2013 (PAHO 2016). The data indicate that 21 Ecuadorians die each day as a result of smoking, and approximately US\$ 478.4 million are spent annually by the government to treat health issues and impacts related to tobacco consumption; this is the direct cost of smoking. This expenditure represented 0.47 percent of Ecuador’s gross domestic product (GDP) and 6.32 percent of total annual public spending on health in 2015. Moreover, 13.4 percent of all deaths among people over the age of 35 in Ecuador can be attributed to this pandemic, which means that controlling tobacco consumption might help avoid some 7,798 deaths annually (Bardach et al. 2016).

The Ecuadorian government has undertaken considerable effort in tobacco control over the past decade. In March 2004, it signed the Framework Convention on Tobacco Control (FCTC), and, in July 2006, it ratified the convention.² Subsequently, in 2011, the Organic Law on Tobacco Regulation and Control was enacted.³ The objective of the law is to promote the right of the population to health and protect the population against the consequences of the consumption of tobacco products and their harmful effects. In February 2012, the regulations governing the implementation of the law were approved. These recognized the Ecuador Inter-institutional Anti-Tobacco Committee as an entity within the Ministry of Public Health charged with coordinating tobacco control nationwide.⁴

Ecuador's government signed the Protocol to Eliminate Illicit Trade in Tobacco Products on September 25, 2013, and, in 2015, the National Assembly ratified the Protocol.⁵ Notably, only six countries in the Latin America and Caribbean region—Brazil, Costa Rica, Ecuador, Guatemala, Panama, and Uruguay—have ratified the Protocol. This demonstrates the importance that the government of Ecuador has attached in recent years to combating the smoking epidemic, the associated externalities, and the harmful direct and indirect effects. The key to the progress achieved was the link established between the economic agenda and the health agenda by means of a key message: tobacco taxes are not only an economic measure; they are also a comprehensive public policy that is effective in reducing smoking and preventing young people from taking up tobacco consumption (Pizarro et al. 2018).

Laws and Regulations

An examination of the national legislation on tobacco control, from the macro level down to specifics, is revealing. Article 361 of the Constitution of Ecuador states that:

The State shall exercise leadership of the system through the national health authorities, shall be responsible for national health policy making, and shall set standards for, regulate, and monitor all health-related activities.

The leadership of the health system is assigned to the Ministry of Public Health, and the Constitution indicates that it is necessary to establish a policy at the national level. Article 364 affirms:

² Article 15 of the FCTC indicates that it is necessary to eliminate all forms of illicit trade in tobacco products (smuggling, illicit manufacturing and counterfeiting), and Article 6 recognizes that price and tax measures are effective and important in various sectors.

³ Published in *Official Gazette* 497 (July 22, 2011), the law sets out guidelines for tobacco control.

⁴ The committee was established by Plutarco Naranjo in 1988. It includes representatives of public and private organizations and civil society actors.

⁵ Among the most important articles on illicit trade in the Protocol is Article 8, which provides that each party shall establish a TTS controlled by the government for all tobacco products that are manufactured in or imported into the national territory.

Addictions are a public health problem. The State shall be responsible for developing coordinated programs for information about and the prevention and control of the use of alcohol, tobacco, and narcotic and psychotropic substances, as well as providing treatment and rehabilitation to occasional, habitual, and problematic users.

Thus, the Constitution establishes that tobacco consumption and the consumption of other narcotic substances are issues of national interest, requiring a comprehensive policy for prevention and for the treatment of users.

The government's road map over the past few years was laid out in the National Plan for Good Living, 2013–2017.⁶ Objective 3 of the plan focused on improving the quality of life of the population and, more specifically, in Objective 3.2, on:

Expanding health prevention and promotion services to improve the living conditions and lifestyles of individuals... [including by] [p]reventing and combating the consumption of tobacco, alcohol, and narcotic and psychotropic substances with emphasis on pregnant women, girls and boys, and adolescents.

This all demonstrates how the government views public policy as a whole and the topic of smoking as an issue that requires commitment at the highest level, particularly because 2016 data show that seven of the ten leading causes of death in Ecuador, accounting for 36.9 percent of total deaths, related to tobacco consumption. These included: ischemic heart disease, 9.65 percent; diabetes mellitus, 7.27 percent; cerebral vascular diseases, 6.35 percent; hypertensive diseases, 5.17 percent; diseases of the urinary system, 2.73 percent; chronic diseases affecting the lower respiratory tract, 2.69 percent; and malignancies of the stomach, 2.43 percent (INEC 2016).

The National Development Plan 2017–2021: *Toda una Vida* ("A Whole Lifetime") entered into effect in 2017 (SENPLADES 2017). The plan is a continuation of earlier plans with adjustments and changes in structure, focus, and objectives. The anti-tobacco efforts are included in Focus 1: Lifelong Rights for All, and, within this focus, in Objective 1: Guarantee a life in dignity with equal opportunity for all. The policies established to achieve this objective include the following: guarantee the right to health care, education, and lifelong comprehensive care that is

⁶ The plan represented a well-defined political stance and the government's guide for the four years from 2013 to 2017. It comprises a set of objectives that indicate the intention to continue the historical transformation of Ecuador, as follows: Consolidate the democratic state and the construction of popular power. Promote equality, cohesion, inclusion, and social and territorial equity within diversity. Improve the quality of life of the people. Strengthen the capacity and potential of citizens. Construct common meeting places and strengthen the national identity, diverse identities, plurinationality and interculturalism. Consolidate the transformation of justice and strengthen overall security, while maintaining strict respect for human rights. Guarantee the rights of nature and promote territorial and global sustainability. Consolidate a sustainable, caring economic system with a social focus. Guarantee decent work in all its forms. Promote the transformation of the production matrix. Ensure the sovereignty and efficiency of strategic sectors for industrial and technological transformation. Guarantee sovereignty and peace, further strategic insertion in the world, and Latin American integration (SENPLADES 2013).

accessible, of good quality, and of local and cultural relevance (1.6); and confront the socioeconomic phenomenon of drugs and alcohol through comprehensive prevention, control, and supply reduction strategies (1.14). The plan proposes the following vision for Ecuador in 2030:

Ecuador will make progress in its guarantee of the right to health through the promotion of healthy lifestyles that focus on the prevention of disease. It proposes that Ecuador reduce sedentarism, improve people's eating habits, and increase physical activity among all groups, regardless of age. This will help reduce stress levels and the number of deaths from cardiovascular diseases, diabetes, excess weight, obesity, and so on. Emphasis will also be placed on combating drug, alcohol and tobacco consumption (especially among adolescents and young people). (SENPLADES 2017, 32)

Reducing tobacco consumption is a key in both national development plans. The plans are spearheaded by the National Secretariat for Planning and Development, but their implementation is the responsibility of all government agencies according to the relevant areas of expertise.

Combating Smoking

The government of Ecuador has aligned its efforts to combat smoking with the six most effective measures stipulated by the WHO MPOWER policies contained in the FCTC: *monitor* tobacco use and prevention policies; *protect* people from tobacco smoke; *offer* help in quitting tobacco use; *warn* about the dangers of tobacco; *enforce* bans on tobacco advertising, promotion, and sponsorship; and *raise* taxes on tobacco (WHO 2017). These efforts have been led mainly by the Ministry of Public Health. With the publication of the Organic Law on Tobacco Regulation and Control, attention was drawn more tightly around the package of MPOWER strategies, as follows:

Protect: 100 percent no-smoking areas were established in enclosed public spaces. This was subsequently expanded to enclosed public and private spaces with public access and open spaces in educational and health care institutions.

Warn: Tobacco packaging was required to bear graphic warnings covering 70 percent of the package surface. The seventh series of health warnings on tobacco packages was launched on July 15, 2018. This includes descriptions of real cases of individuals whose health has been affected by tobacco consumption. Such packaging is required for all tobacco products sold in Ecuador.

Enforce: Measures included a prohibition on all types of advertising, including the sponsorship of sports, cultural, and arts activities, by the tobacco industry, as well as a prohibition on any type of advertising, promotion, or sponsorship of tobacco products or the tobacco industry in any mass media or through interpersonal means of communication. The sale,

including retail sales, to or by individuals under age 18 was prohibited, and regulations on the retail sale and use of vending machines for tobacco products were introduced.

Monitor: Ministry of Public Health data are essential in determining smoking prevalence. Breakdowns by gender and age-group are important in revealing the segments of the population in which smoking prevalence is greater. In 2012, the prevalence of tobacco consumption, defined as the number of persons declaring that they have smoked tobacco at least once in the previous month among those who declared that they had tried tobacco one or more times in their lives, is 28.4 percent among adolescents ages 10–19 and 31.5 percent among individuals ages 20–59. Among both adolescents and adults, prevalence is greater among men and the 15–19 and 20–29 age-groups. Among the 10–19 age-group, 48.7 percent of both sexes declared that they had begun to consume tobacco at 16 or older, compared with 73.5 percent among the population ages 20–59. Among adolescents, 34.1 percent say that it is easy to obtain cigarettes; 38.4 percent say that it is difficult; and 15.8 percent say that it is very difficult. However, 45.5 percent of individuals ages 20–59 who say they have smoked at some point in their lives no longer smoke currently (ex-smokers); the share is larger among men than among women (Freire et al. 2014).

Raise Taxes: In line with the most cost-effective tobacco control measures and the WHO (2010) recommendations, the government has undertaken wide-ranging steps to regulate and control tobacco products to reduce cigarette consumption, prevent young people from starting to consume tobacco products, restrict consumption by vulnerable groups, and encourage cessation of tobacco product use. The strategy has been led by the SRI, with the support of the Ministry of Public Health. The main method has involved raising taxes, leading to a rise in cigarette prices and thus to a decrease in demand. The following section describes the various tax issues in more detail.

Tax Issues

The Excise Tax on Cigarettes

The tax on cigarettes in Ecuador, the special consumption tax (impuesto a los consumos especiales, ICE), was created in 1989 through the enactment of the Law on the Internal Tax Regime.⁷ Its main purpose was to restrict the consumption of luxury goods and products harmful to health. WHO (2010, 2017) recommends that specific taxes on tobacco should represent at least 70 percent of the sales price to generate the desired impact on consumption. Other taxes, such as the value-added tax (VAT), are then added to the specific tax to reach the recommended minimum tax burden of 75 percent. Currently, the tax burden on the top-selling brand of cigarettes in Ecuador is 66.4 percent.

⁷ Published in *Official Gazette* 341 (December 22, 1989).

Trends in the tax burden are reflected in the commercial strategy of the only tobacco producer in Ecuador, which responds to every tobacco tax increase by immediately raising prices, often by more than the tax increase (Table 1). The firm can do this because it has a monopoly on the manufacture of cigarettes in the country, accounting for almost the entire formal cigarette market.

Table 1. Tax Burden on the Top-Selling Cigarette Brand, Ecuador, 2015–18

BREAKDOWN	2015	2016	2017	2018
ICE, per unit ^a	US\$0.13	US\$0.16	US\$0.16	US\$0.16
ICE value, pack of 20	US\$2.64	US\$3.20	US\$3.20	US\$3.20
VAT, %	12	14 ^b	12	12
VAT value	US\$0.32	US\$0.45	US\$0.38	US\$0.38
ICE + VAT	US\$2.96	US\$3.65	US\$3.58	US\$3.58
Manufacturer's suggested retail price	US\$4.25	US\$5.20	US\$5.40	US\$5.40
Tax burden, %	69.5	70.2	66.4	66.4

Source: SRI database.

a. The tax rate, VAT share, and manufacturer's suggested retail price correspond to the values at the close of the fiscal year, that is, in December.

b. In 2016, the VAT rate was increased from 12 percent to 14 percent for one year to raise funds for the reconstruction of areas affected by the April 16, 2016 earthquake.

Ecuador has one of the highest average prices per pack of cigarettes in the region. The retail sale price per pack of the top-selling brand of cigarettes in Ecuador is almost triple that in Colombia, where, in 2018, a pack of cigarettes cost approximately Col\$ 5,000, or US\$ 1.74. This is only 32.2 percent of the price in Ecuador.⁸ In Peru, the top-selling brand costs approximately S/. 11.50, equivalent to US\$ 3.52, or 65.2 percent of the Ecuadorian price.⁹

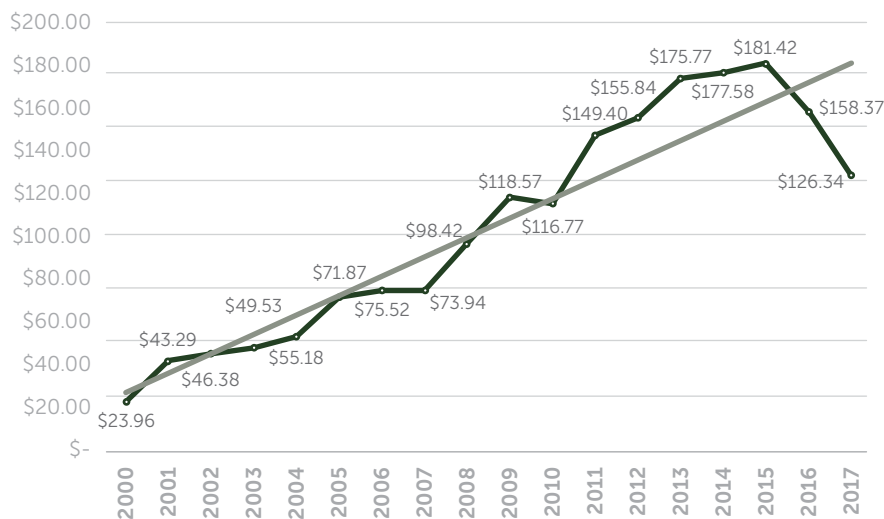
ICE Collections

ICE collections on cigarettes rose steadily from 2000 through 2015 (Figure 1). Starting in 2016, there was a 12.7 percent decline in collections relative to the previous year, a trend that was maintained in 2017 with an even larger drop of 20.2 percent. With the launch in May 2017 of Ecuador's tobacco-product tracking and tracing system (TTS), known as SIMAR, it is hoped that this decline will be much smaller for 2018, because the TTS also tackles issues of under-invoicing and makes it easier to differentiate between legal and illegal products (which allows for greater efficiency in the surveillance process).

⁸ The official exchange rate in June 2018 was Col\$2,777.75 per U.S. dollar.

⁹ The official exchange rate on June 29, 2018, was S/. 3.27 per U.S. dollar.

Figure 1. ICE collections on cigarettes, in US\$ millions (2011-2017)



Source: SRI database.

Thus, the collection of the ICE on cigarettes rose from 2000 through 2015, but has trended downward since then. This analysis must be supplemented with historical data on the volume of sales (closely related to production output) to obtain an accurate analysis of the cigarette market. This analysis is provided below, in the discussion of illicit trade.

Ecuador’s Tax Identification, Marking, Authentication, and Track-And-Trace System

SIMAR, Ecuador’s TTS, is primarily designed to minimize tax evasion associated with domestic products. The goal is to increase tax collections by identifying and tracking legal products and to provide citizens and watchdog organizations with the means to detect products of doubtful origin that can negatively impact the health of Ecuadorians.

The design and implementation of SIMAR for domestically produced cigarettes, beer, and alcoholic beverages began with the launch of an international public tender on April 7, 2016. Following a detailed process, SRI awarded the contract for the SIMAR Project to the SICPA EcuTrace Consortium. The selection criteria were detailed in the terms of reference for the tender (bids had to meet certain minimum criteria for consideration: minimum technical personnel, minimum general and specific experience, minimum experience of the technical personnel, technical specifications or terms of reference, capital, percentage of the minimum Ecuadorian value added, etc.). After these requirements were met, the factors to be scored were established: general experience, specific experience, experience of the technical personnel, other parameters met by the contracting entity (related to additional levels of security), plus financial indicators and the financial bid (Table 2). These criteria were scored

Table 2. Terms of Reference, Bid Scoring, SIMAR, 2016

EVALUATION PARAMETERS	IDEAL SCORE
General experience	11
Specific experience	14
Experience of technical personnel	5
Other	5
Financial bid	55
Subtotal	90
Ecuadorian value added	10
Total	100

Source: Terms of reference for the SIMAR tender.

in accordance with the guidelines set out in Ecuadorian public procurement regulations. It is important to note that only for the item “other” was there freedom for the contracting authority to establish any criterion that it wishes to evaluate, but the scoring of that parameter was just five points.

After completion of the legal process set out in the public procurement regulations, the contract for the implementation of the system was signed in July 2016. The bidding process from the announcement of the specifications through to the awarding of the contract took two months. The cost of the project, as stipulated in the terms of reference, is US\$ 81.5 million for the five-year contract or the marking of 6,678,901,820 units, whichever comes first.¹⁰ The project is financed through the general government budget.

Owing to various contractual, technical, and political factors, implementation took place on different dates for different products. SIMAR went into operation in alcoholic beverages, artisanal beer, and one of the industrial beer producers on February 23, 2017. It was implemented for cigarettes on May 20, 2017. Nonetheless, almost the entire system had been installed on production lines by February 2017, which made it possible to count all of the cigarettes manufactured in the production plant even if they had not yet been marked.

In the case of cigarettes, the SRI defined an indirect type of marking, that is, the application of visible physical security features to the product or the packaging containing the product on the production line.

Physical Security Features

The elements that comprise the physical security features (PSFs) applicable to this type of marking were outlined in the terms of reference of the bidding process. The terms of

¹⁰ This is an estimate based on the actual units marked in 2017 and projections for 2018–22.

reference made it clear that, in addition to the required coding that would facilitate the tracing of the product, there should be at least two components for each of the PSF categories, as follows:

- » Overt, visible security features: security features that can be verified with the naked eye, such as change of color, change of ink, holograms, latent images, watermarks, and security threads
- » Semi-covert security features: security features that can be verified using a simple tool, such as ultraviolet filters, polarized filters, or magnifiers
- » Covert, invisible security features: security features that require the use of specialized robust electronic devices for the verification of authenticity
- » Forensic security features: security features that include forensic markers that can only be identified through a laboratory analysis and that are capable of providing irrefutable proof that may be presented as evidence in a court of law

PSFs also have to include tamper-evident features to prevent the manipulation, transfer, or reuse of security devices. Moreover, PSFs are required to meet general security criteria, as follows:

- » Security based on type of material used: integrate robust high-security features to prevent copying and safeguard against the reuse of the features on illicit products or their reproduction through commercially available means
- » Information-based security: security based on algorithms with unique encryption keys for Ecuador
- » Compatibility with high-speed devices, without affecting the speed and volume of production, within a margin of error of 2 percent
- » Readability by equipment designed for use in the field by SRI users and other inspection and control entities, as well as through a mobile application, enabling oversight by the public¹¹

PSFs are stacked in bundles of 500 units and are delivered on the basis of minimum orders of 124,000 units (SRI 2017). They are affixed automatically by marking equipment installed as part of the SIMAR solution on all production lines of the country's cigarette manufacturer. They are placed on the product by a labeling arm during the final stage of the production process, at a point when the cigarettes packs are not subject to any other processing. This means new products may enter the production line once the paper filters have been attached.

Each taxpayer, the cigarette manufacturer in this case, is obliged to submit an application by e-mail to the account designated by SRI to request the quantity of PSFs needed for manufacturing. The request should take account of historical production amounts and comply with the format and instructions indicated on the website and outlined in Resolution

¹¹ See the terms of reference for the SIMAR recruitment process on the SIMAR website, at <http://www.sri.gob.ec/web/guest/simar>.

NAC-DGERCGC16-00000455, published in the Supplement to *Official Gazette* 878 of November 10, 2016. In cigarette production lines, PSFs are applied in an L shape on the right side of each pack (SRI 2017).

Some of the physical and security characteristics of PSFs placed on cigarette packs are as follows:

- » The rectangular PSF measures 44 x 20 millimeters.
- » The PSF is printed on dry paper with a weight of 80 grams per square meter.
- » Green security ink on the edge of the PSF shows a high sheen under sunlight and shifts to blue if the PSF is viewed from another angle.
- » The data matrix is visible.
- » The Quick Response Code, a barcode, can be scanned using the SRI SIMAR application.¹²
- » A printed alphanumeric code can be scanned and verified using the SRI SIMAR application.
- » The SRI logo shifts between pink and red if it is viewed from different angles.
- » Modulation lines have been added.
- » "Republic of Ecuador, Internal Revenue Service, and SRI SIMAR" is printed in micro-text on the pack (SRI 2017).

PSFs also possess other security features that cannot be revealed. This precaution is necessary to ensure that security solutions are robust and to prevent counterfeiting.

Characteristics of the SIMAR Solution

The SIMAR solution comprises a number of technological components that provide marking and online data storage across various stages, starting with the production plants owned by taxpayers and their interface with registry services and extending to web-based authorizations and the verification of information generated throughout the cycle. The technological platform is based on the installation of information technology equipment in each production plant. Central storage facilities are supplied by the provider. The service relies on various technical channels to process the information, which is the property of SRI, and to ensure adequate control over taxpayers. The technological solution provides a service that allows for adequate control over the technological components, such as web systems, links (SRI–taxpayers–providers), SRI integration, databases, and data visualization.

The SIMAR solution includes two important components of a business intelligence platform (inteligencia empresarial), which contains data facilitating decision making. One is a system

¹² The Quick Response Code holds information about the taxable entity, the reference number on the Single Taxpayer Registry (Registro Único de Contribuyente), the location of the production facility (province, city, canton, address), the date of production, the production line, the time of production, the lot number, the product type, and the ICE code of the product (brand, presentation, packaging, and so on) as stipulated in the terms of reference and control requirements of the tax administration.

for use by cigarette manufacturers and producers of alcohol and beer that facilitates the interface between the tax administration and the provider. The other supports the tax administration's own business intelligence system to allow it to consolidate and group information on the basis of the parameters that the control units might require. The major benefit of such a tool is the flexibility it provides for the preparation of new or the updating of existing reports in response to the changing requirements of the SRI. Furthermore, by avoiding the need to depend completely on the provider, it facilitates more rapid cross-referencing and report preparation. The reports are prepared by trained tax administration officials in accordance with internal requirements and requests. Once they are ready, the provider is requested to roll them out to make them available to all tax administration stakeholders. The provider is expected, at all times, to offer support and advice and to prepare and produce the reports in accordance with the terms and conditions of the contract.

Illicit Trade

Preliminary Considerations

The illicit trade in cigarettes is an international phenomenon. However, the countries of the Americas, including Ecuador, have had difficulties implementing the methodologies that WHO, the Pan American Health Organization, the Inter-American Center of Tax Administrations, and the World Bank recommend for measuring the real scale of the problem.¹⁵ The difficulty extends to characterizing the types of illegal markets and understanding how such markets have developed. Some of the challenges are the absence of time series data, inconsistencies in the data, and the lack of ready comparability of the data because of changes in the methodologies used for collection and analysis.

However, in 2014, SRI, applying a method commonly known as gap analysis, undertook the development of an internal system to measure the scope of the illegal trade in cigarettes and other harmful products, such as alcoholic beverages (Jorratt 2012). The system draws on data from the National Health and Nutrition Survey, which discusses risk factors, including risks associated with alcohol and tobacco consumption (Freire et al. 2014). SRI created estimates of total consumption based on information organized by age-group and prevalence. These consumption data were compared with data in the SRI database on the collection of the ICE to determine whether there were any significant discrepancies or variations that would indicate a high incidence of illicit trade. This method of measurement makes government verification of the consistency of the various data easy, given that the tax data are linked to a specific ICE per cigarette. The SRI estimates have served as inputs for the implementation of the TTS in Ecuador. However, because it contains sensitive information on taxpayers, the study is intended for the sole use of the tax administration.

¹⁵ See Ross's (2015) summary of these methods.

If one were to analyze data from the ICE declarations of the only legal, formal producer of cigarettes in Ecuador, one would be struck by the fact that sales volumes fell drastically between 2014 and 2016. At the same time, because of frequent tax rate increases, tax collections had been on a rising trend up to 2015. The collections did not decline until 2016, when there was a drop of 12.7 percent relative to 2015. This was followed by a reduction in real tax collections of 20.2 percent in 2017 relative to 2016. However, a comparison of collection rates that have been converted into volumes reveals that, between 2014 and 2017, there was a large drop in cigarette production. A cursory analysis might lead one to conclude that the ICE and the public policies being applied in the fight against the tobacco epidemic were having the desired effect.

According to WHO, a good public policy consisting of a 10 percent rise in the tax on a pack of cigarettes in middle-income countries should lead to a 4 percent–8 percent decline in consumption as the economics of the tax tends to make the population more sensitive to price (Jha and Chaloupka 2000). Taking as a reference the 2016 price elasticity study

Table 3. Net Cigarette Sales Volumes, 2012–18
number of cigarettes

MONTH	2012	2013	2014	2015	2016	2017	2018
01	183,715,701 ^a	204,050,000	141,737,600	53,990,000	78,901,400	55,789,800	61,683,500
02	183,715,701 ^a	169,820,000	163,600,000	130,279,000	83,348,500	56,410,000	55,444,500
03	190,501,785.25	173,940,000	142,150,000	131,219,000	106,803,200	65,713,000	64,760,000
04	168,460,000	179,930,000	181,500,000	127,070,000	145,179,500	71,416,000	62,564,100
05	187,580,000	161,590,000	152,034,880	136,954,500	47,179,900	59,378,700	58,293,400
06	194,670,000	178,650,000	160,060,700	124,632,600	76,652,900	67,710,000	
07	189,433,985.19	164,993,070	162,976,000	125,651,700	71,716,700	59,552,400	
08	190,707,550	180,857,860	163,164,400	126,530,000	67,170,000	69,517,000	
09	174,550,000	159,870,000	227,507,700	125,201,900	66,300,000	67,704,020	
10	202,930,000	192,330,000	126,994,200	127,045,500	76,900,000	66,901,000	
11	185,100,000	193,533,420	172,853,500	100,520,000	71,596,300	55,971,000	
12	153,223,690	203,078,530	241,175,300	182,330,000	93,536,100	59,710,000	
Subtotal	2,204,588,412.53	2,162,642,880	2,035,754,280	1,491,424,200	985,284,500	755,772,920	302,745,500
Variation		-1.90%	-5.87%	-26.74%	-33.94%	-23.29%	-1.93% ^b

Source: TSource: SRI database on the basis of taxpayer declarations on cigarettes on which the ICE has been levied.

a. No tax collection data exist for January and February 2012. The figures for these two months were extrapolated from the average of the 10 remaining months of 2012.

b. The variations between 2017 and 2018 were only considered for the first five months of the year (that is, January to May), which is the cutoff point of the available data.

on Ecuador, whereby price elasticity was calculated at a value of 0.87, a 10 percent price increase could lead to an 8.7 percent decline in consumption (Chávez 2016).

In light of these considerations, the data are significant and may be indicative of an illicit cigarette market affecting Ecuador (Table 3). The situation is exacerbated by the negative externalities associated with neighboring countries with much lower cigarette prices.

On the basis of tax collection data from 2012 onwards and the same calculation method for the ICE on cigarettes at a specific rate, it is possible to arrive at the volume of cigarette production in Ecuador. It emerges that, since 2012, sales have fallen each year, which, to a certain extent, reflects the volume of production. Sales fell by 1.9 percent between 2012 and 2013 and by 5.9 percent between 2013 and 2014. In both cases, the reduction in sales can be explained by the price elasticity in those years. In 2014–15, the specific ICE rate rose by 41.6 percent, and sales fell by 26.7 percent. The specific ICE rate was raised again, by 14.8 percent, in 2015–16 to reach US\$0.16 per unit, the current rate. This rate rise resulted in a 33.9 percent drop in the volume of cigarette sales. The specific ICE tariff of US\$ 0.16 was maintained from 2016 to 2017, and sales plummeted once again, by 23.3 percent.

It is not likely that the reduction in sales between 2015 and 2017 was caused solely by the effectiveness of public health policies. Such an outcome would also have to be attributed in part to the growth of the illegal market. The government should carry out its own study of the illicit cigarette trade to discover the cause of the drop. Another key factor to consider in discussing the illicit trade is the volume of seizures and confiscations. This, too, must be approached with caution and should be used only as a point of reference, because a greater number of seizures tends to reflect greater government attention to the illicit trade as well as improved inspection and control, particularly through the application of new technologies. The National Customs Service of Ecuador (SENAE) has recorded a high volume of seizures since 2017, following the adoption of the anti-smuggling plan as a tool to strengthen policies to address the illicit market (SENAE 2017). Spearheaded by SENAE, the plan brings together the efforts and resources of 20 institutions, including SRI, the Ministry of Agriculture and Livestock, the State General Prosecutor, and the Ministry of the Interior. Among the achievements under the plan is the confiscation of over US\$ 36 million in contraband merchandise between May and December 2017, including a large number of cigarettes. As a result of these actions, almost 3,600 jobs have been protected in Ecuador (SENAE 2017).

Many countries have focused on conducting their own analyses of the illicit trade and have sought to do so without interference from the tobacco industry. Colombia, for example, conducted two surveys of smokers (in 2016 and 2017) to estimate both consumption patterns and the scale of illicit trade.¹⁴ Similarly, Euromonitor provides data on the illegal cigarette market, but, because of the methodology and other issues, sole reliance on this data source can be problematic. This underscores the need for governments, academic

¹⁴ The studies were conducted by Anaas (a Colombian civil society organization).

institutions, and civil society organizations to pursue the preparation of their own studies that are not linked in any way to the industry.

Furthermore, considering that a TTS is already in place in Ecuador to provide reliable data on the production and sale of cigarettes from the only tobacco production company in the country, new studies should be implemented to facilitate data comparison with other time periods and to clarify trends. While the illicit trade is difficult to measure because of the nature of the problem, robust methodological approaches have already been developed. This is why every effort must be made to prepare the most rigorous and realistic study possible, with the understanding that, while it may over- or underestimate the extent of the trade, the estimates may be verified after the TTS has enhanced the transparency of the cigarette market and segments of the illegal market have been formalized and regulated.

The data that the SIMAR system can generate will give the SRI ongoing access to real online data on the production of the formal industry and will, in time, allow for estimates of market behavior and sales forecasts. Nonetheless, a study on illicit trade can only be prepared if there are other studies or data on consumption patterns, the preparation of which falls outside the scope of the tax administration. While the SRI conducted a study in 2014 on the basis of existing data, they have not been able, because of the lack of regular surveys on consumption or of time series data, to prepare a new study to confirm the robustness of the first or to analyze trends and behavior patterns. The failure to prepare a new study has also been caused by the fact that the surveys on consumption were conducted using different approaches, assumptions, and methodologies, making comparisons difficult. Furthermore, the data of the national statistical entity for this type of product have usually involved substantial underestimates, owing to the fact that they were gathered on the basis of household surveys that make it notoriously difficult for respondents to reveal the real quantity of cigarettes they consume. It is therefore essential for the government to collect consistent cigarette consumption statistics on an ongoing basis to improve our understanding of the illicit trade and the overall pattern of consumption, which is essential for monitoring the effectiveness of tobacco control.

Data on Cigarette Seizures by Inspection and Control Agencies

According to SENAE data, approximately 2,053,418 cigarettes were confiscated in 2013 and 4,458,950 in 2014. In 2015, 16,839,285 units were seized, and 17,024,324 units in 2016. These data point to the efficiency of the SENAE inspection process and to the existence of an extensive illicit trade that needs to be quantified. Aside from these two issues and over and above questions about the accuracy of the data on seizures, it is evident that the number of cigarettes confiscated after 2015 increased by over 200 percent (SENAE 2017). The bulk of the goods seized were from China (brands such as Elephant and Modern), Colombia, and India, or brands such as Lucky Strike.

Against this background, SRI began, in 2014, to step up efforts to identify a mechanism or strategy to control the illicit trade. A tax monitoring and tracking system was identified as offering a number of potential benefits. On September 2, 2014, the SIMAR Project was adopted in recognition of the need to strengthen and improve oversight of ICE by more carefully monitoring products prone to tax evasion, such as spirits and cigarettes.

SIMAR regulations provide for the confiscation of goods subject to the ICE (beer, cigarettes, and alcoholic beverages) that do not have the required PSFs.¹⁵ SRI started to undertake field inspections and apply confiscation measures after the corresponding regulations were published, which meant that, for a time, products manufactured before the enactment of SIMAR and which did not carry PSFs actually coexisted on the market with SIMAR-compliant products. Between October and December 2017, 55,370 cigarettes were seized through 79 operations carried out in Ambato, Cuenca, Guayaquil, Ibarra, Loja, Machala, Manta, Portoviejo, Quero, Quito, Santo Domingo, and Tisaleo. Between February and April 2018, 4,310 packs were seized in 49 operations carried out in various cities.

Between 2017 and 2018, SENAE carried out a series of large-scale operations that resulted in the seizure of sizable quantities of cigarettes that were being imported into the country as contraband through criminal schemes such as the *cambiado* (switching scam).¹⁶ Cigarettes were identified, together with textiles, fruits, and other foodstuffs, among the products most likely to be trafficked as contraband. According to official SENAE data, the most extensive operations aimed at confiscating cigarettes included the seizure of 1.5 million cigarettes in January 2018 and the raid in the week of December 5–11, 2017, of a clandestine warehouse in the city of Ibarra that had 945,500 units of various brands in storage that were valued at US\$ 235,643. In March 2018, SENAE seized 3 million cigarettes contained in a shipment from Florida. In November 2017, SENAE, through the Unidad de Vigilancia Aduanera (Customs Monitoring Unit), incinerated 10 million cigarettes that would have represented a government revenue loss of more than US\$ 6 million. However, seizures usually represent a small share of total sales. In particular, the largest seizures of 2017 are less than 0.5 percent of the total sales registered that year (756 million; see Table 10.5).

¹⁵ Article 28 of SRI Resolution NAC-DGERCGC16-00000455, published in the Supplement to Official Gazette 878 on November 10, 2016, states expressly as follows:

With effect from February 23, 2017, goods subject to SIMAR control that exit manufacturing premises without the required physical security features will be subject to seizure, and auctioned, destroyed, or donated in accordance with the law. . . . Similarly, with effect from July 11, 2017, products subject to SIMAR control that are on the market without the required physical security features (PSF) will be subject to seizure, and auctioned, destroyed, or donated in accordance with the law. Products subject to SIMAR control that have the required PSF, but are not backed by sales receipts or import documents will be confiscated provisionally, in accordance with the legal provisions in force.

¹⁶ The scheme involves the reentry of containers to the customs control area with items other than those initially declared.

Recommendations

The government has made great progress in a number of the MPOWER measures recommended by WHO and the Pan American Health Organization. Furthermore, the government has worked hard to achieve 100 percent smoke-free areas, and these are growing in number and scope. It has adopted a coordinated approach to reducing prevalence and to multiplying and improving the provision of health care and supporting people wishing to quit using tobacco. It has carried out three tax reforms in under eight years, increasing the ICE on cigarettes. The challenge now is to establish generic packs and adopt other measures, such as prohibiting the sale of packs of fewer than 20 cigarettes. These actions will be addressed through the adoption of a new tobacco control law in Ecuador.

To prepare a complete illicit tobacco trade study, the availability of comprehensive data must be assured. Ideally, the data would be in time series to facilitate a comparative analysis. Time series data are not normally available to governments or do not usually cover all years, and, even in cases in which time series data are available across at least two years, the data often originate from different sources and have been obtained based on different methodologies, thus making comparisons impossible. It is vital for governments to have their own data, limit the use of industry data, and possess protocols based on good methodological practices in data production. In Ecuador, the challenge is to have ongoing access to cigarette consumption statistics to facilitate the preparation of studies on the illicit trade and ensure a greater understanding of the issue. Such data are also essential to monitoring the effectiveness of tobacco taxation in the country.

While it will always be important to have access to information on the confiscation of illicitly traded goods, such as contraband, illicit whites, or other illicit products, this information should be managed with great care and be treated only as supplementary data to be used on a case-by-case basis. Alternatively, statistics in this area can be used to determine specific aspects of the type of illicit trade affecting a country or region. But such data should not be used as a direct indicator of illegal market growth because increases in the number of seizures are more indicative of the efficiency of governments and of the new initiatives that these adopt in the fight against this global scourge.

Since 2017, SRI has been implementing SIMAR for domestically produced cigarettes and other products, such as spirits and beers. This project will, in the short run, be extremely useful in providing the tax administration with real, first-hand data on the production of the national tobacco industry, without the need for the taxable entity to make any declarations whatsoever. At the same time, once information for some time periods has been collected, it will then be possible to make projections of market behavior and trends that will be instrumental in generating a better understanding of the situation. Once the Protocol to Eliminate Illicit Trade in Tobacco Products enters into force, the government can begin implementing the SIMAR for other tobacco products, and, once guidelines are established for an international center for information exchange, an institution described in the Protocol, then the

next step will be to begin sharing the data efficiently on an ongoing basis. SIMAR will be the first TTS in line with the provisions of the Protocol. As early as September 2018, it will be adopted as a binding legal instrument.

The government has also been collaborating with other countries, particularly within the Americas. It has signed international cooperation agreements, such as with the Dominican Republic, and is active in forums organized by WHO and nongovernmental organizations, such as the RENATA National Anti-Tobacco Network of Costa Rica. These organizations have also provided a platform for the government to share its successful experiences in the implementation of the SIMAR TTS and in resolving concerns about the process, addressing industry interference issues, and providing support for other countries to begin work on similar projects to combat the illicit trade and promote tobacco control. The challenge will be to continue its pioneering work and offer support to other countries in the operation of TTSs.

While the fight against the tobacco epidemic is, to a certain extent, the responsibility of the Ministry of Public Health, it is also everyone's responsibility. Thus, other public entities and civil society representatives must play a collaborative and supportive role. If countries are to meet the health goals recommended by WHO and the Pan American Health Organization and successfully reduce illicit trade, lower access and the prevalence of tobacco use, and meet the tobacco challenge head on, then they must approach the issue and work together on various fronts. This highlights the importance of a collaborative effort between health care agencies, budget ministries, tax administrations, and customs authorities. The potential for results is demonstrated in the tremendous progress that Ecuador has achieved over the past few years.

Ecuador's tax burden on cigarettes is one of the heaviest in the region. This achievement, together with the importance assigned by the government to eliminating illicit trade, and the fact that the government has ratified the Protocol and implemented the SIMAR TTS and the anti-smuggling plan, shows the great strides that have been made. Moreover, while the recent decline in legal cigarette sales has been associated with a fall in tobacco tax revenues, a key conclusion of this study is that the current tobacco tax level in Ecuador is sustainable. The government appears to be adopting the appropriate response to the revenue reduction, which is strengthening tax administration.

However, these efforts will not be sufficient without international cooperation and support. The problem of the illicit trade is not confined to Ecuador, nor even to the region of the Americas. It is a global problem that must be tackled through global strategies and international cooperation. Because it is committed to the fight against the tobacco epidemic, the Government of Ecuador will continue its collaborative efforts to increase the effectiveness of each type of action and to support the continuing development of harmonized and coordinated public policies as it pursues the objective of reducing tobacco access, prevalence, and illicit trade.

References

- Agostini, Claudio A. 2017. "Impuesto a los cigarrillos en Chile: Una propuesta." *Economía y Política* 4 (2): 37–60.
- Arias, Diana, Edwin Buenaño, Nicolás Oliva, and José Ramírez. 2008. "Historia del Sistema Tributario Ecuatoriano 1950–1999" [History of the Ecuadorian tax system 1950–1990] [in Spanish], Department of Tax Studies, Internal Revenue Service, Quito, Ecuador.
- Bardach, Ariel, Andrea Alcaraz, Joaquín Caporale, Belén Rodríguez, Alfredo Palacios, Tatiana Villacres, Federico Augustovski, and Andrés Pichon-Riviere. 2016. "Carga de enfermedad atribuible al uso del tabaco en Ecuador y potencial impacto del aumento del precio a través de impuestos." Documento Técnico IECS 20 (November), Instituto de Efectividad Clínica y Sanitaria, Buenos Aires.
- Blecher, Evan, Alex Liber, Hana Ross, and Johanna Birckmayer. 2015. "Euromonitor Data on the Illicit Trade in Cigarettes." *Tobacco Control* 24 (1): 100–01. <https://tobaccocontrol.bmj.com/content/tobacco-control/24/1/100.full.pdf>.
- Canadian Cancer Society. 2012. "Cigarette Package Health Warnings: International Status Report." 3rd ed. (October), Canadian Cancer Society, Toronto.
- . 2014. "Cigarette Package Health Warnings: International Status Report." 4th ed. (September), Canadian Cancer Society, Toronto.
- Chávez, Ricardo. 2016. "Elasticidad precio de la demanda de cigarrillos y alcohol en Ecuador con datos de hogares." *Pan American Journal of Public Health* 40 (4): 222–28.
- DHHS (U.S. Department of Health and Human Services). 2014. *The Health Consequences of Smoking, 50 Years of Progress: A Report of the Surgeon General*. January. Atlanta: Office on Smoking and Health, National Center for Chronic Disease Prevention and Health Promotion, Centers for Disease Control and Prevention, DHHS. <http://www.surgeongeneral.gov/library/reports/50-years-of-progress/full-report.pdf>.
- Drope, Jeffrey, and Neil W. Schluger, eds. 2018. "The Tobacco Atlas." 6th ed. With Zachary Cahn, Jacqui Drope, Stephen Hamill, Farhad Islami, Alex Liber, Nigar Nargis, and Michal Stoklosa. American Cancer Society, Atlanta.
- Freire, Wilma B., María José Ramírez-Luzuriaga, Philippe Belmont, María José Mendieta, Katherine Silva-Jaramillo, Natalia Romero, Klever Sáenz, Pamela Piñeiros, Luis Fernando Gómez, and Rafael Monge. 2014. *Encuesta Nacional de Salud y Nutrición de la población ecuatoriana de cero a 59 años: ENSANUT-ECU 2012*. Vol. 1. [National health and nutrition survey of the Ecuadorian population between zero and 59 years of age] [in Spanish]. July 31. Quito, Ecuador: Ministry of Public Health and National Statistics and Census Institute.
- INEC (National Statistics and Census Institute). 2016. *Compendio Estadístico 2016*. Quito, Ecuador: INEC. <http://www.ecuadorencifras.gob.ec/documentos/web-inec/Bibliotecas/Compendio/Compendio-2016/Compendio%202016%20DIGITAL.pdf>.
- Jha, Prabhat, and Frank J. Chaloupka. 2000. *Tobacco Control in Developing Countries*. Oxford Medical Publications Series. Oxford, UK: Oxford University Press.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

Jorratt, Michel. 2012. "Estimación de la evasión tributaria en los impuestos selectivos al consumo: el caso de Chile." *Revista de Administración Tributaria* 34: 29–45.

Marquez, Patricio V., and Blanca Moreno-Dodson. 2017. *Tobacco Tax Reform: At the Crossroads of Health and Development; A Multisectorial Perspective*. Washington, DC: World Bank.

PAHO (Pan American Health Organization). 2016. *Informe sobre Control del Tabaco en la Región de las Américas: A 10 años del Convenio Marco de la Organización Mundial de la Salud para el Control del Tabaco*. Washington, DC: PAHO.

Pizarro, María Elisabet, Germán Rodríguez-Iglesias, Patricia Gutkowski, Juan Altuna, and Belén Ríos. 2018. "Advances in Tobacco Taxation: The Case of Argentina." *Pan American Journal of Public Health* 42 (May): e46. <http://iris.paho.org/xmlui/handle/123456789/49050>.

Poveda, José Flores, Ana Lucía Pico, and Carlos Alcívar Trejo. 2016. "El impuesto a los consumos especiales y su impacto en el consumo del cigarrillo en el Ecuador, Período 2007–2013" [The special consumption tax and its impact on cigarette consumption in Ecuador, 2007–13]. *Revista Caribeña de Ciencias Sociales* (January). <http://www.eumed.net/rev/caribe/2016/01/impuestos.html>.

Ross, Hana. 2015. "Understanding and Measuring Cigarette Tax Avoidance and Evasion: A Methodological Guide." March, Economics of Tobacco Control Project, School of Economics, University of Cape Town, Cape Town; Tobacconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago, Chicago.

SENAE (Servicio Nacional de Aduana del Ecuador, National Customs Service of Ecuador). 2017. "Plan Nacional de Lucha contra el Contrabando y la Defraudación Aduanera." SENAE, Quito, Ecuador.

SENPLADES (National Secretariat for Planning and Development). 2013. *National Plan for Good Living, 2013–2017*. Quito, Ecuador: SENPLADES. <http://www.buenvivir.gob.ec/versiones-plan-nacional>.

———. 2017. *Plan Nacional de Desarrollo 2017–2021: Toda una Vida*. Quito, Ecuador: SENPLADES. http://www.planificacion.gob.ec/wp-content/uploads/downloads/2017/10/PNBV-26-OCT-FINAL_0K.compressed1.pdf.

SRI (Servicio de Rentas Internas, Internal Revenue Service, Ecuador). 2017. "Ficha Técnica: Manual de Posicionamiento de Componentes Físicos de Seguridad para Cigarrillos 'Posición CFS Cigarrillos'." January, Coordinación de Impuestos Especiales y Reguladores, Subdirección Nacional de Cumplimiento Tributario, Departamento Nacional de Control Tributario, SRI. <http://www.sri.gob.ec/web/guest/implementacion-proyecto-simar>.

WHO (World Health Organization). 2010. WHO Technical Manual on Tobacco Tax Administration. Geneva: WHO.

———. 2017. *WHO Report on the Global Tobacco Epidemic, 2017: Monitoring Tobacco Use and Prevention Policies*. Geneva: WHO.

MEXICO

12

MEXICO:

Controlling the Illicit Cigarette Trade

Belén Sáenz de Miera Juárez¹

Chapter Summary

In the last decade, Mexico has made important progress in tobacco control. Graphic warnings were included on cigarette packs, advertising was restricted, and 100-percent smoke-free environments were implemented in 11 of the country's 32 states. At the same time, tobacco taxation and tobacco tax administration were strengthened, with the homologation of ad valorem excise taxes for all non-handmade tobacco products, and a specific excise was added to reduce price differentials across tobacco products. Mexico's General Law for Tobacco Control, approved in 2008, incorporated two key measures designed to curb illicit tobacco trade: (1) the obligation for firms to obtain health licenses to produce or import tobacco products, and (2) the requirement that firms secure a specific permit for each import process involving tobacco products.

Mexico's customs controls have recently been enhanced. In particular, since late 2017, a fiscal mark for tobacco products is required. This mark consists of an alphanumeric code that is accompanied by a two-dimensional code that can be read with mobile devices. Officials can now immediately verify cigarettes' place and date of production and pull up

¹ Universidad Autónoma de Baja California Sur, Mexico.

detailed information about the producer or importer. The system is expected to improve tax compliance and could help identify potential diversion of national production into the illicit market.

Unfortunately, a lack of transparency has characterized Mexico's implementation of fiscal marks. This is exemplified by the absence of a public bidding process for the development of the technologies used to generate the codes. This casts doubt on the measure's integrity and ultimate effectiveness. In addition to clarifying this process and evaluating the effects on tax compliance of the information that is being generated with the codes, the Mexican tax authority will have to consider possible improvements in the physical characteristics of the fiscal marks (e.g., adding covert elements to make them more secure).

Although Mexico has relatively low levels of tobacco smuggling (below 3 percent, according to a recent national survey), regional cooperation must be strengthened to rein in illicit tobacco. Available evidence indicates that most of the current supply of illicit cigarettes in Mexico consists of products that are introduced into the country illegally, rather than domestically produced.

Finally, Mexico requires much more vigorous action on tobacco taxation. The lack of excise tax hikes during the last seven years has been accompanied by an increase in cigarette affordability and a reduction in the tax incidence, which was already below the level recommended by the World Health Organization.

1. Context

1.1 Tobacco Control in Mexico

In May 2004, Mexico became the first country in the Americas to ratify the World Health Organization Framework Convention on Tobacco Control (WHO FCTC). However, Mexico's General Law for Tobacco Control (LGCT), which includes most of the regulations designed to curb the country's tobacco epidemic, did not enter into force until August 2008. The LGCT and its regulations impose measures such as: smoke-free indoor environments with special smoking areas; restrictions on tobacco advertising;² a complete ban on tobacco-product sponsorships and promotional items; and requirements for product packaging and labeling. The LGCT also requires firms to obtain health licenses to manufacture or import tobacco products, along with a permit for each import process.

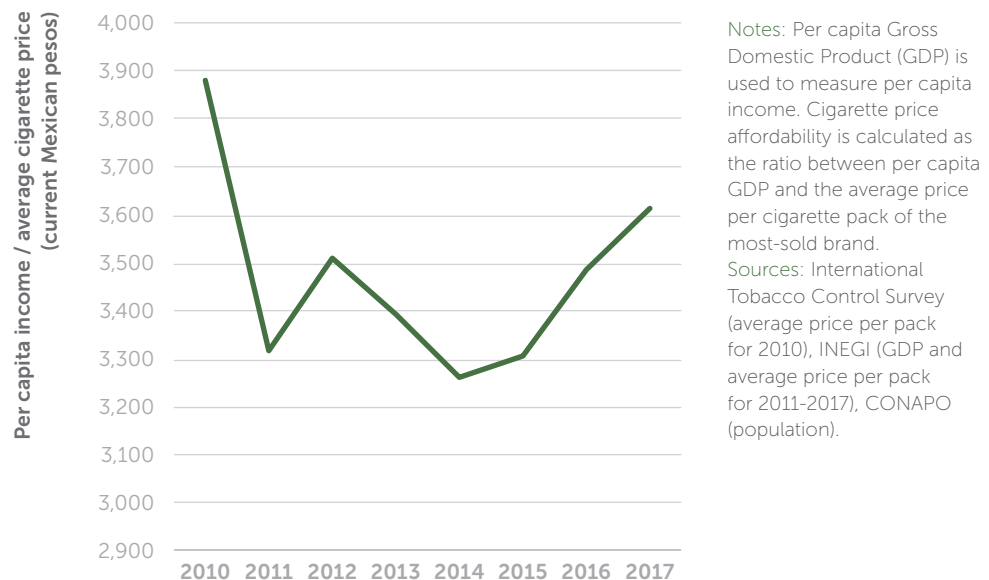
Mexico has made substantial strides in tobacco control at the local level. Although the LGCT does not fully protect non-smokers, 11 Mexican states have laws in place providing smoke-free environments. Such legislation currently protects 45 percent of the country's population.

² Advertisements for tobacco products may only be directed at persons of legal age and placed in magazines for adults, personal mail, or within adult-only facilities (Article 23 of the LGCT).

The first of these laws was Mexico City’s 2009 Non-Smokers’ Health Protection Law (*Ley de Protección a la Salud de los No Fumadores en el Distrito Federal*). The Mexico City measure was followed by similar laws in the states of Tabasco, Morelos, Veracruz, Zacatecas, Estado de México, Baja California, Baja California Sur, Oaxaca, Nuevo León, and Sinaloa.

Mexico’s national tobacco excise tax, called the Special Tax on Production and Services (IEPS), increased steadily between 2000 and 2011. Originally, the IEPS was an ad valorem excise tax that varied across tobacco products, for example imposing lower rates on unfiltered cigarettes. However, a uniform tax was adopted in 2005 for all types of cigarettes. In 2007, the uniform tax was extended to virtually all tobacco products. (The uniform rate does not cover cigars and other tobacco products that are entirely handmade, but these account for less than 0.5 percent of tobacco sales in Mexico [Waters et al. 2010].) In 2010, the excise tax structure was also revised to include a specific component (Sáenz de Miera Juárez 2013). Effective from that year, a mixed tax that comprises the ad valorem excise and a specific excise denominated in pesos for each unit of product is in force (see Section 2.1.). At first, the specific component was set at 4 cents per cigarette but was increased to 35 cents in 2011. The reduction in price differentials across brands, aimed to limit consumers’ options for switching to cheaper cigarettes, is one of the key advantages of this change, particularly given the sharp increase in the specific excise tax in 2011 (Sáenz de Miera Juárez et al. 2014).

Figure 1. Cigarette Affordability in Mexico, 2010-2017



Taking account of increases in per capita income and inflation as well as cigarette prices (Blecher 2010), the affordability of cigarettes in Mexico increased by 8.5 percent from 2011 to 2017, as shown in Figure 1 (all prices are in current pesos). Cigarettes clearly became less

affordable as a result of the most recent tax hike, implemented in 2011. However, per capita income has once again grown faster than cigarette prices in recent years.

While considerable efforts have been made over the past decade to improve Mexico's tobacco control strategy, significant gaps remain. Partial protection provided to non-smokers under the LGCT and the lack of adjustments to the special taxes over the past seven years perhaps best illustrate the stagnation in policies aimed at mitigating the harmful effects of tobacco on health and the economy. This, in turn, is reflected in the performance of key epidemiological indicators.

Although the average number of cigarettes consumed by daily smokers, who account for roughly half of current smokers, fell from 9.4 cigarettes per day in 2009 to 7.7 in 2015, no changes in smoking prevalence were observed (PAHO and INSP 2017). Both the Global Adult Tobacco Survey (GATS) and the National Addictions Survey (ENA, recently renamed National Survey on Drug, Alcohol, and Tobacco Consumption or ENCODAT) indicate that, between 2009 and 2016, there were no changes in overall smoking prevalence or in prevalence by gender or age group (Table 1). This was the case as regards smoking prevalence both among daily and occasional smokers (INPRF et al. 2017; PAHO and INSP 2017). Currently, smoking prevalence among women is about one-third the prevalence among men (approximately 8 percent vs. 25 percent, respectively).

Contrary to the experience in other countries (World Bank 2017), the rise in tobacco affordability from 2011-2017 did not increase prevalence, a tribute to the effectiveness of the other tobacco control steps the federal and local governments were taking. This speaks, however, to the reduction in prevalence that could have occurred, and the significant future death and disease that could have been prevented, if tobacco excise taxes had been raised significantly, at least enough to keep cigarette affordability from increasing.

1.2 Institutions Tasked with Designing and Monitoring the National Tobacco Control Strategy

The *Comisión Nacional contra las Adicciones* (National Commission Against Addictions, CONADIC) is responsible for devising and spearheading the national policy on the prevention and treatment of addictions. As a decentralized administrative body of the Ministry of Health, this Commission enjoys technical, operational, and administrative autonomy. Its mandate includes: (a) proposing programs for the prevention, treatment, and control of addictions to the Secretary of Health, and spearheading and coordinating their implementation once approved; (b) proposing crosscutting programs and strategies for actions to other agencies of the Federal Public Administration; (c) serving as a liaison with the bodies that may be established by states to deal with addiction prevention and control; and (d) proposing to the relevant bodies preliminary draft reforms of legal provisions on the production, marketing, and consumption of alcoholic beverages, tobacco, and other psychoactive substances. Established at the same time as the LGCT, the *Oficina Nacional para el Control del*

Table 1. Smoking Prevalence in Mexico Based on Selected Demographic Characteristics, 2009-2016

	GATS (15 YEARS OLD AND ABOVE)				ENA/ENCODAT (12-65 YEARS)			
	2009		2015		2011		2016	
	%	CI (95%)	%	CI (95%)	%	CI (95%)	%	CI (95%)
Total								
Current smokers	16	(14.8, 17.1)	16.4	(15.4, 17.3)	17.0	(16.1, 18.0)	17.6	(16.9, 18.3)
Daily smokers	7.6	(6.8, 8.3)	7.6	(6.9, 8.3)	7.0	(6.4, 7.6)	6.4	(6.0, 6.9)
Occasional smokers	8.4	(7.6, 9.2)	8.8	(8.1, 9.5)	10.0	(9.3, 10.7)	11.1	(10.6, 11.7)
Gender								
Men	25	(23.2, 26.6)	25.2	(23.6, 26.9)	25.2	(23.5, 26.9)	27.1	(26.0, 28.2)
Women	7.8	(6.7, 9.1)	8.2	(7.3, 9.3)	9.3	(8.4, 10.2)	8.7	(8.1, 9.3)
Age*								
15-24 years	17	(14.8, 19.0)	17.4	(15.5, 19.5)	22.0	(19.2, 24.7)	23.0	(21.6, 25.1)
25-44 years	17.0	(15.6, 18.4)	18.7	(17.2, 20.4)	20.0	(18.2, 21.0)	21.0	(19.6, 21.8)
45-64 years	16	(13.8, 17.7)	14.6	(12.8, 16.5)	17.0	(14.6, 18.5)	17.0	(15.9, 18.3)
65 years and above	8.0	(6.4, 9.9)	8.2	(6.5, 10.2)				

Notes: GATS = Global Adult Tobacco Survey, ENA = National Addictions Survey, ENCODAT = National Survey on Drug, Alcohol, and Tobacco Consumption. The ENA was recently renamed ENCODAT, but maintains the same goal and objectives. The definition of a current smoker is the same for both the GATS and the ENA and refers to persons who have smoked in the past 30 days. *Age groups for ENA/ENCODAT differ slightly from those for the GATS. Specifically, in the case of ENA/ENCODAT, the first age group ranges from 18 to 24 years, while the last age group ranges from 45 to 65 years.

Source: PAHO/INSP (2017), INPRF et al. (2017).

Tabaco (National Tobacco Control Office, ONCT) is currently located within CONADIC and is focused on FCTC implementation in Mexico.

Established in 2001, the *Comisión Federal para la Protección contra Riesgos Sanitarios* (Federal Commission for Protection Against Health Risks, COFEPRIS), another decentralized body of the Ministry of Health, is responsible for monitoring compliance with the LGCT and enforcing administrative sanctions for violations.

The *Subsecretaría de Ingresos* (Office of the Undersecretary for Revenue) in the Ministry of Finance and Public Credit (SHCP)—through the *Unidad de Política de Ingresos* (Revenue Policy Unit) and the *Unidad de Legislación Tributaria* (Tax Legislation Unit)—is tasked with designing tobacco taxes, while the *Sistema de Administración Tributaria* (Tax Administration Service, SAT), a branch of the SHCP, has responsibility for their administration. Broadly speaking, the SAT is responsible for applying tax and customs legislation, ensuring that taxpayers comply with tax and customs provisions, and generating the information needed to devise and evaluate tax policy.

Lastly, if the application of the LGCT, the tax laws, or the customs law reveals the possible commission of smuggling or counterfeiting offenses, the Office of the Attorney General (PGR) is charged with instituting criminal proceedings (upon filing of a criminal complaint by the aggrieved party)³ and, where appropriate, applying the relevant punitive measures. To address criminal complaints pertaining to counterfeiting, the Mexican Institute of Industrial Property (*Instituto Mexicano de la Propiedad Industrial*, IMPI) is charged with preparing the technical statement needed to bring criminal justice action.

1.3 Political Situation

Mexico has recently been engaged in a large-scale electoral process in which over 3,400 local and federal offices were contested. On July 1, 2018, Andres Manuel Lopez Obrador, often described as an anti-establishment figure, was elected President for the 2018-2024 term. At the same time, a completely new Federal Congress was ushered in (including 500 federal house members, 300 elected by direct vote and 200 by proportional representation, along with 128 senators). State-level elections were held in 30 of the country's 32 states, including Mexico City. Governorships and other offices were contested in nine states, while other jurisdictions elected mayors and/or local lawmakers. After a 100-year ban on the reelection of lawmakers, senators can now be reelected for up to two consecutive terms while members in the lower house can serve up to four consecutive terms, paving the way for newly elected lawmakers to potentially remain in office until 2030. While these developments will make it possible for organized civil society and citizens in general to demand that their representatives ensure continuity and progression in tobacco control policies, it is also expected that the industry will scale up its efforts to influence decision making (see Section 1.4).

The sharp rise in violence and high levels of corruption—the primary concerns of the Mexican people⁴—have naturally dominated the political agenda. In 2016, the *Instituto Nacional de Estadística y Geografía* (National Institute of Statistics and Geography, INEGI) recorded 23,953 homicides, or 20 homicides per 100,000 inhabitants, more than double the figures recorded ten years earlier (8,867 homicides or eight homicides per 100,000 inhabitants in 2007). These increases were observed in 30 of the 32 states. The homicide rate quintupled between 2007 and 2016 in states such as Baja California Sur and Guanajuato, and increased tenfold in such states as Colima (INEGI 2017).⁵ Corruption has

³ In order to institute legal proceedings in cases involving smuggling offenses, the SHCP, in accordance with the country's Tax Code, must file a criminal complaint, notify the tax authorities of the harm caused, and draft its statement.

⁴ The 2017 National Survey on the Impact and Quality of Governance (ENCIG) conducted by INEGI indicates that insecurity and crime, followed by corruption, are the most pressing concerns of the Mexican people. It further notes that, between 2015 and 2017, the percentage of people expressing these concerns rose from 66.4 percent to 73.7 percent with respect to insecurity and from 50.9 percent to 56.7 percent in the case of corruption (INEGI 2018).

⁵ The number of journalists murdered is another indicator of violence in the country. Reporters Without Borders (RSF) ranks Mexico as the world's deadliest country at peace for journalists. In 2017, 11 journalists were murdered in Mexico, making the country second only to Syria in this ranking (Reporters Without Borders 2017).

also worsened in the country. Mexico ranked 123 out of 176 countries on Transparency International's Corruption Perceptions Index in 2016 and 135 out of 180 countries in 2017, making it the most corrupt nation in the OECD (Organization for Economic Cooperation and Development) (Transparency International 2018).

In this context, although the main presidential candidates presented a number of general health proposals, the legislative-branch candidates paid scant attention to this issue. It is therefore difficult to predict if the new configuration of the Federal Congress will facilitate the approval of the necessary reforms to the LGCT and the LIEPS (Law on the Special Tax on Production and Services) and the possible ratification of the Protocol for the Elimination of the Illicit Trade in Tobacco Products.

1.4 The Tobacco Industry

Mexico's tobacco industry is dominated by two companies—Philip Morris Mexico and British American Tobacco Mexico—both of which are subsidiaries of transnational corporations that control a large share of the global cigarette market. The 2015 GATS reported that the Philip Morris Marlboro cigarette brand was the most popular among just over half of Mexican smokers (52.7 percent), followed by Pall Mall and Montana from British American Tobacco (17.8 percent) (PAHO and INSP 2017).

As is the case in many other countries, the tobacco industry has used various methods to obstruct progress on tobacco control in Mexico (Madrazo and Guerrero 2012). Industry representatives have focused much of their effort on tax policy. The claim that higher tobacco taxes will increase the illicit tobacco trade is the industry's most frequently used argument against tax hikes.

One of the most common strategies employed by the industry is lobbying, conducted directly by representatives of the large corporations or indirectly through lobbying firms. Another approach is the mobilization of business organizations or small distributors (Fundación InterAmericana del Corazón Argentina, et al. 2012). Along with other authorities and stakeholders, the tobacco industry also currently participates in the *Mesa de Combate a la Ilegalidad*, a task force convened by the SAT to coordinate actions against smuggling and counterfeiting of various products, including tobacco products (see Section 2.6).

2. Combating the Illicit Tobacco Trade in Mexico: Legal and Institutional Framework

2.1 Excise Taxes on Tobacco Products

In Mexico, the LIEPS contains all the provisions relating to excise taxes (IEPS). In addition to tobacco products, excise taxes are also imposed on a wide range of goods and services, including: alcoholic beverages, energy drinks, flavored drinks, pesticides, fuels, high-calorie,

non-staple foods, betting and sweepstakes games, and mobile and internet services provided through public telecommunications networks.

To put the role of excise taxes in context as a source of financial resources for the country, Table 2 shows the origin of the federal government's budget revenue. Currently, three-quarters of this revenue is generated by taxes. Specifically, close to 10 percent of all federal revenue comes from the IEPS. While revenue from the IEPS on gasoline and diesel far surpasses revenue from other applications of this tax, tobacco products contribute close to 11 percent of the revenue from the IEPS and approximately 1 percent of total revenue.

The IEPS currently has two components: an ad valorem component, calculated based on the price to the retailer, and a specific component, consisting of a fee in Mexican pesos per unit of product (number of cigarettes or grams) (Table 3). The exact composition of the excise on tobacco products has varied over time (Figure 2).

The manufacturers or importers of tobacco products are responsible for paying the IEPS to the Tax Administration Service (SAT). The deadline for payment is the seventeenth day of the month following the sale of the products. In addition, during the first month of the year,

Table 2. Federal Government Revenue, Mexico, 2017

ITEM	MILLIONS OF PESOS	% OF TOTAL	% OF TAX REVENUE	% OF THE IEPS
Total	3,837,584.6	100.0%		
Oil	437,346.8	11.4%		
Non-oil	3,400,237.9	88.6%		
Tax Revenue	2,854,799.3	74.4%	100%	
Income tax	1,573,688.3	41.0%	55.1%	
Flat Rate Business Tax (IETU)	-1,744.4	0.0%	-0.1%	
Tax on Cash Deposits (IDE)	-739.1	0.0%	0.0%	
Value Added Tax (VAT)	816,039.1	21.3%	28.6%	
Special Tax on Production and Services (IEPS)	367,834.4	9.6%	12.9%	100%
IEPS on gasoline and diesel	216,498.7	5.6%	7.6%	58.9%
IEPS on manufactured tobacco	39,123.6	1.0%	1.4%	10.6%
IEPS on alcoholic drinks	14,958.2	0.4%	0.5%	4.1%
IEPS on beer and carbonated drinks	35,007.7	0.9%	1.2%	9.5%
IEPS on betting and sweepstakes games	2,741.4	0.1%	0.1%	0.7%
IEPS on public telecommunications networks	5,752.1	0.1%	0.2%	1.6%

Table 2. Federal Government Revenue, Mexico, 2017, Cont.

ITEM	MILLIONS OF PESOS	% OF TOTAL	% OF TAX REVENUE	% OF THE IEPS
IEPS on energy drinks	7.9	0.0%	0.0%	0.0%
IEPS on flavored drinks	23,162.9	0.6%	0.8%	6.3%
IEPS on high-calorie, non-staple foods	18,339.4	0.5%	0.6%	5.0%
IEPS on pesticides	705.2	0.0%	0.0%	0.2%
IEPS on carbon	11,537.2	0.3%	0.4%	3.1%
IEPS on water, soda, and concentrates	0.0	0.0%	0.0%	0.0%
IEPS on other goods and services	0.0	0.0%	0.0%	0.0%
Imports	52,330.1	1.4%	1.8%	
Exports	0.4	0.0%	0.0%	
Motor vehicle tax	0.0	0.0%	0.0%	
New automobiles	10,536.3	0.3%	0.4%	
Tax on exploration and extraction of hydrocarbons	4,329.6	0.1%	0.2%	
Hydrocarbons Income Tax	0.0	0.0%	0.0%	
Other	376.9	0.0%	0.0%	
Other related government charges	32,147.7	0.8%	1.1%	
Non-tax revenue	545,438.6	14.2%		
Betterment levy	50.8	0.0%		
Non-oil duties	61,283.2	1.6%		
Earnings	7,830.5	0.2%		
Government charges	476,274.1	12.4%		

Notes: Oil revenue includes transfers from the Mexican Oil Stabilization and Development Fund and income tax on contractors and assignation holders for exploitation of hydrocarbons.
Source: Ministry of Finance and Public Credit (SHCP).

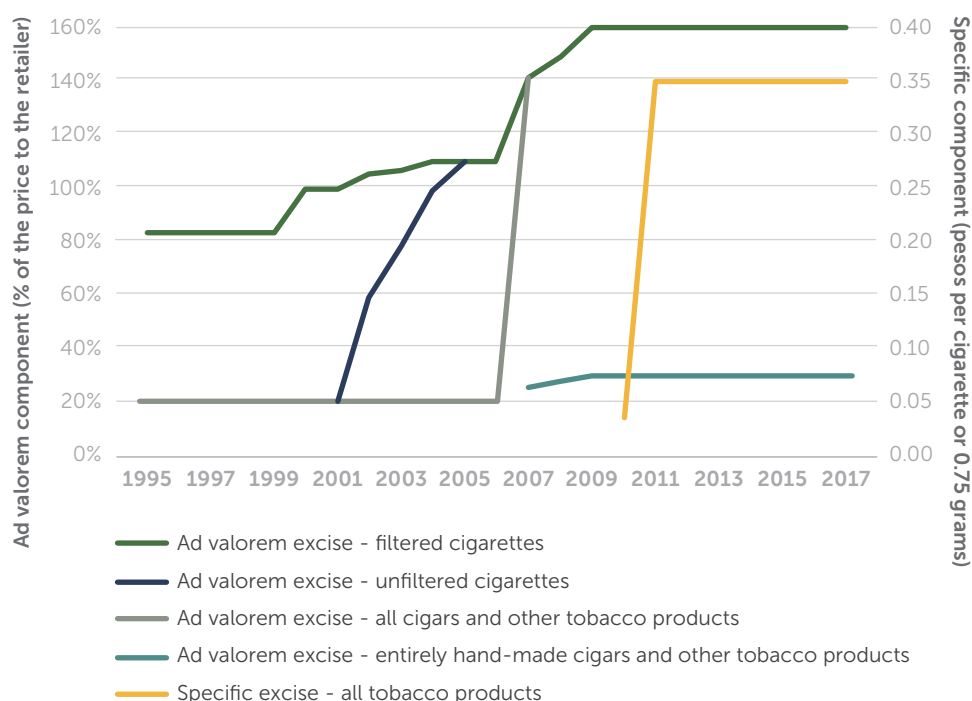
Table 3. Special Tax on Tobacco Products in Mexico, 2018

PRODUCT	AD VALOREM (% OF THE PRICE TO THE RETAILER)	SPECIFIC
Cigarettes	160%	\$0.35 per cigarette
Cigars and other manufactured tobacco products	160%	\$0.35 per 0.75 grams
Cigars and other entirely hand-made manufactured tobacco products	30.4%	Exempt

Notes: The weight of the cigars and other tobacco products other than cigarettes must take into account the weight of other substances mixed with the tobacco, except for the filter, paper, or any other tobacco-free substance in which they are wrapped.

Source: Special Tax Law on Production and Services (LIEPS).

Figure 2. Components of the Excise Tobacco Tax, Mexico 1995-2018



Notes: The specific component of the excise tax implemented in 2010 applied to all tobacco products, but in 2014 entirely handmade cigars and other tobacco products were exempted from this duty.

Sources: Law on the Special Tax on Production and Services (LIEPS).

manufacturers and importers must present to the tax authority a list of prices for all their products classified by brand and presentation. This list must include the price to the wholesaler, the price to the retailer, and the suggested price to the end consumer. If the prices are modified before January of the following year, the manufacturer or importer must present the list of updated prices within five days after the changes are implemented.

In the third month of each year, manufacturers and importers of tobacco products must also present to the SAT data on the products sold the previous year. Similarly, at the start of each quarter (January, April, July, and October), they must present data on their 50 main clients and service providers during the previous quarter. Lastly, they are required to provide monthly data on the price and volume of the tobacco products sold, classified by brand.

2.2 Other Taxes Applicable to Tobacco Products

In addition to the IEPS, tobacco products are subject to payment of the Value-Added Tax (VAT) of 16 percent of the sale price to the consumer (Law on Value-Added Tax). This price includes the price to the retailer (taxable base of the ad valorem component of the IEPS), the IEPS (ad valorem and specific), and the retailer's revenue and expenses. The retailer is responsible for expressly passing on the VAT to buyers of the products and then paying it to the SAT.

Tobacco products that are imported from a number of countries are also subject to an additional ad valorem tax. The applicable rate for imported cigarettes is 67 percent of the price to the importer, while the rate for cigars and cigarillos is 45 percent (Law on General Import and Export Taxes). The price to the importer includes the cost of the products, packaging expenditures, transportation costs, and insurance. However, as a result of the trade agreements in effect, imports of tobacco products from some countries, such as the United States and Canada, are exempt from payment of these import duties. It is worth highlighting that the majority of the cigarettes consumed in Mexico are manufactured domestically, and those that are imported come largely from countries for which duties are not levied. In the case of imported tobacco products, the price to the retailer used to calculate the IEPS includes the price to the importer, the import duty, and the importer mark-up.

Import taxes, when applicable, are paid by importers at the time of initiating the process. This is also recorded in a customs declaration that importers must present to the customs brokers. The customs declaration also contains detailed information on the products that are being imported, such as weight and volume. Travelers over the age of 18 can bring into the country a maximum of ten packs of cigarettes, 25 cigars, or 200 grams of loose tobacco tax free.

In the event that the customs authorities detect lack of compliance with the tax provisions during the import process, they must impose the administrative sanctions provided for in the Customs Law. These sanctions are determined based on the percentage of resulting tax evasion or in accordance with intervals specified in the law. It is important to mention that administrative sanctions are independent of sanctions arising from criminal proceedings,

which may be imposed by a judicial authority. In the case of products that are in transit, the Customs Law establishes in detail the periods, documents, and means of transport that can be used.

2.3 Fiscal Markings on Tobacco Products

Unlike with alcoholic beverages, Mexican law does not require that tobacco products include tax stamps or tags. The fiscal mark that had been provided for in the LIEPS since late 2009 was a security code to be printed on packs of cigarettes manufactured or imported for sale in Mexico. This was scheduled to enter into effect in July 2010, which would have given the SAT time to establish rules governing the characteristics and mechanisms for printing the codes. However, these rules were not published and, therefore, the codes were not implemented.

Subsequently, with the reform of the LIEPS approved in December 2013—which was part of a much broader tax reform process—the possibility of reviving the security code system presented itself. Details were then added about the codes, and another period was established for the publication of more specific rules and the implementation of appropriate mechanisms. However, successive Miscellaneous Tax Resolutions (RMF) postponed the system's entry into force. Ultimately, the final version of the rules was presented in the RMF for 2016, while the resolution for 2017 determined that the requirement should be met from July of that year. Accordingly, since late 2017, cigarettes packs sold in Mexico bear an alphanumeric code accompanied by a two-dimensional, machine-readable code.

On one hand, these codes could lay the foundation for a system to monitor and track tobacco products, which would help improve tax compliance and identify potential diversion of national production to the black market. However, the lack of transparency in the implementation process casts doubt on its effectiveness. In principle, recent RMF indicate that only the SAT can generate the security codes, but both the SAT itself or pre-authorized companies can act as providers of the codes for manufacturers and importers.⁶ If the former is true, cigarette manufacturers and importers must:

- » Print the code as part of the process of producing the cigarette packs or prior to importing them,
- » Record and store the data contained in the security code,
- » Supply the SAT with the data on entries online and in real time, and
- » Implement all the technical and security features established by the SAT.
- » Specifically, the code must be random and encrypted; include a graphic representation readable with mobile devices; and contain the following information visible to the user to authenticate the products:

⁶ It is important to mention that the reform of the LIEPS approved in 2013 established that the code was to be handled through authorized third parties, but subsequent RMF opened the possibility that the SAT could act directly as provider of the codes.

- a. Random security folio;
- b. Place and line of production;
- c. Manufacturing machine;
- d. Date, time, and place of production;
- e. Brand and commercial characteristics;
- f. Number of cigarettes in the pack;
- g. Country of origin and number of import permit, if applicable;
- h. Federal Taxpayer Registry (RFC) and name of the producer or importer; and
- i. Banner of the Ministry of Health "Smoking kills slowly."
- j. No other physical high-security features are required (e.g., covert elements).

If authorized printing-service providers are employed, these providers have to carry out the printing, recording, storage, and submission of data derived from the code. However, to date, no certification process for authorized providers has been made public.⁷ On the other hand, it is not clear who developed the technology to generate the codes and how the SAT acquired it (no public bidding process was implemented), how much it cost, and whether it was paid with public resources. In other words, it is impossible to rule out conflicts of interest in the implementation process and to assess the extent to which the code is under exclusive control of the SAT.

2.4 Health Markings on Tobacco Products

In accordance with the LGCT, packaging for tobacco products must contain the following:

- » A pictogram or image covering 30 percent of the front of the package; rotating pictograms should be printed directly on the packages,
- » A health message covering 100 percent of the back and one of the sides of the package; rotating health messages should also be printed and should include a telephone number at which to obtain information on prevention, cessation, and treatment of illnesses or adverse effects caused by tobacco consumption, and
- » The caption "For sale exclusively in Mexico."

Warnings and textual information should be in Spanish on all packaging and external labeling of all tobacco products.

Although the LGCT entered into force in 2008 and its regulations in 2009, it was after the publication of the initial agreements of the Ministry of Health in September 2010 that the packaging started being printed as described above. These agreements set forth in detail

⁷ According to recent RMF, the list of authorized providers (including name, fiscal address, website and RFC) would have to be published on the SAT's website, just as is done with other service providers.

the features and content of the health warnings and images. Originally, the images could be freely downloaded in high resolution from the Ministry of Health's website, but now they are only provided directly to authorized manufacturers and importers to prevent forgery of the images. So far, there have been nine rounds of warnings implemented, the last of which will be in force up to May 2020.

2.5 Health Import Licenses and Permits

Although smuggling is not expressly defined in the LGCT, the law provides for at least two measures that aim to prevent it. First, the LGCT establishes that all manufacturers or importers of tobacco products must have a health license from the COFEPRIS. This license is valid for three years, although it can be renewed as long as the administrative and technical requirements set forth in the RLGCT continue to be fulfilled. The administrative requirements include the payment of fees in the manner authorized by the SHCP and proof of legal personality, while the technical requirements refer to issues of hygiene, order, and other health-related aspects. Second, importers must request health permits from the COFEPRIS for each import process. The main objective of this permit is to verify that the merchandise entering the country corresponds to what the importer is claiming to import. These permits are only granted to holders of health licenses that comply with the applicable requirements and are valid for 90 days, which can be extended for another 90 days if the health authority's requirements continue to be fulfilled.⁸ Importers of tobacco products must present the health permits at the time of customs clearance along with the customs declaration confirming payment of the applicable taxes (see Section 2.2).

Based on the foregoing, it follows that tobacco products brought in without health permits issued by the COFEPRIS are considered to be illegally imported and, consequently, are subject to the applicable security measures (e.g., seizure and destruction) and penalties. Penalties can range from 4,000 to 10,000 times the general minimum wage, according to the provisions of the LGCT.

As a result of its supervision activities, at least since 2014, the COFEPRIS has issued health alerts in which it includes the cigarette brands that do not fulfill the regulations regarding packaging and/or the import health permits. Generally speaking, these are "non-traditional" brands, meaning they are different from those of the corporations that dominate the cigarette market in Mexico (see Section 1.4) and, therefore, are not listed in the index of brands that the SAT periodically publishes, based on the information submitted to it by cigarette manufacturers and importers.

⁸ The requirements for requesting an import permit, according to the RLGCT, are: (1) Certificate issued by competent authority of the country of origin indicating that the tobacco product was manufactured in the country of origin, its physicochemical composition, the place of origin, with validity by batch or by certificate of free sale that mentions that this product is consumed without restrictions in the country of origin; (2) Copy of the establishment's health license; (3) Original label of origin; (4) Original label with which it will be marketed in Mexico; (5) Proof of payment of fees.

In 2017, the government announced a strategy called *Aduana Siglo XXI* (21st-Century Customs) to modernize Mexican customs by incorporating the best international practices. Some of the actions contemplated are: the use of new technologies to improve the detection of illicit products, the modernization of points of inspection to automate customs clearance, the elimination of cash payments, the simplification of procedures, and the implementation of import permits readable with mobile devices, among others.

2.6 Key Institutions in the Fight against the Illicit Trade

In general, illicit trade takes the form of administrative offenses and/or tax-related crimes or counterfeiting, which fall under the jurisdiction of the Federal Government. The most relevant authorities in the fight against the illicit tobacco trade are: the COFEPRIS, charged with verifying compliance with health regulations (packaging, health import licenses, and permits); the SAT, responsible for monitoring compliance with tax and customs regulations (import taxes and requirements); the PGR, charged with initiating criminal proceedings when necessary; and the IMPI, responsible for issuing an opinion in counterfeiting proceedings. Coordination among these multiple institutions is critical.

One of the measures implemented to improve interinstitutional coordination was the establishment of the *Mesa de Combate a la Illegalidad*, in April 2013, at the initiative of the SAT. In addition to the COFEPRIS, the PGR, and the IMPI, the Ministry of Economy (SE) and the Federal Consumer Protection Agency (PROFECO) from the public sector are also involved, along with the Mexican Confederation of Industrial Chambers (Confederación de Cámaras Industriales de los Estados Unidos Mexicanos, CONCAMIN), the Confederation of National Chambers of Trade, Services, and Tourism (Confederación de Cámaras Nacionales de Comercio, Servicios y Turismo, CONCANACO), and the Mexican Confederation of Associations of Customs Agents (Confederación de Asociaciones de Agentes Aduanales de la República Mexicana, CAAREM) from the private sector. The main purpose of this task force is to promote joint action to identify, prevent, and combat major illegal practices relating to five products: alcoholic beverages, tobacco, automobiles, footwear, and clothing. However, although reports available for 2015 and 2016 provide an account of various positive results for sectors other than tobacco (e.g., increase in revenue collection, auditing, cancellation of licenses, etc.), in the case of tobacco, they only report the incidence of cigarette destruction (283 occasions with 51.09 million cigarettes destroyed by customs officials in 2016). Moreover, this initiative ignores the fact that the FCTC establishes specific guidelines on how governments and the tobacco industry, which is part of CONCAMIN, should interact.

3. Outcomes of the Strategy to Combat Illicit Trade

The health markings required on cigarette packs since late 2010 have drastically changed their appearance and, therefore, facilitated identification of illegal products. However, the most important reform with respect to combating illicit tobacco trade has been the

introduction of the security code. That said, as of this writing, the code has only been in use for a few months, and critical details about the way in which it is being applied are still unknown. Specifically, the RMF stipulates that only the SAT can generate the codes, but there is no information on the technology that is being employed and the process followed to acquire that technology, as no public bidding process took place. In addition, although the LIEPS originally contemplated that the printing of the codes, as well as the registration, storage, and submission of data derived from the codes would be done through previously authorized independent third parties, the RMF indicates that the SAT can directly provide the codes to the manufacturers/importers. Since the SAT has not published a list of authorized providers, it must be acting as the provider of the codes, but it is not clear whether this will continue in the future. Finally, if the SAT itself generates and distributes the codes, but the producers/importers print them and store the data generated, it is unclear how the SAT guarantees that the flow of information is transparent. Given these conditions, rather than seeking to evaluate the outcomes of the policies, a brief review was done of the status of the illicit trade in Mexico in recent years.

According to the GATS, less than 1 percent of Mexican smokers consumed illegal cigarettes in 2009 (Sáenz de Miera Juárez and Zúñiga Ramiro 2013). More recent data indicate that this percentage stood at 2.7 percent in 2015; that is, there was a slight increase (Sáenz de Miera Juárez, et al. 2018). However, these figures are considerably lower than the global average and lower than the estimates for other Latin American countries, which generally stand at approximately 10 percent (Ramos 2009).

It is worth highlighting that two of the factors associated with higher incidence of illicit trade are the presence of criminal organizations and high levels of corruption. Given that both are serious problems in Mexico, it is possible that some of the previously described improvements, such as strengthening health controls, may have counteracted those factors to some degree and helped maintain a low incidence of illicit trade. However, more detailed studies are needed to better understand the situation.

Small-scale smuggling associated with cross-border shopping is another issue that merits attention. While some reports suggest that Mexico is most commonly the source of illicit trade between Mexico and the United States, historical smuggling trends seem to suggest the opposite (Colledge 2013). A recent report by the United States Government Accountability Office (GAO) also points in that direction (GAO 2017). In particular, the GAO focuses on high-volume cigarette sales of US duty-free stores located near the border that are largely smuggled into Mexico or diverted into the US market. While the magnitude of this problem is not estimated, and seizures by Mexican Customs authorities are presented as the main evidence, the GAO indicates that most of the cigarettes smuggled into Mexico are from “non-traditional” brands, i.e., brands that according to COFEPRIS do not fulfill the Mexican regulations regarding packaging and/or import health permits. If this is the case, the consumption of these cigarettes would be accounted for in the estimates of illicit cigarette consumption

mentioned above. In other words, although there is evidence of smuggling at the country's northern border, its magnitude would be small. In any case, this situation exemplifies a side of the illicit-trade problem for which international cooperation is indispensable.

4. Recommendations

One of the main weaknesses of Mexico's strategy to combat the illicit trade in tobacco products was for many years the absence of a system for monitoring and tracking products manufactured in the country. Such a mechanism is indispensable to prevent tax evasion and to identify potential diversion of products for their illegal distribution, whether domestically or in other countries. However, with the implementation of the security code visible on Mexican cigarette packs since late 2017, it is possible for the first time to obtain data on characteristics including: the production line and location from which a pack originated; the production machine used; the date, time, and place of manufacture; the brand and commercial features; the number of cigarettes per pack; the country of origin and customs declaration number (in the case of imported cigarettes); and the Federal Taxpayer Registry (RFC) and name of the manufacturer or importer. Yet, because of the lack of transparency regarding the generation of the codes, it is unclear if this process is independent and free of conflicts of interest. As is stipulated in the rules included in the RMF, it is critical that the tax authority publish the list of security code service providers and periodically supply information about how the data generated are used. It is also important to consider that the security features of the code are relatively basic. Other successful tracking and tracing systems, such as the one implemented in Brazil, combine visible and non-visible elements to improve efficacy.

However, while control of domestic production is essential to combating illicit trade, the available evidence (e.g., alerts from COFEPRIS) indicates that the bulk of illegal tobacco products in Mexico are cigarettes that were illegally brought into the country. In this sense, although the process of enhancing the customs authority has begun, border controls must be strengthened, particularly at the country's southern border, where the presence of free zones impedes inspection processes. Regional cooperation in the drive to combat the illicit trade is indispensable.

Recent action to strengthen interinstitutional collaboration is certainly a positive step. However, given the tobacco industry's participation in the *Mesa de Combate a la Illegalidad*, details of concrete collaborative actions between government bodies and the industry should be made public to eliminate possible conflicts of interest.

Also, it is important for the country to officially monitor the illicit trade in tobacco products. Even though in recent years the SAT has improved the recording of data on embargos in general, it does not have its own indicators of the magnitude of, and trends in, the illicit trade.

Finally, Mexico's relatively low rate of smuggling and relatively strong administrative capacity, including tax and customs, reinforce the arguments for the country to undertake much

more vigorous action on tobacco tax reform. This is all the more the case as evidence accumulates that it is the effectiveness of customs and tax administration, and not comparative tax rates, that primarily drive illicit tobacco trade (World Bank 2017).

It is unfortunate that the affordability of tobacco products has been allowed to increase over the past six years, even though Mexico has otherwise been making efforts to reduce tobacco consumption and the resultant death and disease. Total cigarette excise taxes, specific and ad valorem, account for only 53 percent of the retail price of cigarettes in Mexico in 2018 (Fundación Interamericana del Corazón México 2018), as compared to the WHO recommendation of at least 70 percent (WHO 2010). Relevant steps called for by the World Bank (2017) include: “Go big, go fast. Attack affordability. Change expectations. Tax by quantity: replacing ad valorem excises with specific, preferably uniform, excise taxes.” Following these steps maximizes health benefits by reducing “downward substitution,” as well as increasing tax revenues and simplifying tax administration.

References

Blecher E. Targeting the affordability of cigarettes: a new benchmark for taxation policy in low-income and middle-income countries, *Tobacco Control* 2010; 19:325-330.

Colledge JW. Comercio ilícito de Tabaco entre México y Estados Unidos, in: Reynales Shigematsu LM, Thrasher JF, Lazcano Ponce E, Hernández Ávila M (eds.). *Salud pública y tabaquismo, volumen I. Políticas para el control del tabaco en México*. Cuernavaca, Mexico: INSP; 2013.

Fundación InterAmericana del Corazón Argentina, Fundación InterAmericana del Corazón México, Corporate Accountability International Colombia, Alianza de Control de Tabagismo. *La salud no se negocia. La sociedad civil frente a las estrategias de la industria tabacalera en América Latina, Case studies 2010-2012*. Buenos Aires, Argentina: FIC Argentina.

Fundación InterAmericana del Corazón México. *XIII Informe de la sociedad civil: a 10 años de la Ley General para el Control del Tabaco*. Mexico City, Mexico: FIC Mexico; 2018.

Government Accountability Office (GAO). Tobacco Trade. Duty-Free Cigarettes Sold in Unlimited Quantities on the U.S. – Mexico Border Pose Customs Challenges, *Report to the Ranking Member, Committee on Finance, U.S. Senate*, GAO-18-21; 2017.

INEGI. Datos preliminares revelan que en 2016 se registraron 23 mil 953 homicidios, *Press Release 298/17*; 2017.

INEGI. Resultados de la Encuesta Nacional de Calidad e Impacto Gubernamental, *Press Release 136/18*; 2018.

- INPRF, INSP, CONADIC, Ministry of Health. *National Survey on Drug, Alcohol, and Tobacco Consumption 2016-2017: Reporte de Tabaco*. Reynales-Shigematsu LM, Zavala-Arciniega L, Paz-Ballesteros WC, Gutiérrez-Torres DS, García-Buendía JC, Rodríguez-Andrade MA, Gutiérrez-Reyes J, Franco-Núñez A, Romero-Martínez M, Mendoza-Alvarado L. Mexico City, Mexico: INPRF; 2017.
- Madrazo-Lajous A, Guerrero-Alcántara A, Estrategias de la industria tabacalera en México para interferir en las políticas de control del tabaco, *Salud Pública de México* 2012; 54(3):315-322.
- PAHO, INSP. *Global Adult Tobacco Survey. Mexico 2015*. Cuernavaca, Mexico: INSP/PAHO; 2017.
- Ramos A. *Illegal trade in tobacco in the Mercosur countries*. Framework Convention Alliance; 2009.
- Reporters Without Borders. *Annual Report 2017*. France: Reporters Without Borders; 2017.
- Sáenz de Miera Juárez B. Impuestos al tabaco en México: análisis del periodo 2006-2012, en: Reynales Shigematsu LM, Thrasher JF, Lazcano Ponce E, Hernández Ávila M (eds.). *Salud pública y tabaquismo, volumen I. Políticas para el control del tabaco en México*. Cuernavaca, Mexico: INSP; 2013.
- Sáenz de Miera Juárez B, Zúñiga Ramiro J. Comercio ilícito de productos de tabaco en México: evidencia disponible y legislación vigente, in: Reynales Shigematsu LM, Thrasher JF, Lazcano Ponce E, Hernández Ávila M (eds.). *Salud pública y tabaquismo, volumen I. Políticas para el control del tabaco en México*. Cuernavaca, Mexico: INSP; 2013.
- Sáenz de Miera Juárez B, Thrasher JF, Reynales Shigematsu LM, Hernández Ávila M, Chaloupka FJ. Tax, Price and cigarette brand preferences: a longitudinal study of adult smokers from the ITC Mexico Survey, *Tob Control* 2014; 23:i80-i85.
- Sáenz de Miera Juárez B, Rodríguez MA, Reynales LM. Measuring illicit cigarette consumption with tobacco surveillance data: evidence from the Global Adult Tobacco Survey in Mexico, *Tob Induc Dis* 2018; 16(Suppl 1): A132.
- Transparency International. *Corruption Perceptions Index 2017*. Berlin, Germany: Transparency International; 2018.
- Waters H, Sáenz de Miera B, Ross H, Reynales Shigematsu LM. *The Economics of Tobacco and Tobacco Taxation in Mexico*. Paris: International Union Against Tuberculosis and Lung Disease; 2010.
- WHO. *WHO technical manual on tobacco tax administration*. Geneva: WHO; 2010.
- World Bank. *Tobacco Tax Reform. At the Crossroads of Health and Development. A Multisectorial Perspective*. Washington, D.C.: World Bank; 2017.

URUGUAY

13

URUGUAY:

Tackling Illicit Tobacco Trade

Winston Abascal and Alejandro Ramos-Carbajales¹

Chapter Summary

Tobacco use has health, economic, and social consequences for populations. It is associated with Uruguay's two leading causes of death, cardiovascular diseases and cancer.

After ratifying the World Health Organization Framework Convention on Tobacco Control (WHO FCTC) in September 2004, Uruguay put in place a strong national tobacco control policy implementing a comprehensive set of measures, including 100 percent smoke-free environments; pictorial health warnings; a ban on advertising, promotion, and sponsorship; and the inclusion of tobacco dependence treatment in all health care settings. Uruguay has achieved the highest levels of implementation of MPOWER, the WHO-recommended package of six key evidence-based measures proven to reduce tobacco use. Following the implementation of these measures in 2005, prevalence of tobacco use has significantly declined, both among young people and adults. Highest prevalence is observed in the poorest third of Uruguay's population.

¹ W. Abascal (Director of International Cooperation Centre for Tobacco Control, WHO FCTC Secretariat and Former Director of the National Program for Tobacco Control, Ministry of Public Health, Uruguay); A. Ramos-Carbajales (Former Planning and Research Director at CIET [Research Center for the Study of the Tobacco Epidemics] Uruguay).

There are several approaches to measuring the illicit cigarette trade in a country. The method adopted here uses data from the Global Adult Tobacco Survey (GATS) 2009 and 2017, which included questions on cigarette brands smoked. The size of the illicit market is estimated at 12 percent of total cigarette consumption in Uruguay.

In the last 15 years, illicit cigarettes entering the Uruguayan market are largely manufactured in Paraguay and transported across the Brazilian border by small trucks. Illicit traders often make multiple trips to the Brazilian border to pick up incoming cigarettes, and most seizures of cigarette cargo take place on Uruguay's network of National Routes. In addition, cigarettes are being brought by small boats via the Uruguay River from Argentina.

Although illicit trade legislation in general involves many different laws, Uruguay has passed specific legislation on tobacco with the Tobacco Control Act of 2008, which notably introduced a regulation mandating the Executive Branch to secure the human and material resources needed to proceed to the elimination of all forms of illicit tobacco trade. Nonetheless, analysis of Uruguay's legislation on illicit tobacco points to an important deficit in terms of compliance with FCTC Article 15 and the newly ratified Protocol for the Elimination of Illicit Tobacco Trade (the Protocol).

Tobacco control policies, and particularly tax policies, are undermined by illicit trade. GATS 2009 and 2017 data show that, while the proportion of Uruguay's smokers who consume illicit brands has not increased in the last eight years, the country's poorest smokers are the main consumers of illicit tobacco products. In this sense, controlling the illicit tobacco trade is a special priority, since the burden of health consequences falls mainly on the poor.

Ratification of the Protocol in 2014 spurred the creation of an Inter-Agency Commission for the Implementation of the Protocol. The Commission includes delegates from several ministries, Uruguay's customs and tax authorities, the judiciary, and two non-governmental organizations. Uruguay has the chance to develop a robust long-term fiscal policy on tobacco products, thanks to legislation giving the Executive Branch a wide mandate to set the tobacco tax base.

It is necessary to address illicit tobacco at a regional level through the MERCOSUR Inter-Governmental Commission on Tobacco Control. An important aspect of the Protocol (Part V) refers to the international exchange of information on law enforcement, technical assistance, and cooperation.

When Uruguay ratified the FCTC, it acquired obligations but also substantive support to apply the policy measures contained in the agreement. This has been fundamental in the evolution of tobacco control in the country. With the entry into force of the Protocol, Uruguay once again enjoys an opportunity to benefit from partnerships, implement necessary policy changes, and ultimately eliminate illicit tobacco trade.

1. Overview of Tobacco Control Policy in Uruguay

Given that tobacco use is associated with the two leading causes of death in Uruguay, cardiovascular diseases and cancer,² its control constitutes a public health measure of fundamental importance.

Tobacco use is a complex phenomenon and has consequences in the health, economic and social fields. Therefore, the response from public policy, as established by the WHO FCTC,³ must encompass a set of measures that involve multiple areas. For more than a decade in Uruguay, the prevalence of tobacco use remained almost constant, according to the four household surveys carried out between 1994 and 2006 by the National Board on Drugs (JND).^{4 5 6 7} Tobacco control policy as such began with the new Government in March 2005. Uruguay had ratified the FCTC in September 2004 and, from 2005 on, the country implemented a strong, FCTC-guided tobacco control policy that resulted in a comprehensive package of measures. The central axis was the implementation of smoke-free environments, a measure that determines a change in society's view of smoking, as it denormalizes smoking behavior. In addition, it discourages the beginning of consumption, decreases its magnitude, and stimulates quit attempts.

The implementation of other measures such as health warnings; the wide prohibition of advertising, promotion, and sponsorship; the increase of prices through tax hikes; and the incorporation of free treatment of tobacco dependence added to these regulations. Apart from their own impact, they contributed to a contextual change in the social perception of tobacco use and the risk of this behavior.⁸

In 2009, the size of graphic warnings was increased to 80 percent of both main faces of the cigarette package, and the existence of variants within the same brand was forbidden ("single presentation requirement"). In 2014, the ban on advertising and promotion became total by eliminating the exception that had existed at the point of sale and including the prohibition to display tobacco products. The Protocol for the Elimination of Illicit Trade in Tobacco Products was ratified in the same year.⁹ Box 1 presents a summary of relevant policies, including those approved before 2005. These measures include the main recommendations of the WHO FCTC.

² Ministerio de Desarrollo Social, Presidencia, Oficina de Planeamiento y Presupuesto, Report Uruguay 2015 - http://200.40.96.180/images/ReporteUruguay2015_OPP_web.pdf

³ World Health Organization. WHO Framework Convention on Tobacco Control. Geneva: WHO, 2005.

⁴ Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1994

⁵ Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1998

⁶ Junta Nacional de Drogas. Secretaría Nacional de Drogas. UNDP. 3ra. Encuesta Nacional de Prevalencia del Consumo de Drogas, 2001.

⁷ Junta Nacional de Drogas. Secretaría Nacional de Drogas, 4ta. Encuesta Nacional en Hogares sobre Consumo de Drogas. Uruguay, 2006.

⁸ Abascal W, Esteves E, Goja B, González F, Lorenzo A, Sica A. Impacto de las políticas de control de tabaco en Uruguay 2006-2009. Programa Nacional para Control del Tabaco. Archivos de Medicina Interna, 35(Supl.4),1-16

⁹ Ley 19259. Available at: http://archivo.presidencia.gub.uy/sci/leyes/2014/08/mrree_3855.pdf

Box 1. History of Key Tobacco Control Policies and Programs in Uruguay

POLICY	SUMMARY OF MEASURES
Earlier restrictions on smoking	Bans in public workplaces and in retail food stores since 1996. Bans in public transportation since 1981; bans in hospitals and all health facilities since 2004.
Tobacco control policy after March 2005	Legislation prohibiting smoking in work and closed public places introduced in Uruguay in September 2005 by Decree, became effective on March 1, 2006, at national level. A comprehensive tobacco control law was passed in Parliament in 2008, including smoke-free environments (no change in 2006 bans). ¹⁰
Tobacco tax	Used as a tool to decrease demand through tax hikes from March 2005 until 2010 and from March 2014 to the present. From 2010-2014, there were no tax increases.
Illicit trade control	A specific strategy to tackle illicit tobacco trade was applied to the operation of free-trade zones and other tax-free spaces in the early 1990s to prevent rerouting to the domestic market (see section 8.3).
Mass media campaigns (MMCs)	Large-scale MMCs were implemented at the time of Uruguay’s initial systematic tobacco control policies in 2005, in particular in connection with smoke-free environment legislation. Campaigns included “Un millón de gracias” (“A million thanks,” 2006) and “Uruguay Libre de Humo de Tabaco” (“Smoke-Free Uruguay”). Subsequently, additional mass media campaigns, in particular via the internet: “Me declaro ex” (“I’m a former smoker,” 2016) and now “Bienvenida independencia” (“Welcome independence”), a mass media and graphic campaign (www.msp.gub.uy)
Health warnings	Text warnings since 1982, mandated inclusion of text in TV advertising. Although text warnings became a legal requirement in Uruguay in 1982, a new and more direct text was implemented in 2003, encompassing warnings on cancer, respiratory and cardiovascular diseases, and risks for pregnant women. Since May 2005, health warnings included pictorials covering 50% of the pack. Since 2009, picture and text warnings covering at least 80% of the front and back of tobacco packaging.
Advertising and promotion	Television advertising for tobacco products banned, May 2005. Uruguayan Comprehensive Tobacco Control Law 18256 of 2008 banned all advertising, promotion, and sponsorship except for point of sale. ¹¹ Complete ban on advertising, promotion, and sponsorship, 2014, also prohibits point-of-sale advertising. A standardized tobacco packaging bill is before Parliament pending approval as of June 2018.
Youth access	Minimum age for tobacco sales set at 18 years since 1982. Vending machine ban implemented.
Treatments to help smokers quit	Extensive provision of free stop-smoking services providing counselling and access to pharmacotherapy from 2004 onwards. Nicotine replacement therapy (NRT), bupropion, and varenicline available on prescription.

¹⁰ Ley 18.256 – Ley de Control del Tabaquismo. (Tobacco Control Act, 2008) - <https://parlamento.gub.uy/documentosleyes/leyes/ley/18256>

¹¹ http://archivo.presidencia.gub.uy/_web/leyes/2008/03/S405_19%2010%202007_00001.PDF

2. Regional Partners: Uruguay and the MERCOSUR Agreement¹²

The MERCOSUR countries created the “Comisión Inter-gubernamental para el Control del Tabaco” (Inter-Governmental Commission for Tobacco Control, CICT) in 2004. Two of the main topics of discussion at the Commission have been (i) the need to control illicit tobacco trade and (ii) tax harmonization.¹³ However, over the years, the Commission’s recommendations to the governments of MERCOSUR have not produced any policy changes. There is also the problem that the Commission is mostly the responsibility of health ministers, and finance and economic ministers have generally not shared health officials’ concern about the illicit tobacco trade.

3. Trends in Tobacco Use in Uruguay

Following the implementation of the main measures established in the WHO FCTC, Uruguay has shown a sustained decrease in the prevalence of tobacco use, both among young people and adults.

3.1 Tobacco Prevalence Among Adults

Before the implementation of systematic tobacco control measures, beginning in 2005, Uruguay’s adult tobacco consumption prevalence stood between 32 and 33 percent, according to multiple surveys.^{14 15 16 17} In 2006, STEPS¹⁸ reported a prevalence of 32.7 percent for the population between 25 and 64 years of age. Three years later, however, GATS 2009¹⁹ found a substantially lower prevalence of 25.0 percent in the same age group.

¹² Since January 1995, MERCOSUR (Argentina, Brazil, Uruguay and Paraguay) is a trade area with free trade for all goods circulating in the region. It has also established a Customs Union, not full yet, with the existence of a Common External Tariff (AEC). Chile and Bolivia are associated members, while Venezuela is a full member but is currently suspended.

¹³ Paraguay has one of the lowest tobacco tax rates and tax shares of retail price in the world. Paraguay has been since the early 2000s the source of most illicit tobacco trade in the region.

¹⁴ Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1994

¹⁵ Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1998

¹⁶ Junta Nacional de Drogas. Secretaría Nacional de Drogas. UNDP. 3ra. Encuesta Nacional de Prevalencia del Consumo de Drogas, 2001.

¹⁷ Junta Nacional de Drogas. Secretaría Nacional de Drogas, 4ta. Encuesta Nacional en Hogares sobre Consumo de Drogas, 2006.

¹⁸ STEPS- Primera Encuesta Nacional de Factores de riesgo de enfermedades crónicas no transmisibles (First Survey of risk factors for Non-communicable diseases).2006 http://www.msp.gub.uy/sites/default/files/archivos_adjuntos/1er_enfrecnt_2006_1.pdf

¹⁹ Global Adult Tobacco Survey (GATS 2009) - World Health Organization, Pan American Health Organization, Centers for Disease Control and Prevention. Ministry of Health of Uruguay, National Institute of Statistics Uruguay. Uruguay, 2017 - https://paho.org/hq/index.php?option=com_content&view=article&id=1751&Itemid=1185&lang=en

The most recent tobacco survey at the national level (Uruguay GATS 2017 Fact Sheet)²⁰ points to a further decrease in male smoking prevalence since 2009, but no significant decline among women. Male smoking prevalence decreased from 30 percent to 25 percent, while female smoking prevalence slipped from 19.8 percent to 18 percent in the period 2009-2017.

Overall, the prevalence of tobacco smoking among adults aged 15 years and older decreased significantly, from 25.0 percent in 2009 to 21.6 percent in 2017 (Table 1). By age groups, the most important decrease was shown in the 15-24 group, with a drop from 24.7 percent in 2009 to 14.6 percent in 2017.

The greatest impact on the decrease in smoking prevalence was observed following implementation of the broad tobacco control measures introduced in 2005-2006.

Table 1. Evolution of Tobacco Smoking Prevalence, Uruguay, 2009-2017

	TOTAL	MEN	WOMEN
GATS 2009	25.0%	30.7%	19.8%
GATS 2017	21.6%	25.6%	18.0%

Source: Global Adult Tobacco Survey (GATS), Uruguay, 2009 and 2017. Prevalence figures include daily and non-daily smoking.

The main tobacco product smoked in 2017 was cigarettes, including manufactured (18.4 percent) and hand-rolled cigarettes (5.9 percent).

Using the distribution of wealth²¹ as a proxy for income, the 2017 results in Table 2 confirm that the lower income tercile has the highest smoking prevalence.²² We also note that the prevalence of roll-your-own (RYO) consumption is much higher (almost 10 times) in the poorest tercile, compared with the richest tercile.

In Table 3, 2017 GATS data show that adults who completed only elementary and early secondary schooling have the highest smoking prevalence.

Two other facts that point to a successful tobacco control policy are the decrease in tobacco smoke exposure at home and the percentage of smokers who want to quit. Regarding exposure to tobacco smoke at home, a significant decrease was registered, from 29.2 percent in 2009 to 20.0 percent in 2017. The percentage of smokers who state that they want to

²⁰ Global Adult Tobacco Survey (GATS). (Fact sheet) https://www.paho.org/uru/index.php?option=com_docman&view=document&alias=576-uru-gats-2017-core-factsheet&category_slug=publications&Itemid=307.

²¹ Ramos Carbajales, A; Clemente, A; Gonzalez Rozada, M. Impuestos al tabaco y políticas para el control del tabaco en Uruguay. Fundacion Interamericana del Corazón, México 2013 - http://tabaco.ficmexico.org/wp-content/uploads/2014/08/uruguay_web.pdf

²² In Uruguay, smoking hand-rolled tobacco is an established custom, and the use of this product increased after 2012.

Table 2. Prevalence of Tobacco Smoking by Income Level, 2017

	ALL SMOKED TOBACCO	RYO
Tercile 1 (richer)	17%	1.30%
Tercile 2	23%	4.55%
Tercile 3 (poorer)	26%	11.70%

Source: Author's calculations based on GATS 2017.

Table 3. Adult Tobacco Prevalence and Educational Attainment

PREVALENCE OF TOBACCO SMOKING BY EDUCATIONAL LEVEL (ALL TOBACCO PRODUCTS)	
Elementary school	24.1%
Secondary levels 7-9	27.1%
Secondary levels 10-12	23.6%
University	14.2%

Source: Authors' calculations, based on GATS 2017 data

quit smoking continues to be substantial: 10.9 percent of current smokers in 2009 and 10.3 percent in 2017 planned to or were thinking about quitting within the next month.

3.2 Tobacco Prevalence Among Youth

Regarding young people, the decline in prevalence has been even more pronounced. The National Survey on Drug Use among Secondary Education Students is performed by the National Board on Drugs (JND) among 13 to 17 year-olds.^{23 24 25 26 27 28} Results show a steady decrease in smoking prevalence from the year 2003 onward (Figure 1).

²³ Junta Nacional de Drogas. 1ra. Encuesta Nacional y 2da. en Montevideo sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OEA-SIDUC. October 2003.

²⁴ Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 2da. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD. Abril 2006

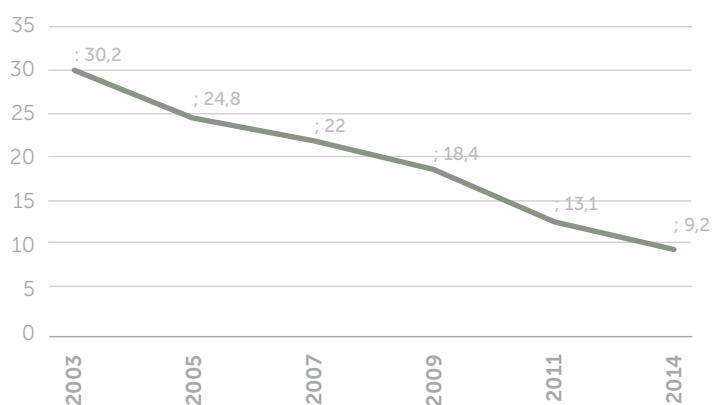
²⁵ Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 3ra. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD/OEA-SIDUC. Abril 2007

²⁶ Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 4ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD/United Nations-Office on Drugs and Crime. October 2010

²⁷ Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 5ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD. October 2012

²⁸ Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 6ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD. Uruguay, 2014

Figure 1. Trends in 30-Day Smoking Prevalence in Youth (%)



Source: National Survey on Drug Consumption among Secondary Students, JND. Population 13-17 years old.

The United States Surgeon General²⁹ notes that, "Almost all smokers start smoking during childhood and adolescence. 88 percent of adult smokers started before age 18." In 2017, according to GATS Uruguay, smoking initiation patterns in the country are similar to those described for the United States. In Uruguay, 89.0 percent of adult smokers started smoking before age 20. "This has strategic implications in the planning of [policy] measures, and it is crucial that, in deciding national tobacco-control policies, a line of work aimed at the younger population be established."³⁰

3.3 Impact of Tobacco Control Policy on Prevalence, Compared with Argentina

To better evaluate what has happened with tobacco consumption in Uruguay, Argentina was chosen as a comparator, "not only because of its geographical proximity and common language and culture, but also because Argentina did not enact comprehensive nationwide anti-tobacco legislation until June 2011."³¹

Between 2005 and 2011, per capita consumption of cigarettes in Uruguay decreased by 4.3 percent per year, while in Argentina it increased by 0.6 percent per year. Between 2003 and 2009, the prevalence of tobacco consumption in the previous 30 days among young people aged 13, 15, and 17 years fell by 8.0 percent annually in Uruguay, while in Argentina the figure decreased by just 2.5 percent annually. Among adults, current tobacco use (including daily and occasional smokers) decreased by 3.3 percent annually between 2005 and 2011 in Uruguay, while Argentina registered an annual decrease of 1.7 percent.

²⁹ US Department of Health and Human Services. Public Health Services. Preventing tobacco use among youth and young adults. A Report of the Surgeon General. Atlanta, GA: US Department of Health and Human Services, Centers for Disease Control and Prevention, National Centre for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2012

³⁰ Abascal W, Lorenzo A. Impact of tobacco control policy on teenager population in Uruguay. *Salud Pública de Mex* 2017;59suppl 1:S40-S44. <http://doi.org/10.21149/8051>

³¹ Abascal W, Esteves E, Goja B, González F, Lorenzo A, Sica A, et al. Tobacco control campaign in Uruguay: a population-based trend analysis. *Lancet* 2012;380(9853):1575-1582. [https://doi.org/10.1016/S0140-6736\(12\)60826-5](https://doi.org/10.1016/S0140-6736(12)60826-5)

4. Evolution of the Price of Cigarettes and RYO and Smoking Prevalence

Tax and price increases have been one of the key factors in decreasing prevalence in the 2009-2018 period, as measured by the two GATS surveys. Tobacco smoking in the population age 15 and older was estimated at 25 percent in 2009 (GATS 2009). It had fallen to 20.4 percent by early 2018, a nearly 19 percent decrease over the period. The real price of cigarettes rose by 50 percent and the price of RYO tobacco by more than 160 percent between 2009-2018 (Table 4 and Figure 2). The impact of this tax and price increase has been substantial, even considering that there were no tax increases from March 2010 to November 2014. Another factor that limited the impact of tax and price increases was real income growth in the period (discussed below in Section 4.1).

Table 4. Evolution of Tobacco Prices and Adult Smoking Prevalence

	INDEX OF REAL PRICE OF 20-STICK CIGARETTE PACK	INDEX OF REAL PRICE OF 45G RYO TOBACCO PACK	ADULT SMOKING PREVALENCE
2009	73	41	25.0%
2011	87	61	23.9%
2014	86	80	22.2%
2017	100	100	21.6%
2018	109	105	20.4%

Source: Authors, using data from INE, GATS, and household surveys.

4.1 Evolution of Adult Smoking Prevalence and Real Income

Consumption is the result of prevalence and intensity of smoking. In Uruguay, some surveys do not report intensity.³² For this reason, analysis of prevalence and income is presented in Table 5, while Table 6 discusses consumption only at the beginning and end of the 2009-2017 period.

One of the reasons for the slow decrease in prevalence despite important increases in taxes and real tobacco product prices was the parallel increase in real income. Uruguay was recovering from the economic downturn of the early 2000s, and real income grew by about one-third between 2009 and 2017.

³² After INE participated in the GATS survey of 2009, it kept some questions on smoking prevalence in the Household Surveys (Encuesta Nacional de Hogares) of 2011 and 2014. Table 5 uses the same GATS definition of prevalence and the data is comparable. Unfortunately, intensity as measured in smoked cigarettes per day was not included in the Household Surveys, consequently consumption may only be measured in 2009 and 2017.

Given that, over the period, opposing forces affected the demand for cigarettes, there is a need to consider simultaneously the impact of the increase in real prices and the rise in real income. This involves the calculation of an index of affordability of tobacco products. A detailed analysis of affordability is beyond the scope of this chapter. However, a discussion of this important topic is provided in Annex B.

Table 5. Adult Smoking Prevalence and Real Income

YEAR	PREVALENCE	REAL PER CAPITA INCOME (INDEX 2009=100)
2009	25.00%	100
2011	23.90%	116.3
2014	22.20%	129.1
2017	21.60%	135.2

Source: ASource: GATS 2009 and 2017, Household Surveys of INE for 2011 and 2014. Central Bank of Uruguay for real income.

5. Evolution of Legal Sales of Tobacco Products

The retail price of RYO had always been lower than for finished cigarettes, and consumption traditionally was male and low-income. Women, particularly young women, increasingly started smoking RYO after 2002, and many kept smoking it after the economy and personal income and employment improved.

Figure 2. Trends in Legal Sales of Tobacco Products, Uruguay, 1999-2017

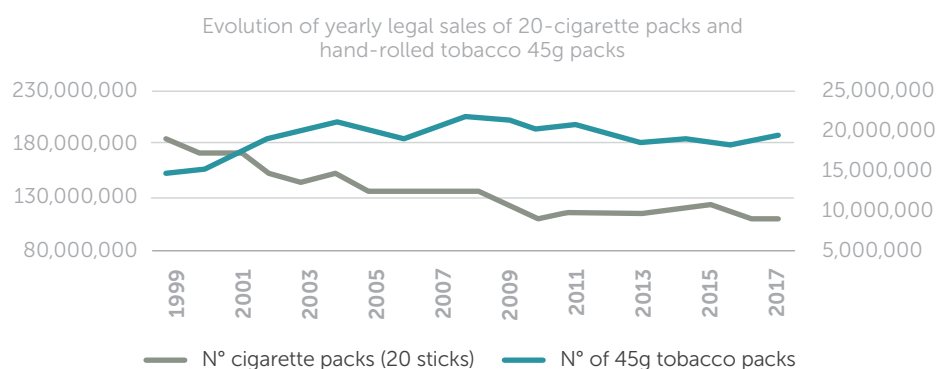


Figure 2 above shows that, after 2010, when there were no tax increases on tobacco products for almost four years, cigarette sales started to grow, but RYO stabilized. After 2015, with the advent of new tobacco-product tax increases, cigarette sales followed a renewed

downward trend, but RYO sales did not. Comparing the average cigarette and RYO sales in 1998-2004 with the 2005-2017 period (Table 6), cigarette sales fell 25 percent, but RYO sales went up 16 percent.

Table 6. Evolution of Legal Sales of Tobacco Products

	N° OF CIGARETTE PACKS (20 STICKS)	N° OF 45G RYO PACKS
Average 1998-2004	165,612,822	16,469,643
Average 2005-2017	124,937,199	19,179,720
% change	-25%	16%

Source: Authors, using data from DGI (tax authority)

6. Tax Legislation and Policy

Uruguay's present tobacco tax regime has been set since 2007, when a comprehensive tax reform was implemented through Law 18.083. (Annex B provides a complete description of successive changes in the country's tobacco excise tax legislation.) Even though cigarettes and RYO are both tobacco products, they have generally received a different tax treatment. The difference in tax rates between the two types of products began during the 1980s. Part of the strategy to fight contraband from Brazil was to keep lower taxes and prices on RYO. This strategy ultimately proved counterproductive, but was maintained for many years.

Early legislation (consolidated through the 1996 Texto Ordenado) had given the Executive Branch authority to set and update the tobacco excise tax base and the rate, stipulating that the base was the retail price or a proxy, and the rate was restricted to a maximum legal rate of 70 percent. Subsequently, the Uruguayan Tax Authority (Dirección General Impositiva, or DGI) and the Ministry of Economy and Finance (MEF) set by Government Decree a proxy for the retail price by means of a multiplier (a unique multiplier for cigarettes and another for RYO) for each brand.

In line with Law 18.803, Decree 232/79 of June 2007 provided a unique value for the tax base of cigarettes (though not yet RYO), which, when multiplied by the tax rate, produced a specific tax amount for all cigarette brands. The tax base is not related to any price. It simply reflects the decision of the Government to move at a certain speed in terms of tax and retail price, given that the tobacco industry normally passes through the tax to retail prices. This tax system continues to operate today, incorporating similar changes to RYO taxation, as well as additional tax rate increases (Annex C).

One of the main features of tobacco excise tax practice in Uruguay from 2001 to the present has been that policy changes were achieved without the need for new legislation, given

the ample authority assigned by Parliament to the Executive Branch. This system continues to function and is a distinctive framework that most countries do not share.

7. Background on Illicit Tobacco Trade in Uruguay

During the early 1980s and the 1990s, illicit cigarette trade from Brazil created a tax revenue problem in Uruguay. Meanwhile, retailers in some Uruguayan cities near the border with Brazil (Rivera, Chuy) were suffering extensive decreases in sales due to Brazil's cheaper prices for a range of goods. Buyers from other parts of Uruguay also travelled to these border cities to purchase goods. There were complaints by retailers (and also by local governments).

The government in power after 1985 passed legislation to strengthen retail trade by means of the creation of "tax-free shops." The preamble to the new legislation mentioned the need to promote economic activity in border towns using a new regional tourism promotion tool.³³ Legally, Uruguayan residents could not buy goods in the new shops. Instead, the tax-free shops fueled illicit cigarette trade. Very quickly, cigarettes of Uruguayan manufacture and some international brands became a key illicit trade item by being diverted from tax-free shops to the local market. Cigarettes intended for sale only to tourists and non-residents were rerouted and ended up in the hands of Uruguayan smokers by means of extensive illegal networks.³⁴

Cheaper prices for the same brands they usually smoked became popular among Uruguay smokers. The size of this illicit trade reached between 10 and 20 percent of the total domestic market.³⁵ In that period (the 1990s), no other major sources of illicit trade in cigarettes existed in Uruguay.

At the beginning of the 2000s, several government decrees were passed to strengthen control of cigarettes (and whisky) taken from free-trade zones to the tax-free shops. Decrees sought to hold every participant in the supply chain accountable and increased the excise tax charged on cigarette sales in duty-free shops. Later, authorities entirely eliminated the excise tax rate differential between cigarettes sold in duty-free shops and those sold legally in the domestic market. At this point, the only tax benefit of buying cigarettes in the special shops was VAT exemption.

In the late 1990s, a major change occurred in the source of illicit cigarettes in Uruguay. In Brazil, the Souza Cruz company (a BAT subsidiary) was accused by independent sources of using a "carousel"³⁶ tax evasion strategy: exporting cigarettes (free of taxes) to Paraguay, then

³³ Decree 222/86 (not available online)

³⁴ Ramos, A. "The illegal trade in tobacco in the Mercosur Countries". *Trends in Organized Crime* 2009;12:267-306. Another link in English: http://www.fctc.org/images/stories/INB-3/INB3_report_illegal_trade_in_MERCOSUR.pdf. A synthesis in: <http://www.fctc.org/media-and-publications-20/fact-sheets/illicit-trade/278-inb3-fact-sheet-illicit-trade-in-mercosur>

³⁵ Source: authors' estimate base on DGI (tax authority).

³⁶ FATF Illicit tobacco trade, 2012. <http://www.fatf-gafi.org/media/fatf/documents/reports/Illicit%20Tobacco%20Trade.pdf>

largely funneling them back into Brazil through illicit distribution channels. The Government of Brazil initially reacted with export bans and later with very high export taxes. Meanwhile, Paraguayan (and Brazilian) manufacturers seized the opportunity and started an enormous illicit cigarette business. Within a few years, manufacturers in Paraguay were producing and selling around 60 billion cigarette sticks per year, using their own brands (brands not sold in the domestic Paraguayan market and not registered as legal exports). Sales went to Brazil and other markets, including Uruguay.

In the last 15 years, illicit cigarettes entering the Uruguayan market are largely manufactured in Paraguay. Tobacco companies in Paraguay may pay the very low domestic tobacco and VAT taxes there, but these brands of cigarettes are not intended for Paraguayan domestic consumption. The products are thus classified as “illicit whites,” or “cheap whites,” cigarettes that have been described as manufactured by legitimate business enterprises in a given jurisdiction but sold usually outside the jurisdiction where they are produced, without payment of duties and taxes in the destination country.³⁷

Today, Paraguayan illicit whites destined for Uruguay are mostly transported by ground routes and brought into Uruguay after unloading in warehouses in the Uruguayan-Brazilian border zone. Small trucks are generally used to smuggle the products into Uruguay. Most cigarette cargo seizures are reported along Uruguay’s National Routes, with smugglers often making several trips from the Brazilian border to Montevideo (350-500 km, depending on the specific border town).

Cigarettes are also being brought by small boats through the River Uruguay bordering Argentina, or using the bridge that links Salto (Uruguay) to Concordia (Argentina). Corrupt customs officers may facilitate this traffic in some cases. The Uruguayan Customs Authority (DNA) has initiated prosecutions to tackle such corruption.³⁸

8. Estimates of Illicit Trade

There are several approaches to measuring the illicit cigarette trade in a country.³⁹ The method used in this report takes advantage of the recent GATS 2017 survey, which included questions on cigarette brands smoked. This information provided a clear indication on illicit brands, since the total number of legal brands in Uruguay is small, and the illicit brands (Paraguayan) are very well known.⁴⁰

³⁷ Hana Ross et al. A closer look at ‘Cheap White’ cigarettes. <https://tobaccocontrol.bmj.com/content/early/2015/09/28/tobaccocontrol-2015-052540>

³⁸ Illicit trade via containers “in-transit” through the port of Montevideo was not cited as a problem in our interviews with judges, prosecutors, and DNA authorities, and there are no recorded seizures from this setting. On the other hand, the DNA only occasionally inspects transit containers: for example, when it has received specific alerts from other Customs agencies, when suspicious documentation is received, or when owners’ background appears to warrant special action.

³⁹ Ross, Hana. Understanding and Measuring Illicit tobacco trade. A methodological guide. *Tobacconomics* 2015. https://tobacconomics.org/wp-content/uploads/2015/03/Ross_Methods_to_Measure_Illicit-Trade_03-17-15.pdf

⁴⁰ By law, brands must register with the Ministry of Health. If registration is not updated yearly, then the brands become illegal.

In 2009, the size of the illicit cigarette market in Uruguay was estimated through that year's GATS at around 12 percent of cigarettes smoked. About 8.5 percent of smokers bought illicit cigarettes. The results of the new survey in 2017 were similar in terms of the proportion of smokers acknowledging consumption of illicit brands (7.8 percent) (Table 7).

The results summarized in Table 7 use microdata from GATS 2009 and 2017 on population, prevalence, and intensity of cigarette smoking.⁴¹ (There is currently no evidence concerning illicit RYO trade.)

Illicit cigarettes have been entering Uruguay from Paraguay. The brands involved (in fact, mainly one single brand, Eco), are perfectly identifiable. They belong to TABESA (the largest tobacco company in Paraguay). The brands that reach Uruguay are not sold in the Paraguayan market, and there are no legal cigarette exports from Paraguay to Uruguay (or most places). Thus, cigarettes of Paraguayan origin found in Uruguay are illicit goods by definition.

In Uruguay, there currently appear to be no illicit brands that originate from sources other than the Paraguayan connection. PMI and BAT in Uruguay import legally from Argentina; together they have a market share of around 15-20 percent. The company Montepaz S.A., Uruguay's only domestic tobacco manufacturer, holds the rest of the market (80 percent-85 percent).⁴² The Uruguayan market includes only a few legal brands. The two bestselling brands from Montepaz together comprise around 65-70 percent of the country's total legal cigarette market.

In Table 7, the population size is defined as in the two surveys, that is, people aged 15 and older. Prevalence is the number of smokers of cigarettes (daily and non-daily) over total population aged 15 and over. The number of smokers includes those who smoke only manufactured cigarettes and those who smoke both manufactured cigarettes and RYO. Intensity of smoking is measured as the average number of cigarettes smoked daily per smoker. In the case of smokers of both products, only the number of manufactured cigarettes was included.

YEARLY TOTAL CONSUMPTION OF CIGARETTES=INTENSITY X NUMBER OF SMOKERS X 365

Total consumption includes both legal and illicit cigarettes. From the prevalence data on of smokers of illicit brands, their number was calculated. The GATS data also provide the intensity of cigarette smoking in the total calculation. Finally, the number of illicit cigarettes smoked

⁴¹ For the analysis of microdata, the authors gratefully acknowledge the assistance of Alejandra Clemente (for GATS 2009) and Dr. Martin Gonzalez Rozada (for GATS 2017), both from the University Di Tella, Buenos Aires, Argentina. The GATS 2009 Report did not include data on illicit brands, and the GATS 2017 Report is still pending as of July 2018.

⁴² Source: Euromonitor International.

Table 7. Estimate of Illicit Trade in Cigarettes, Uruguay, 2009 and 2017

	2009	2017
Population aged 15 and older	2,580,349	2,762,798
Prevalence of total smokers (daily and non-daily) of manufactured cigarettes	20.58%	18.30%
N° of smokers of manufactured cigarettes (includes cigarette smokers who also smoke RYO)	531,036	505,592
Average intensity of smoking among daily and non-daily smokers of manufactured cigarettes	10.85	11.61
Yearly total consumption of cigarettes (number of sticks)	2,103,305,982	2,142,522,083
% of smokers of illicit brands/total population 15+	8.50%	7.77%
N° of daily smokers of illicit brands	45,138	39,285
Intensity of smoking illicit brands of cigarettes, all smokers	15.3	17.65
Yearly illicit consumption of cigarettes, all smokers (number of sticks)	252,073,413	253,080,577
Illicit trade as % of total cigarettes smoked	11.98%	11.81%

Source: Authors, using data from GATS 2009 and 2017

yearly was calculated, and the ratio with the previously calculated total yearly consumption provides estimates of the percentage of illicit cigarettes in the market in both years.

Findings:

As seen earlier, total prevalence of cigarette smoking has decreased 11 percent (18.30/20.58-1= -11 percent) in the 2009-2017 period and the number of cigarette smokers has also dropped by 5 percent (505.592/531.036-1= -5 percent). However, intensity increased in the period by 7 percent (11.61/10.85-1=7 percent). The resulting total yearly cigarette consumption remained almost unchanged.

Smokers of illicit cigarettes (measured by brand, as previously explained) were 7.7 percent in 2017 versus 8.5 percent in 2009, for a decline of 8.6 percent. However, the intensity of smoking increased 15.4 percent (17.62/15.3-1= 15.4 percent). This seems plausible, since remaining smokers are more addicted. Finally, the numbers of illicit sticks smoked in 2009 and 2017 are roughly the same, and the estimate of the illicit cigarette trade close to 12 percent in both years.

The conclusion is that the illicit market has not shown substantive changes in the period. Possibly, the decrease in the number of smokers who smoke illicit brands is compensated by the higher intensity of those who do not abandon smoking, the total illicit market remaining about the same.

Table 7 shows that the total number of smokers of illicit brands was 7.8 percent in this survey, and that they smoked a daily average of 17.65 cigarettes. Intensity was lower in 2009 (15.3 cigarettes). This might indicate that some of the heavy smokers who do not abandon tobacco are more inclined to switch to illicit brands of cigarettes.

In GATS 2009, the percentage of smokers of illicit brands was estimated at 8.5 percent of total cigarette smokers, accounting for 12 percent of the total cigarettes smoked. Given that the affordability of the legal market of tobacco products has not changed much in the 2009-2017 period, the size of the illicit market has seemingly not varied greatly. This could suggest that, even when legal cigarettes became more affordable, between 2010 and 2014 (See Annex B), the market for illicit cigarettes did not decrease. It seems, then, that this market could be stable.⁴³

To shed some light on the period of increased affordability, there is information from another survey taken during 2011-2012. The International Tobacco Control Policy Evaluation Project (ITC) has been performing a longitudinal study of smokers in Uruguay since 2006,⁴⁴ with a new wave every two years. Wave 3 in 2011-12 introduced a question regarding the health warnings included on the cigarette pack, to check for possible illicit brands (defined as those that did not show the standard warning).

As shown in Table 8, an estimated 13.1 percent of cigarette packs were not properly labelled with the health warnings that were standard at the time in Uruguay. The authors concluded that this could point at tax avoidance/evasion. These results are also consistent with those discussed above in relation to the size of the illicit cigarette market (Table 7).

Table 8. An Illicit-Trade Estimate Derived Through Improper Labelling of Cigarettes, 2010-2011

PROPERLY LABELED PACKS WITH HEALTH WARNINGS	NON-STANDARD LABELS	NO WARNING LABEL
86.90%	6.50%	6.60%

Source: ITC Uruguay Project. Figure 31. Percentage of smokers' cigarette packs showing evidence of possible tax avoidance/evasion, Wave 3 (2010-11).

Illicit trade, RYO, and Poverty

The GATS 2009 in Uruguay showed that poor smokers are those most likely to turn to illicit brands (Table 9). Smokers in the poorest third of the population are much more likely to smoke illicit cigarettes [$3.56 / (18.29 + 3.56) = 16$ percent] than are those in the middle tercile (7 percent), while among smokers belonging to the richest third of the population, practically

⁴³ This issue requires additional research.

⁴⁴ The International Tobacco Control Policy Evaluation Project ITC Uruguay National Report Findings From the Wave 1 to 3 surveys (2006-2011) August 2012

none (0.13 percent) reported smoking illicit brands. Table 9 shows that poor people’s strategy was, when continuing smoking, to buy relatively more illicit cigarettes and RYO than legal cigarettes, as compared with wealthier groups.⁴⁵ In light of these findings, illicit tobacco trade control in Uruguay takes on added priority, since the burden of health consequences falls predominantly on the poor. This is a substantial health equity problem.

Table 9. Prevalence of Smokers by Tercile of Wealth (2009)

TERCILE	CIGARETTES		RYO ONLY
	LEGAL	NOT LEGAL	
1 (Wealthiest)	18,33%	0,13%	0,55%
2 (Middle)	21,12%	1,70%	1,89%
3 (Poorer)	18,29%	3,56%	7,76%

Source: Authors, using GATS 2009 data.

9. Illicit Trade Control Legislation

9.1 Background

Article 15 of the FCTC, which Uruguay ratified in 2004 and is part of the country’s national legislation since then, has not yet brought substantial changes in the rules and controls applied to illicit tobacco trade. In 2014, Uruguay ratified the Protocol, but except for the creation of the Interagency Commission to eliminate illicit tobacco trade (See Annex D on illicit trade legislation), there have been no advances of significance following that ratification.

Article 15 of the FCTC⁴⁶ states that illicit tobacco trade includes “smuggling, illicit manufacturing, and counterfeiting.” There is as yet no specific legislation in Uruguay to deal with the illicit tobacco trade as such. Customs and penal legislation and regulations have not yet been affected by the country’s international commitments.

Legislation on smuggling in general has long existed in Uruguay, but very few regulations apply specifically to tobacco products. The recent Customs Code (2015) and Criminal Procedures Code (applicable since November 2017) have not addressed tobacco as a specific concern, and smuggling is still generally treated using the traditional approach emphasizing fiscal revenue loss. Illicit trade control legislation deals mostly with contraband in general terms and does not distinguish tobacco products from other types of goods. Only weapons, narcotics, and medicines have their own special crime legislation in Uruguay.

⁴⁵ Unfortunately, comparable results for 2017 were not available for this report.

⁴⁶ Cf. Protocol Part IV, “Measures Relating to the Reduction of the Supply of Tobacco,” as well as FCTC Article 15, “Illicit Trade in Tobacco Products.”

Previously, Law 18.256, the Tobacco Control Act of 2008, included a provision that the Executive Branch should ensure the availability of necessary human and material resources to proceed to the elimination of all forms of illicit tobacco trade. Since it formulated a country-wide responsibility bestowed on the Executive, this law was never accompanied by a Decree regulating it. Such a Decree might, for example, have prescribed actions for the MEF and its agencies, particularly the DNA, as well as law enforcement. The legislation has a wide reach, including all customs special primary territories (such as free-trade zones, economic special zones, and free ports that do not have specific exemptions from customs surveillance). The law applies to all types of transportation and storage.

Main relevant features of Uruguay's illicit tobacco trade legislation include the following (See also Annex D).

- » Customs law in Uruguay, as in other countries, exists for the main purpose of facilitating and protecting legal trade operations, and it encompasses the smuggling of many types of products. There is no specific, systematic approach to dealing with illicit tobacco trade or even contraband in tobacco products.
- » The law stipulates fines and other penalties and mandatory referral to criminal courts, when illicit cargo reaches a defined value. The law's principal objective is historically to protect fiscal revenue from the loss of import duties and other applicable taxes.
- » DNA has no customs police functions, and customs officers cannot carry weapons.
- » DNA has preeminence in illicit trade control in Uruguay's primary customs territory (almost the whole national territory). The law allows DNA to request assistance from other state agencies and law enforcement (Police, Coast Guard), when needed.
- » The Customs Code and the Penal Code treat the crime of tobacco smuggling in different ways, but the approach is mainly that of a misdemeanor, and violators receive penalties accordingly (fines, confiscation of vehicles, etc.).
- » In March 2015, the new Customs Code came into effect, systematizing and unifying the various laws and previously approved regulations that apply across the entire Uruguayan territory, including free zones. All customs offenses are incorporated. The crime of contraband is maintained, and customs fraud is added as a new crime. Penalties do not increase but "aggravating circumstances" are included (Articles 258 and 260), such as a contraband committed by three or more people (meaning an organization), several similar crimes committed by the same offenders (recidivism), or smuggling goods whose value is over UI 5 million (UI are indexed units, presently UI 5 million is over US\$ 600,000). Interestingly, Article 260 Paragraph D establishes that, "When the goods of the contraband are weapons, ammunition, narcotics, or any substance potentially affecting peace or public health," the minimum penalty is mandated to be from two to six years of prison time. Even though tobacco products are not included as such, a relatively minor legal clarification to

explicitly include tobacco products among goods that threaten public health could make a difference in the criminalization of the illicit tobacco trade, in line with the Protocol.

- » There is no compliance with Article 12 of the Protocol. Even when DNA has the legal authority, traditionally "in-transit" goods are not inspected, given the judicial interpretation of the legal status of such a policy.

Other features of the legislation are discussed in detail in Annex D.

9.2 Cigarette Markings and Track-And-Trace Options

FCTC Article 15 established in its heading that each country "shall adopt and implement legislative, executive, administrative or other effective measures to make all packages or packaging of tobacco products and any external packaging of such products bear an indication to help the parties determine the origin of tobacco products." However, Uruguay has not complied with these provisions. The country has not established any markings or tracing mechanism for tobacco packs or boxes, such as a stamp, whether affixed or not. Only cigarettes to be sold in tax-free and duty-free shops are mandated to be marked with a legend authorizing "sale only" in those premises.

Given that the Paraguayan factory that produces the illicit cigarettes that reach Uruguay is very well known and it does not export any legal cigarettes to Uruguay, a traceability system would not have any effect on the present "illicit white" type of illicit trade.^{47 48} However, a traceability system in place would increase controls on the existing tobacco companies that manufacture tobacco products in Uruguay (Montepaz S.A) or import them legally (BAT and PMI affiliates), and on any other legal tobacco company in the future, by limiting their potential to divert non-duty or untaxed tobacco into the domestic Uruguayan market. We note, however, that this maneuver has not as yet been documented in Uruguay by DGI and DNA or other law enforcement agencies.

10. Lessons Learned

In Uruguay, the tax share in the retail price of cigarettes and RYO has yet to match the recommendations established by WHO⁴⁹ and anchored in the Guidelines for Implementation of Article 6 of the FCTC. These norms stipulate that excise taxes should constitute at least 70

⁴⁷ Brazil has the same "illicit white" cigarette problem as Uruguay, but on a larger scale. A traceability system for cigarettes (and alcoholic beverages) in operation in Brazil since 2007 has not stemmed the inflow of illicit cigarettes from Paraguay. In fact, evidence suggests that illicit trade represents a much larger share of the total cigarette market in Brazil than in Uruguay. See Szcklo A et al. Trends in Illicit Cigarette Use in Brazil Estimated from Legal Sales, 2012–2016. <https://ajph.aphapublications.org/doi/10.2105/AJPH.2017.304117>

⁴⁸ The Paraguayan "illicit white" cigarette trade has similarities with the European Union experience with cigarettes from Belarus and other Eastern countries. See for instance: <https://www.euractiv.com/section/trade-society/news/minsk-under-pressure-to-take-action-against-illicit-whites/>

⁴⁹ WHO Tobacco Tax Administration Manual. WHO, 2011.

percent of sales price.⁵⁰ However, while its total tax share is below this target, Uruguay has one of the highest retail cigarette prices in the region, as confirmed in the most recent WHO Global Tobacco Control Report (GTCR VII, released in July 2016).⁵¹ The increase in affordability of tobacco products over the period 2010-2014 is quite inconsistent with the World Bank recommendation to raise tobacco taxes substantially: "Go big, go fast," and "attack affordability."⁵²

The increase in taxes and prices has produced an increase in Uruguay's total fiscal revenue during recent years (when the revenue from VAT since 2007 is included). This underscores that, as in most other countries, there is a double beneficial impact of tobacco tax and price increases. They reduce consumption and raise fiscal revenue. Nevertheless, economic authorities have not been in the frontline to raise taxes, and a whole-of-government approach to tobacco taxation and illicit trade control has not yet emerged.

Tobacco control policies, and particularly tax policies, are undermined by illicit trade. Uruguay has not passed legislation to focus on illicit tobacco trade or introduce more stringent penalties. Existing penal legislation sentences in customs and criminal courts tend to involve no jail time (illicit tobacco violations are essentially treated as misdemeanors). This contradicts a key provision of the Protocol.

The illicit tobacco trade is mostly fragmented through multiple small shipments to evade prison sentences if caught. Organized crime is not usually targeted via law enforcement on tobacco, even though illicit tobacco trade involves a substantial fiscal revenue loss and a serious health problem for Uruguay. The criminal courts and the General Prosecutor's office have not yet aligned their practices to deal with criminal groups involved in illicit tobacco trade and do not view this as a priority. Investigations are conducted by the economic section of the General Prosecutor's Office and do not usually end in criminal prosecution. The Customs Court has the approach that goods "in transit" need not be controlled, since they involve no fiscal revenue loss for Uruguay.

The tobacco industry and its proxies will continue to fight back against increases in tobacco taxes, but this strategy has lost force in view of companies' pricing policies since Uruguay's modern tobacco control tax policy began in 2005. The tobacco industry has tried to interfere with tobacco control policy in various ways, and with tax policy in particular.

- » Every time there has been an increase in taxes on cigarettes, industry spokespeople have launched press releases⁵³ and presentations in the media warning about a purported imminent increase in smuggling. Meanwhile, despite its concerns about higher taxes made public through the media, the tobacco industry has seized the opportunity of tax hikes to raise prices above the level of pass-through of the tax.

⁵⁰ WHO-FCTC Article 6 Guidelines. Available at: http://www.who.int/fctc/treaty_instruments/Guidelines_article_6.pdf

⁵¹ GTCR 2016

⁵² *Tobacco Tax Reform: At the Intersection of Health and Development*, World Bank, 2017.

⁵³ See for example: <https://www.elobservador.com.uy/consumo-tabaco-formal-crecio-pero-el-contrabando-gana-terreno-n271171>

- » In the period from March 2010 to December 2014, when no tax changes occurred, the tobacco industry also increased its profits per unit by raising product prices. The consequences of such aggressive pricing policies included a decrease in the tax share of cigarette retail prices.
- » The small retailers' association attempts to use the same arguments as the tobacco industry against Uruguay's tobacco tax policy.⁵⁴
- » Surveys and studies sponsored by the industry systematically report much higher levels of illicit cigarettes than independent, scientifically sound surveys. The industry's studies are not normally made public, but the results are disseminated in the media.

A whole-of-government approach to tobacco tax increases (and tobacco control generally) is lacking. During the period 2010 to 2014, the MEF was particularly concerned with tax hikes' potential impact on inflation. In Uruguay, the weight of cigarettes and RYO within the CPI is substantial. Prosecution and judicial decisions also signal a lack of whole-of-government integration in dealing with illicit tobacco trade.

11. The Road Ahead

Uruguay has taken steps to address its declining but still unacceptable smoking prevalence among men and the stagnant rate among women. An important policy issue is whether the country should be making more aggressive use of tax policy. The issue is urgent because, as we have shown, poorer citizens and women have not yet garnered the full benefits of tobacco tax hikes. Among other strategies, maximizing such benefits will require confronting the illicit tobacco trade.

There are several potential legal changes to deal more effectively with illicit tobacco. An ideal scenario would involve a new, tailored piece of legislation addressing all illicit trade control (contraband, counterfeit, and illicit manufacturing) in line with the Protocol.

Uruguay and the Implementation of the Protocol to Eliminate Illicit Trade of Tobacco Products

Uruguay's ratification of the Protocol in 2015 led to the creation of an Inter-Agency Commission for the Implementation of the Protocol.⁵⁵

Through periodic meetings, the different sectors of government have received information and exchanged views on the illicit tobacco trade and the best way to solve the problem. The

⁵⁴ <http://www.montevideo.com.uy/Noticias/Asociacion-de-Kioscos-del-Uruguay-ve-suba-del-precio-de-cigarrillos-como-campana-para-recaudar-uc297507>

⁵⁵ The Commission comprises a delegate from the MOH (who serves as chair), along with representatives of the Ministries of Foreign Affairs, Economics and Finance, Homeland Security (Interior), Defense, Agriculture, Industry, and Education. The Commission also includes representatives of the tax authority, DNA, and the judiciary. Two delegates represent non-governmental organizations.

Commission has received private suppliers dealing with track-and-trace technology. It has also collected information from national experts from countries with tracking and tracing systems currently in place.

The Inter-Agency Commission for the Implementation of the Protocol has also conducted analysis of current legislation and the changes that are necessary to make it more robust. One example is a draft law for establishing licensing, as set out in the Protocol. This would address the supply chain of tobacco products including manufacturing, distribution, and marketing equipment.

MERCOSUR as a Potential Lever

Among MERCOSUR countries, Paraguay is an FCTC Party, but is not expected to ratify the Protocol in the near future. Argentina would be interested in better control of illicit tobacco trade, even though it is not a Party to the FCTC. Brazil is also one of the countries in the region most affected by illicit tobacco and would be an important partner. For each Party, even those that have themselves ratified the relevant accords, it is important that the other countries in the region also ratify and implement the Protocol. Important features of the Protocol refer to the exchange of information on law enforcement, technical assistance and cooperation, training, research, and prosecution of infringements, along with reciprocal administrative assistance, reciprocal legal assistance, and extradition.⁵⁶

The drive to ratify the Protocol will surely be one of the most important issues on the agenda of MERCOSUR's Inter-Governmental Commission for Tobacco Control (CICT), in order to produce the results that government authorities are expecting in the immediate future.

When Uruguay ratified the FCTC in 2004, it acquired obligations but also support to apply the policy measures contained in the agreement. This has been fundamental in the evolution of tobacco control in the country. The text of the treaty served as the basis for the 2008 Tobacco Control Act that gave the necessary legal foundation to tobacco control policy in Uruguay. Now, with the entry into force of the Protocol, there is once again an opportunity to advance comprehensive approaches and implement needed tax and legislative changes. The country may be poised to make fresh advances towards the goal of eliminating the illicit trade in tobacco products.

12. Final Suggestions and Recommendations

- » Priority should be given to illicit tobacco trade by the Prosecutor's Office. Criminal procedures are currently placed within the "economic crime" unit and do not constitute a priority. Appropriate changes will require additional resources for the Prosecutor's Office, including a larger and more specialized staff. A percentage of tobacco fiscal revenue could be earmarked and directed to this objective.

⁵⁶ Part V of the Protocol to Eliminate the Illicit Trade in Tobacco Products.

- » DNA has all the tools and connections to coordinate relevant transport surveillance at the regional level with neighboring and other countries. However, there may be a need for a political perspective on these activities, with governments agreeing to cooperate and promote a higher level of tobacco control efforts in the region.
- » Uruguay has the opportunity to develop a long-term fiscal policy for tobacco products, thanks to the IMESI tax legislation endowing the Executive Branch with a wide mandate to set the tobacco tax base. This is unusual, since in most other countries, legislation fixes the tax base and rate, and changes require a new law.
- » A system for tracking and tracing tobacco products should be established, even though presently the bulk of illicit trade comes from illicit manufacturing (Paraguayan illicit whites). Uruguay as a ratifying Party to the Protocol will have to comply with Article 8 and acquire a traceability system within the next five years. This will be part of a regional and global effort to improve control and share information, and as such a key policy.
- » The situation of the illicit whites entering from Paraguay should receive attention and become a MERCOSUR priority. Without a political focus, the solution to this form of illicit tobacco trade will prove extremely difficult. The Brazilian and Uruguayan experiences offer an example to consider, as does the European Union's experience with the illicit cigarette trade from Belarus.⁵⁷
- » A full risk analysis of illicit trade in Uruguay should be undertaken to evaluate the strengths and weakness of DNA and other participating agencies, as well as the key legislation that requires modification. Changes may include provisions for greater coordination and sharing of information among agencies including law enforcement and others, with the designation of a focal point to gather data and lead the new policy. Overall, changes will aim at a more efficient illicit tobacco control policy.

The main areas where changes in legislation would be required are as follows:

- » New legislation on licensing and due diligence regarding the supply chain of tobacco products. This would allow for better control of tobacco companies, importers, distributors, and retailers. At present, surveys show that many formal retailers sell both legal and illicit cigarettes.
- » Better legislation is needed for criminalization of illicit tobacco trade and to ensure appropriate sanctions against perpetrators, in line with the Protocol. This could be done in several ways, such as changes in legislation to penalize tobacco smuggling and other forms of illicit tobacco trade. Legislative changes could be similar to those in place for intellectual property rights and counterfeit, or the illicit trade of weapons and narcotics. This would allow seizures of illicit tobacco cargo by DNA and other law enforcement agencies to be submitted directly to criminal courts without first being submitted to the Customs Court.

⁵⁷ <https://www.euractiv.com/section/trade-society/news/minsk-under-pressure-to-take-action-against-illicit-whites>

- » There is a clear need for a whole-of-government approach to deal with illicit cigarette trade in Uruguay. The Inter-Agency Commission created to deal with the implementation of the Protocol could be upgraded and given more coordinating capabilities with participating agencies, in addition to its present mainly advisory role. With new legislation, agencies could in turn receive a mandate to prioritize illicit tobacco trade, since the country will have ratified a Protocol that has entered the stage of full implementation.

Annexes

ANNEX A – Calculations on the Evolution of Retail Prices, Taxes, and Tax Share of Tobacco Products.

Table A1. Uruguay: Evolution of tax and retail price of best selling brand of manufactured cigarettes (in current UR\$ and %)

	APR-04	DEC-04	MAY-05	NOV-06	JUN-07	JUN-09	MAR-10	NOV-11	JUN-14	DEC-14	JUN-15	FEB-16	DEC-16	DEC-17
wholesale price	5,22	5,60	5,50	6,17	6,8	6,80	6,80	9,15	11,0	12,3	14,5	16,9	18,5	20,7
tobacco tax (IMESI)	16,48	17,68	20,79	23,32	21,50	28,00	38,00	38,00	38,00	41,10	45,21	52,22	60,05	67,26
COFIS (VAT after 29 June 2007)	0,68	0,73	0,80	0,93	7,72	9,45	12,01	12,87	13,38	14,59	16,30	18,88	21,45	24,02
distribution margin	1,4	1,5	1,4	1,9	2,3	2,8	3,0	3,8	3,9	4,3	4,8	5,5	6,3	7,0
retail margin	4,2	4,5	4,5	5,7	6,8	8,3	10,2	11,3	11,7	12,8	14,3	16,5	18,8	21,0
TOTAL RETAIL PRICE	28,0	30,0	33,0	38,0	45,0	55	70,0	75,0	78,0	85,0	95,0	110,0	125,0	140,0
Tobacco tax/retail price	58,9%	58,9%	63,0%	61,4%	47,8%	50,8%	54,3%	50,7%	48,7%	48,3%	47,6%	47,5%	48,0%	48,0%
Overall tax burden	61,3%	61,4%	65,4%	63,8%	64,9%	68,0%	71,5%	67,8%	65,9%	65,5%	64,8%	64,6%	65,2%	65,2%
Nominal tobacco tax rate	68,5%	68,5%	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%	70%
tax coefficient	4,61	4,61	5,4	5,4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Tax base (wholesale price x multiplier)	24,06	25,82	29,70	33,32	30,72	40	54,29	54,29	54,29	58,71	64,59	74,6	85,79	96,08

Note: The tax base was calculated as a multiplier set periodically by decree multiplied by the wholesale price of each brand before June 2007. Afterwards it was fixed value in UR\$, unique for all brands, COFIS was a general consumption tax levied on all goods and services since 2003, in addition to VAT. Tobacco VAT rate was zero until the Tax Reform of 2007.

Table A2. Evolution of tax and retail price per 20 cigarette pack in constant UR\$ of December 2017

	RETAIL PRICE	IMESI	VAT (OR COFIS)	TOBACCO WHOLESALE, DISTRIBUTION AND RETAIL
Apr-04	76,1	44,8	1,9	29,5
Dec-04	79,4	46,8	1,9	30,7
May-05	85,9	54,1	2,1	29,7
Dec-06	89,0	54,6	2,2	32,2
Jul-07	100,7	48,1	17,3	35,3
Jun-09	106,6	54,2	18,3	34,1
Mar-10	129,5	70,3	22,2	37,0
Nov-11	122,6	62,1	21,0	39,4
Jun-14	103,0	50,2	17,7	35,1
Dec-14	107,6	52,0	18,5	37,1
Jun-15	115,0	54,7	19,7	40,5
Feb-16	125,0	59,3	21,5	44,2
Dec-16	133,3	64,0	22,9	46,4
Dec-17	140,0	67,3	24,0	48,7

Source: Author with data from Table A1.

Table A3. Evolution of manufactured cigarettes retail prices, taxes and tobacco industry shares in current and in constant December 2017 prices

	RETAIL PRICE RYO IN UR\$	IMESI TAX PER 20 CIGARETTE PACK	TAX SHARE INCLUDING VAT IN UR\$	IMESI SHARE OF RETAIL PRICE, %	TOTAL TAX SHARE (IMESI + VAT) OF RETAIL PRICE, %	TOBACCO INDUSTRY AND RETAIL SHARE, %	CPI BASE JANUARY 2017 = 100	RETAIL PRICE CIGARETTES IN CONSTANT UR\$	TOTAL TAXES (IMESI+VAT) IN DECEMBER 2017 UR\$	TOBACCO INDUSTRY AND RETAIL SHARE IN CONSTANT UR\$
Apr-04	28,0	16,48	17,2	58,9%	61,3%	38,7%	36,8	76,1	46,7	29,5
Dec-04	30,0	17,68	18,4	58,9%	61,4%	38,6%	37,8	79,4	48,8	30,7
May-05	33,0	20,79	21,6	63,0%	65,4	34,6%	38,4	85,9	56,2	29,7
Dec-06	38,0	23,32	24,2	61,4%	63,8%	36,2%	42,7	89,0	56,7	32,2
Jul-07	45,0	21,50	29,2	47,8%	64,9%	35,1%	44,7	100,7	65,4	35,3
Jun-09	55	28,00	37,5	50,8%	68,0%	32,0%	51,7	106,6	72,5	34,1
Mar-10	70,0	38,00	50,0	54,3%	71,5%	28,6%	54,1	129,5	92,5	37,0
Nov-11	75,0	38,00	50,9	50,7%	67,8%	32,2%	61,2%	122,6	83,2	39,4
Jun-14	78,0	38,00	51,4	48,7%	65,9%	34,1%	75,8	103,0	67,8	35,1
Dec-14	85,0	41,10	55,7	48,3%	65,5%	34,5%	79,0	107,6	70,5	37,1
Jun-15	95,0	45,21	61,5	47,6%	64,8%	35,2%	82,6	115,0	74,5	40,5
Feb-16	110,0	52,22	71,1	47,5%	64,6%	35,4%	88,0	125,0	80,8	44,2
Dec-16	125,0	60,05	81,5	48,0%	65,2%	34,8%	93,8	133,3	86,9	46,4
Dec-17	140,0	67,26	91,3	48,0%	65,2%	34,8%	100,0	140,0	91,3	48,7

Source: Author's calculations based on Table A1, INE for the CPI and market prices

TABLE A4. Uruguay: Evolution of Tax and Retail Price for the Best-Selling Brand of Roll-Your-Own Tobacco (RYO)

	APR-04	DEC-04	MAY-05	NOV-06	JUN-07	JUN-09	MAR-10	NOV-11	JUN-14	DEC-14	JUN-15	FEB-16	DEC-16	DEC-17
wholesale price	11,99	12,99	13,04	16,02	18,98	25,03	39,97	42,01	45,03	47,06	55,02	60,01	69,96	79,99
tobacco tax (IMESI)	6,6	7,15	6,8	8,35	7,6	7,95	8,10	9,40	11,30	11,30	14,45	14,45	17,20	20,30
COFIS (VAT after 29 June 2007)	2,69	2,92	3,31	4,07	4,32	7,79	17,00	17,00	17,00	18,30	20,13	23,26	26,75	29,96
distribution margin	0,30	0,33	0,33	0,40	3,26	4,29	6,86	7,21	7,72	8,07	9,44	10,30	12,01	13,73
retail margin	0,6	0,65	0,65	0,80	0,95	1,25	2,00	2,10	2,25	2,35	2,75	3,00	3,50	4,00
	1,8	1,95	1,95	2,4	2,85	3,75	6	6,3	6,75	7,05	8,25	9	10,5	12
TOTAL RETAIL PRICE	12	13	13	16	19	25	40	42	45,00	47	55	60	70	80
Tobacco tax/retail price	22,9%	22,9%	27,4%	26,6%	22,4%	31,6%	42,5%	40,5%	37,8%	38,9%	36,6%	38,8%	38,2%	37,5%
Overall tax burden	25,3%	25,3%	29,9%	29,0%	40,4%	49,7%	60,5%	58,5%	55,8%	57,0%	54,6%	56,8%	56,2%	55,5%
Nominal tobacco tax rate	27%	27%	28%	28%	29%	50%	70%	70%	70%	70%	70%	70%	70%	70%
Tax base	9,97	10,80	11,83	14,53	14,90	15,58	24,29	24,29	24,29	26,14	28,76	33,23	38,21	42,80

Source: Author with data from DGI and markets.

Table A5. Evolution of RYO retail prices, taxes and tobacco industry shares in current and in constant December 2017 prices

	RETAIL PRICE RYO IN UR\$	IMESI TAX PER 20 CIGARETTE PACK	TAX SHARE INCLUDING VAT IN UR\$	IMESI SHARE OF RETAIL PRICE, %	TOTAL TAX SHARE (IMESI + VAT) OF RETAIL PRICE, %	TOBACCO INDUSTRY AND RETAIL SHARE, %	CPI BASE JANUARY 2017 = 100	RETAIL PRICE CIGARETTES IN CONSTANT UR\$	TOTAL TAXES (IMESI+VAT) IN DECEMBER 2017 UR\$	TOBACCO INDUSTRY AND RETAIL SHARE IN CONSTANT UR\$
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)
Apr-04	12	2,7	3,0	22,4%	24,9%	75,1%	36,8	32,6	8,1	24,5
Dec-04	13	2,9	3,2	22,4%	24,9%	75,1%	37,8	34,4	8,6	25,8
May-05	13	3,3	3,6	25,5%	28,0%	72,0%	38,4	33,8	9,5	24,4
Dec-06	16	4,1	4,5	25,4%	27,9%	72,1%	42,7	37,4	10,5	27,0
Jul-07	19	4,3	7,6	22,7%	39,9%	60,1%	44,7	42,5	17,0	25,6
Jun-09	25	7,8	12,1	31,2%	48,3%	51,7%	51,7	48,4	23,4	25,0
Mar-10	40	17,0	23,9	42,5%	59,7%	40,3%	54,1	74,0	44,1	29,8
Nov-11	42	17,0	24,2	40,5%	57,6%	42,4%	61,2	68,7	39,6	29,1
Jun-14	45	17,0	24,7	37,8%	54,9%	45,1%	75,8	59,4	32,6	26,8
Dec-14	47	18,3	26,4	38,9%	56,1%	43,9%	79,0	59,5	33,4	26,1
Jun-15	55	20,1	29,6	36,6%	53,8%	46,2%	82,6	66,6	35,8	30,8
Feb-16	60	23,3	33,6	38,8%	55,9%	44,1%	88,0	68,2	38,1	30,1
Dec-16	70	26,7	38,8	38,2%	55,4%	44,6%	93,8	74,7	41,3	33,3
Dec-17	80	30,0	43,7	37,5%	54,6%	45,5%	100,0	80,0	43,7	36,3

Source: Author's calculations based on Table A5, INE and market prices

Annex B: Affordability of Cigarettes and RYO in Uruguay⁵⁸

» A measure commonly used to define affordability⁵⁹ is the relative income price (RIP), which measures the percentage of real income (a proxy is GDP per capita) needed to

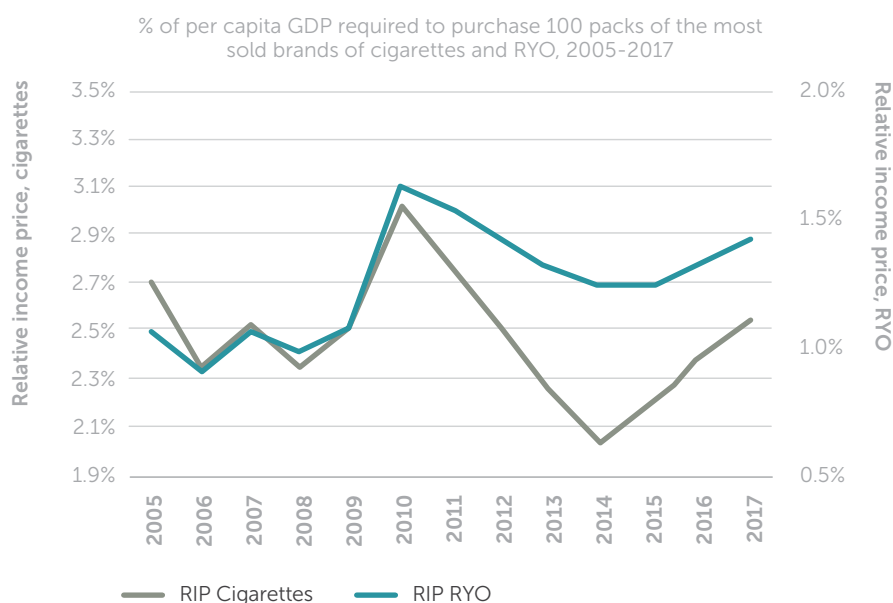
⁵⁸ The measure used was the share of GDP per capita needed to purchase one hundred 20-cigarette packs or one hundred 45g packs of RYO tobacco.

⁵⁹ Blecher, E. and Van Walbeck, C. An analysis of cigarette affordability. https://www.tobaccofreekids.org/assets/global/pdfs/en/TAX_Cigarette_affordability_report_en.pdf

buy given amounts of tobacco products. Figure B1 shows trends in RIP. It indicates that tobacco tax policy after 2008 was successful in reducing affordability until March 2010, when in the case of cigarettes RIP reached a maximum. At that time, 3 percent of GDP was needed to buy 100 packs of the most-sold brand of cigarette, while 1.6 percent of GDP was needed to buy a 45g pack of RYO tobacco.

- » During the following period (March 2010 to December 2014), real taxes and retail prices decreased. Since GDP increased over the same period, tobacco products became increasingly affordable. The maximum level of affordability was reached at the end of 2014, when just 2.1 percent of GDP was needed to buy 100 packs of cigarettes.
- » Tobacco tax policy regained momentum after the new government took office on March 1, 2015. It continued the previously abandoned policy until March 2010 and then began increasing the tax base at levels higher than inflation and real income change. This has resulted in periodic decreases in affordability from early 2015 to the present, however at a slower pace than in the 2008-2010 period.

Figure B1 – Affordability of Tobacco Products, 2005-2017 (Higher RIP values indicate lower affordability)



Source: Authors, using data from INE and the Central Bank of Uruguay.

ANNEX C – Tobacco Tax Legislation in Uruguay

Table A5. Evolution of RYO retail prices, taxes and tobacco industry shares in current and in constant December 2017 prices

LEGISLATION ON TOBACCO TAXATION IN URUGUAY				APPLICABLE TAX RATE		TAX STRUCTURE		
LAW OR DECREE	DATE	CONCEPT		CIGARETTES	RYO	OBSERVATIONS	CIGARETTES	RYO
Title 11 Texto Ordenado (Comprehensive tax legislation restated and updated), Dec. 338/96	08/28/96	Title 11 is excise taxes. Art. 1. Structure. The "Impuesto Especifico Interno" (IMESI) will be levied at the first sale of a list of goods sold by the producer or importer; rate for all tobacco products had a maximum of 70% rate on retail sale (art. 9) or a proxy. At the time the MEF set the cigarette rate at 66.5% and RYO at 28%.		66.5%	27%	A proxy of the retail price was legally allowed and traditionally used by DGI by means of setting (by Government Decree) a multiplier of the factory price. Until 2001 the proxy used was equal to: factory price x 4.6 (the multiplier), and the tax rate 66.5% for cigarettes, 27% for RYO	ad valorem	ad-valorem
Law 17296, art. 562	02/21/2001	Traditionally the excise tax had been an ad-valorem, but since this law of 2001 was passed the Executive Power was allowed to change the structure to a specific system or a mixed specific ad-valorem system in the case of tobacco products (art.9 of the 1996 Texto Ordenado). No change in tax rates by Decree in the previous 5 years.		66.5%	27%	The tax system had been ad-valorem until this law was passed. Even when the law allowed for a different tax structure, changes were not done until later with Decree 142/03 in 2003	ad valorem	ad-valorem
Law 17345	05/31/2001	VAT had been traditionally (since the seventies) set at 0% rate for tobacco products. This law of 2001 introduced the COFIS (Cofinanciamiento de la Seguridad Social) as a general consumption taxes and tobacco products were not exempt.		66.5%	27%	COFIS rate was set at 2.5% of retail price (without COFIS tax)	ad valorem	ad-valorem
Decree 245/002	6/28/2002	Art. 4 increased the tax rate of cigarettes to 68.5%		68.5%	27%		ad valorem	ad-valorem

Table A5. Evolution of RYO retail prices, taxes and tobacco industry shares in current and in constant December 2017 prices, Cont.

LEGISLATION ON TOBACCO TAXATION IN URUGUAY							
LAW OR DECREE	DATE	CONCEPT	APPLICABLE TAX RATE		OBSERVATIONS	TAX STRUCTURE	
			CIGARETTES	RYO		CIGARETTES	RYO
Decree 142/03	11/04/03	First time and for the next four years the DGI used the legal authorization given by law 17.296 and establishes a mixed tax system. There was a minimum tax base (not a minimum tax) periodically adjusted by the Government taking into account inflation (but it was not indexed). The new system applied only to cigarettes and not RYO. For lower priced brands the system became specific, but soon there were no brands with retail prices below the minimum.	68,5%	27%	If the tax base (calculated by means of the multiplier and the factory price as before) was found a value below the minimum tax base for any given brand, the latter would be used as the base. The tax system would be specific. However, if the tax base was found to be higher than the minimum, then the base would be the sum of the minimum with the addition of the difference with the retail price. Then, it would be an ad-valorem system since it took account of a price (in this case, the retail price) of each brand.	mixed	ad-valorem
Decree 164/05	05/30/05	The tax rate for cigarettes is increased to the maximum and the rate for RYO increased to 28%	70,00%	28%			
Law 18.083 (Comprehensive Tax Reform)	12/27/2006	The tax base for cigarettes changed to a specific amount provided by the tax authority (to be approved and updated by Decree the following years), the system for RYO continue to be ad-valorem. Another main change was that VAT at 22% rate applied to all tobacco products. COFIS was abandoned. The tax reform was effective July 2007.	70,00%	28%	The cigarette tax system became fully specific, since it was calculated as the base value provided by the tax authority multiplied by the tax rate. This calculation was independent of any price; the tax was the same for all 20 cigarettes pack. RYO taxation continued as previously.	specific	ad-valorem

Table A5. Evolution of RYO retail prices, taxes and tobacco industry shares in current and in constant December 2017 prices, Cont.

LEGISLATION ON TOBACCO TAXATION IN URUGUAY							
LAW OR DECREE	DATE	CONCEPT	APPLICABLE TAX RATE		OBSERVATIONS	TAX STRUCTURE	
			CIGARETTES	RYO		CIGARETTES	RYO
Decree 268/09	03/06/09	Main change was increasing the RYO tax rate to 50%	70,00%	50%	Specific tax base for all cigarettes was updated and also the multiplier of the tax base of RYO, same ad-valorem system as before.	specific	ad-valorem
Decree 069/10	02/20/20	RYO tax structure also went specific. The DGI set the base for all RYO brands at a specific amount and also raised the tax rate to 70%. This Decree also raised the tax rate to free-shop cigarette sales at 70% (after this Decree the only tax exemption of free-shops is VAT).	70%	70%	This was the last increase of President Vazquez first presidential period. During the following years there were no changes in the tax base.	specific	specific
Decree 375/014	12/19/2014	An update of the tax base was approved at the end of this government period.	70%	70%	There were two tobacco industry price increases in the period, in November of 2011 and June 2014	specific	specific
Decrees 064/2015, 04/2016, 380/2017		New Vazquez government in power since March 1, 2015 updated periodically tax bases of all tobacco products;	70%	70%	Since 2017 there is a yearly update of the tax base over the inflation rate and real income, but the Government has not set any targets.	specific	specific

Source:
Author
with data
from
DGI and
IMPO.

Annex D - Illicit Trade Legislation

The new Criminal Procedure Code (CPP) and a major change in criminal law

The “Codigo de Proceso Penal” (Criminal Procedure Code) is a major change in criminal law in Uruguay. It was approved in 2015, and its implementation began in November 2017. It fundamentally reshapes the procedural approach to dealing with criminal investigation and prosecution. Previously, the responsibility was part of the judge’s functions; prosecutors were not on the frontline during the investigation phase and participated only when evidence of a crime had been gathered by the judiciary. The new Code transfers to prosecutors the main responsibility for the investigative process, gathering of evidence, and formulation of charges.

The new law also includes other provisions, such as the option for prosecutors to negotiate a reduced sentence with the accused (“plea bargaining”). Another important feature of the new Code is the possibility for the Prosecutors Office to organize itself in a more specialized fashion, in the interest of faster and more efficient proceedings. Thus, in November 2017, the General Prosecutors Office was reorganized in six areas. One corresponds to economic crime and involves contraband, asset laundering, and tax fraud.

The Office of the Prosecutor, according to the new functions attributed to it by the CPP, has fresh options for improving the control of organized crime. For example, as noted, the new rules give prosecutors the power to negotiate reduced penalties for accused persons in exchange for cooperation.

The Code has faced several problems during initial implementation and may require minor adjustments. Overall, however, it will be a valuable mechanism to strengthen Uruguay’s judicial procedures.

A summary of legislation applicable to contraband is shown below.

SUMMARY OF URUGUAYAN ILLICIT TOBACCO TRADE LEGISLATION

	DESCRIPTION	RATIONALE
Overview of applicable legislation	Customs Code, Penal Code, Criminal Procedures Code, anti-asset laundering, intellectual property rights protection law (counterfeiting), Tax Code (other illicit trade such as illicit manufacturing. The tobacco control Act, Law 18.256 and Decree 284 are also applicable)	There is no systematic approach to dealing with illicit tobacco trade. Customs law in Uruguay, as in other countries, exists primarily to facilitate and protect legal trading operations. However, penalties and mandatory referral to criminal courts exist to respond to violations. The country has a single Customs Court with limited territorial responsibility. In addition to the Penal Code, some provisions of other laws are also applicable, such as the recent Criminal Procedural Code (CPP), the Anti-Asset Laundering Law (Ley N° 19574 of 2017). Counterfeit and illicit manufacturing have their own crime legislation.
Main illicit trade control agencies	DNA (Customs Authority) since contraband is the main crime related to cigarette illicit trade. The Ministry of Interior (police, national and local forces), the Prefectura Nacional Naval (Coastguard), the Tax Authority	DNA's main functions include control, inspection, intelligence gathering and tax collection. DNA has no customs police functions, and customs officers cannot carry weapons. However, DNA has been assigned leadership in fighting illicit trade in Uruguay's primary customs territory (almost the whole national territory). The law allows DNA to enlist other state authorities and law enforcement agencies (Police, Coast Guard) for help when needed.
Intelligence and contraband control operations	There are border control and other divisions in charge of contraband control.	DNA has an intelligence unit (RILO) that is normally in contact with similar units in regional Customs agencies and elsewhere. DNA has also been allowed to engage an outsourced group of law enforcers (Grupo de Respuesta e Inteligencia Aduanera, GRIA). GRIA has a robust record of seizures of illicit goods, including tobacco. GRIA's human resources are mainly retired and active policemen (who may carry guns) on commission work from the Ministry of the Interior (Homeland Security).
DNA authority and reach	DNA has full authority in the primary customs zone and may require the use of police at any time.	Principal enforcer within the main customs zone of Uruguay, defined as all the national territory except for areas specially designated by law. Article 11 of the Customs Code establishes the preeminence of DNA's responsibility with respect to any other public agency or body (except the judiciary) in the primary customs zone, and then empowers it to ask for the help of any public security force (e.g., the police) to successfully discharge its functions (Article 12). This article also establishes that DNA can perform seizure procedures without police support if it so determines.
DNA and other special customs zones (FTZ, free ports, etc.)	Except free trade zones, free ports, and other economic zones so declared by law	DNA's authority excludes customs "exclaves" (special customs zones that are part of foreign customs responsibility). However, almost no such special zones are currently operative.
Legislation on penalties	Misdemeanor or felony, depending on aggravating circumstances	The Customs Code and the Penal Code treat the crime of tobacco smuggling in different ways, but the approach is mainly that of a misdemeanor and receives penalties accordingly. A criminal court sentence could be for misdemeanor (less than two years in jail, eligible for parole) or for a felony (from two to six years, always involving jail time, but parole may be requested after one-half of the assigned jail time has been served).

SUMMARY OF URUGUAYAN ILLICIT TOBACCO TRADE LEGISLATION

	DESCRIPTION	RATIONALE
Additional penalties	Organized crime, association to commit a crime	Article 150 of the Penal code criminalizes the act of "association for criminal offence" with a sentence of six months to five years. If the association is to commit the crime of smuggling, the penalty increases from 18 months to eight years in prison.
Judicial proceedings	Customs Court of Montevideo and Canelones, penal courts, organized crime courts	Most confiscation procedures end in the Customs Court (with authority only in Montevideo and a neighboring Department), but if the judge considers that a felony may have been committed, the case is transferred to criminal court. In the remainder of the country, proceedings are held in regular judicial courts. Here again, if a felony is suspected, the judge may send the case to criminal court. The trial should be held in a special organized crime court, if the value of the contraband exceeds USD 20,000 (according to the Anti-Asset Laundering Law).
DNA's customs authority in other special customs zones	DNA has authority over incoming and outgoing merchandise. The information systems available and the obligation to report all movements have improved surveillance and control. There is also full authority during transportation of goods through the primary territory.	There is no compliance with article 12 of the Protocol. Traditionally, "in-transit" goods are not inspected, not because DNA lacks relevant authority, but due to judicial interpretation. The Customs Court has held that seized illicit "in-transit" cargo (tobacco or other products) should be allowed to go free, given that this form of illicit trade implies no fiscal revenue loss for Uruguay.
How seized cigarettes are disposed of	Destruction (not auction), but not by means of burning.	Auction is the general rule after customs confiscation of illicit goods in Uruguay. However, seized cigarettes are not auctioned; confiscation implies destruction (following Article 12 of Law 18,256).

References

- Abascal W, Esteves E, Goja B, González F, Lorenzo A, Sica A. Impacto de las políticas de control de tabaco en Uruguay 2006-2009. Programa Nacional para Control del Tabaco. Archivos de Medicina Interna, 35(Supl.4),1-16
- Abascal W, Esteves E, Goja B, González F, Lorenzo A, Sica A. et al. Tobacco control campaign in Uruguay: a population-based trend análisis. Lancet 2012;380(9853):1575-1582. [https://doi.org/10.1016/S0140-6736\(12\)60826-5](https://doi.org/10.1016/S0140-6736(12)60826-5)
- Abascal W, Lorenzo A. Impact of tobacco control policy on teenager population in Uruguay. Salud Pública de Mex 2017;59suppl 1:S40-S44. <http://doi.org/10.21149/8051>
- Blecher, E. and Van Walbeck, C. An analysis of cigarette affordability. https://www.tobaccofreekids.org/assets/global/pdfs/en/TAX_Cigarette_affordability_report_en.pdf
- FATF Illicit tobacco trade, 2012. <http://www.fatf-gafi.org/media/fatf/documents/reports/Illicit%20Tobacco%20Trade.pdf>
- Global Adult Tobacco Survey (GATS). (Fact sheet) https://www.paho.org/uru/index.php?option=com_docman&view=document&alias=576-uru-gats-2017-core-factsheet&category_slug=publications&Itemid=307
- Global Adult Tobacco Survey (GATS 2009) - World Health Organization, Pan American Health Organization, Centers for Disease Control and Prevention. Ministry of Health of Uruguay, National Institute of Statistics Uruguay. Uruguay, 2017 - https://paho.org/hq/index.php?option=com_content&view=article&id=1751&Itemid=1185&lang=en
- Hana Ross et al. A closer look at 'Cheap White' cigarettes. <https://tobaccocontrol.bmj.com/content/early/2015/09/28/tobaccocontrol-2015-052540>
- Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1994
- Junta Nacional de Drogas. Secretaría Nacional de Drogas. 2da. Encuesta Nacional de Prevalencia del Consumo de Drogas, 1998
- Junta Nacional de Drogas. Secretaría Nacional de Drogas. UNDP. 3ra. Encuesta Nacional de Prevalencia del Consumo de Drogas, 2001.
- Junta Nacional de Drogas. 1ra. Encuesta Nacional y 2da. en Montevideo sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OEA-SIDUC. October 2003.
- Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 2da. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD. Abril 2006
- Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 3ra. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/OD/OEA-SIDUC. Abril 2007
- Junta Nacional de Drogas. Secretaría Nacional de Drogas, 4ta. Encuesta Nacional en Hogares sobre Consumo de Drogas. Uruguay, 2006.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 4ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/ODU/United Nations-Office on Drugs and Crime. October 2010

Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 5ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/ODU. October 2012

Junta Nacional de Drogas. Observatorio Uruguayo de Drogas. 6ta. Encuesta Nacional sobre Consumo de Drogas en Estudiantes de Enseñanza Media. JND/ODU. Uruguay, 2014

Ley 19259. Available at: http://archivo.presidencia.gub.uy/sci/leyes/2014/08/mrree_3855.pdf

Ley 18.256 – Ley de Control del Tabaquismo. (Tobacco Control Act, 2008) - <https://parlamento.gub.uy/documentosyleyes/leyes/ley/18256> http://archivo.presidencia.gub.uy/_web/leyes/2008/03/S405_19%2010%202007_00001.PDF

Ministerio de Desarrollo Social, Presidencia, Oficina de Planeamiento y Presupuesto, Report Uruguay 2015 - http://200.40.96.180/images/ReporteUruguay2015_OPP_web.pdf

Ramos, A. "The illegal trade in tobacco in the Mercosur Countries". Trends in Organized Crime 2009;12:267-306. Another link in English: http://www.fctc.org/images/stories/INB-3/INB3_report_illegal_trade_in_MERCOSUR.pdf. A synthesis in: <http://www.fctc.org/media-and-publications-20/fact-sheets/illlicit-trade/278-inb3-fact-sheet-illlicit-trade-in-mercosur>

Ramos Carbajales, A; Clemente, A; Gonzalez Rozada, M. Impuestos al tabaco y políticas para el control del tabaco en Uruguay. Fundacion Interamericana del Corazón, México 2013 - http://tabaco.ficmexico.org/wp-content/uploads/2014/08/uruguay_web.pdf

Ross, Hana. Understanding and Measuring Illicit tobacco trade. A methodological guide. Tobacconomics 2015. https://tobacconomics.org/wp-content/uploads/2015/03/Ross_Methods_to_Measure_Illicit-Trade_03-17-15.pdf

STEPS- Primera Encuesta Nacional de Factores de riesgo de enfermedades crónicas no trasmisibles (First Survey of risk factors for Non-communicable diseases).2006 http://www.msp.gub.uy/sites/default/files/archivos_adjuntos/1er_enfrecnt_2006_1.pdf

Tobacco Tax Reform: At the Intersection of Health and Development, World Bank, 2017.

US Department of Health and Human Services. Public Health Services. Preventing tobacco use among youth and young adults. A Report of the Surgeon General. Atlanta, GA: US Department of Health and Human Services, Centers for Disease Control and Prevention, National Centre for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health,2012

WHO-FCTC Article 6 Guidelines. Available at: http://www.who.int/fctc/treaty_instruments/Guidelines_article_6.pdf

WHO Tobacco Tax Administration Manual. WHO, 2011.

World Health Organization. WHO Framework Convention on Tobacco Control. Geneve: WHO, 2005.

SOUTH ASIA
& EAST ASIA

14

BANGLADESH

15

INDONESIA

16

MALAYSIA

17

PHILIPPINES

BANGLADESH

14

BANGLADESH:

Illicit Tobacco Trade

Sadiq Ahmed, Zaidi Sattar, and Khurshid Alam¹

Chapter Summary

In step with the country's notable recent tobacco taxation reforms, Bangladesh is taking action to fight the illicit tobacco trade. Bangladesh currently has a low estimated illicit cigarette trade incidence (2 percent), compared to estimated global rates of 10-12 percent. Annual revenue losses from illicit cigarette trade are about Taka 8 billion (\$100 million), or around 4 percent of total tobacco revenues. It is crucial to keep the illicit cigarette trade from expanding.

Bangladesh has established a strong legal and institutional foundations for tackling illicit tobacco. The Ministry of Health (MoH) has responsibility for setting, implementing, and monitoring health-related tobacco policies, while the Ministry of Finance (MoF) has primary responsibility for tobacco taxation and oversees the fight against illicit tobacco trade. Within the MoF, primary responsibility for illicit tobacco rests with the National Board of Revenue (NBR).

Cigarette taxation in Bangladesh is enforced through the cigarette stamp and banderole system, introduced in 2002. This system, together with control of smuggling and tightening of cigarette intelligence, has helped keep the illicit cigarette trade in check.

Illicit trade incidence for biri (cheap, hand-rolled cigarettes) is unknown owing to lack of data. However, industry intelligence reports suggest that the incidence of illicit biri trade

¹ Policy Research Institute of Bangladesh. Additional guidance for this chapter was provided by Sher Shah Khan (World Bank Group) and Ceren Ozer (World Bank Group).

could be significantly higher than for cigarettes. Despite the likely high volume of illicit biri trade, the revenue loss is presently not significant owing to the low effective tax rate for biri. However, recent reforms have for the first time aligned the biri tax base to the products' actual retail price. This change, coupled with a projected increase in the biri tax rate to match the rate for cigarettes, will raise the opportunity cost of illicit biri trade in Bangladesh.

The following recommendations are made:

- » **Monitor biri production and distribution:** The monitoring of biri production and distribution presents a major challenge for Bangladesh. The government could potentially improve the security of the biri banderole in a similar manner to cigarettes.
- » **Monitor both inputs and outputs to prevent tax evasion:** While the government needs to continue enforcement against illegal tobacco products at the different manufacturing points as well as at the retail level, officials should also increase their vigilance in monitoring tobacco sourcing.
- » **Strengthen regional VAT offices:** The regional VAT field offices and the customs intelligence administration are two critical NBR agencies for the control of illicit tobacco trade and would need to be strengthened.
- » **Strengthen local-level task forces:** Policy makers have begun to test the innovative idea of establishing low-cost implementation task forces at the local level to implement tobacco laws, including those concerning illicit trade. This approach has potential and needs to be fully developed, including through allocation of resources. Local task forces could be made functional in all districts and sub-districts, as envisaged by the government.
- » **Develop and publish a database on the incidence of illicit tobacco trade and actions taken:** Presently there is no reliable NBR database on the incidence of illicit tobacco trade. This gap should be addressed systematically. This should involve going beyond industry sources to develop independent estimates of illicit tobacco trade. The government could supplement industry illicit trade figures with its own efforts to estimate illicit cigarette trade.
- » **Ratify the Illicit Tobacco Trade Protocol:** Bangladesh was the first country to sign the FCTC. Consistent with its significant achievements in the areas of tobacco control, Bangladesh should sign and ratify the Illicit Tobacco Trade Protocol.

Overview

In recent years, Bangladesh has made progress in reducing tobacco use by implementing a comprehensive tobacco control program. The prevalence of both smoked and smokeless tobacco use in the country has fallen (Table 1). Tobacco use prevalence significantly declined among adults from 43.3 percent in 2009 to 35.3 percent in 2017 (GATS 2017).

Nevertheless, the overall prevalence of smoking in Bangladesh remains high at 18 percent, and nearly 21 percent of the Bangladeshi population uses smokeless tobacco (GATS 2017). In 2016, 25.54 percent of male deaths and 9.68 percent of female deaths in the country were estimated to have resulted from tobacco-related diseases (American Cancer Society 2018). As a result, despite recent progress, the challenge ahead for tobacco control in Bangladesh remains formidable.

Table 1. Prevalence of Tobacco Use in Bangladesh

INCIDENCE OF TOBACCO USE (%)	GATS BANGLADESH REPORT OF 2009	GATS BANGLADESH REPORT OF 2017
Overall tobacco use among adults	43.3	35.3
Tobacco use among males	58.0	46.0
Tobacco use among females	28.7	25.2
Overall smoking prevalence	23.0	18.0
Smoking prevalence among males	44.7	36.2
Smoking prevalence among females	1.5	0.8
Overall smokeless tobacco (SLT) use	27.2	20.6
Smokeless tobacco use among males	26.4	16.2
Smokeless tobacco use among females	27.9	24.8

Source: Global Adult Tobacco Survey, Bangladesh 2009 and 2017. 2017 Fact Sheet & Comparison Fact Sheet (issued on August 7, 2018).

<http://www.searo.who.int/bangladesh/gatsbangladesh2017comparison14aug2018.pdf>

<http://www.searo.who.int/bangladesh/gatsbangladesh2017fs14aug2018.pdf>

Bangladesh is a small player in the global tobacco market. The country's total production of cigarettes and "biris" (low-cost, low-quality, hand-rolled cigarettes) was estimated at 128 billion sticks in FY2016/17, equivalent to 2.3 percent of total estimated global cigarette production (BAT 2018). Illicit trade is estimated to represent between 10 and 12 percent of total global tobacco trade, and there are wide variations in the incidence of illicit tobacco trade by countries (CDC 2016). Available estimates suggest that Bangladesh has a comparatively low level of illicit cigarette trade (2 percent). No data are available for the volume of illicit biris. The database on smokeless tobacco products is almost non-existent because of the home-based nature of their production and consumption.

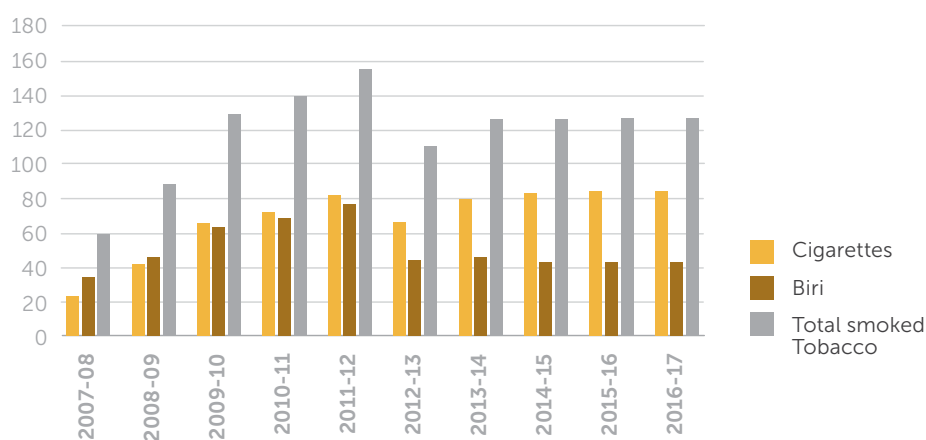
Bangladesh's revenue losses from illicit cigarette trade are about Taka 8 billion (US\$100 million) per year, roughly 4 percent of total revenues from tobacco. The loss from illicit biri trade is not likely to be high, because of the low tax rate currently applied to biri. On the other hand, the potential gains from higher and better-structured tobacco taxes are considerable. Bangladesh taxes low-end cigarettes at a substantially lower rate than higher-end

cigarette products. Indeed, biris were barely taxed at all until very recently. Consequently, the tax incentives for continued consumption of lower-end cigarette products and biris have not only affected public health adversely, but have also reduced tax revenues.

1. Bangladesh’s Tobacco Production, Revenues, and Illicit Trade: A Situation Analysis

Production Trend and Control Policies: Figure 1 shows the recent trend in the production of smoked tobacco products in Bangladesh, by main categories. Total cigarette and biri production rose rapidly from FY2007/08 to FY2011/12, growing at a pace of 27 percent per year. Production then fell sharply from the peak level of 154.9 billion sticks in FY2011/12 to 111 billion in FY2012/13. It recovered to 126.5 billion in FY2013/14 but has remained basically flat since then. This remarkable drop in smoked tobacco production reflects the government’s efforts to reduce smoking in Bangladesh through a range of measures including anti-smoking regulations, educational campaigns, and taxation measures.

Figure 1. Recent Trend in Cigarette and Biri Production

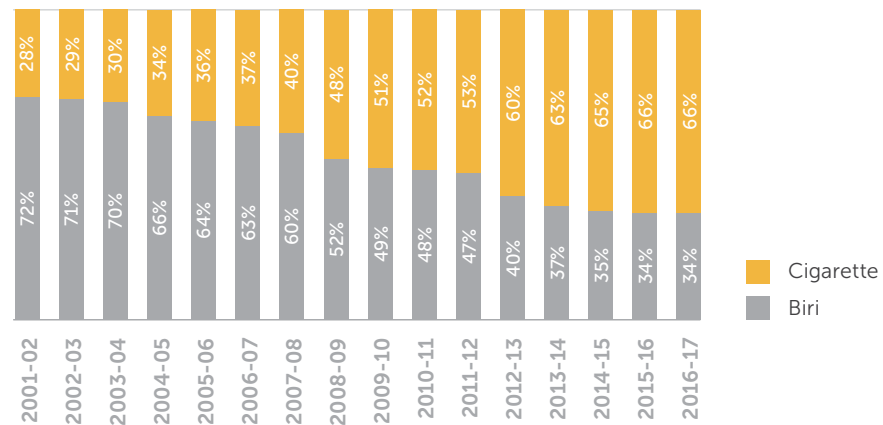


Sources: National Board of Revenue

A list of non-tax government regulations aimed at discouraging smoking is contained in Annex 1, at the end of this chapter. Bangladesh has no separate law on tobacco taxation. Rather, tobacco taxation is implemented as part of the Value-Added Tax (VAT) Law of 1991. Anti-tobacco laws and regulations, including taxation, have been progressively tightened since Bangladesh signed the WHO Framework Convention on Tobacco Control (FCTC) in 2003. Bangladesh has the distinction of being the first country to sign the FCTC and was among the first to ratify the treaty, in May 2004. The country’s tobacco control laws, regulations, and policies now encompass all four major areas of anti-smoking strategy: smoke-free places; advertising, promotion, and sponsorships; packaging and labeling; and taxation aimed at increasing prices and lowering the affordability of tobacco products.

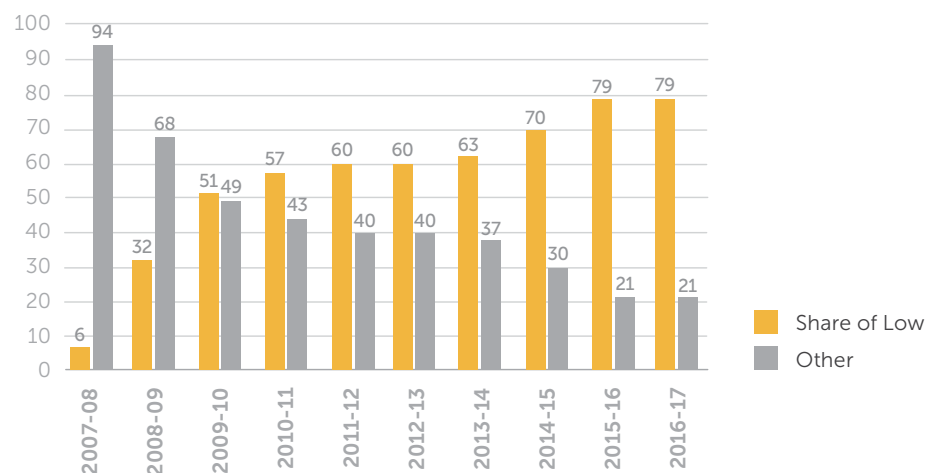
Despite the progress noted above, results regarding the changing composition of tobacco products are mixed. Smoked tobacco in Bangladesh comprises two major products: cigarettes and biris. Biri is a crude hand-rolled tobacco product that creates more health damage than cigarettes, on average. It is also very cheap, incurs low tax rates, and yields very little revenue compared with cigarettes. Over time, the share of biri in total production has declined from 72 percent in FY2001/02 to 34 percent in FY2016/17 (Figure 2). This is a positive development in terms both of health outcomes and government revenues. Within the cigarette market, there are four lines of products for pricing and taxation purposes in Bangladesh: Premium, High, Medium, and Low. Much of the country's cigarette production is concentrated around the low grade, and its relative share has risen substantially over time (Figure 3). Low-grade cigarettes have a relatively higher health hazard compared with higher grades and yield lower revenues owing to lower tax rates.

Figure 2. Shares of Cigarettes and Biri in Total Production (%)



Sources: National Board of Revenue

Figure 3. Share of Low-Grade Cigarettes Among Total Cigarettes (%)



Sources: National Board of Revenue

Pricing and Taxation Policies: Although the government has not banned cigarette imports, it imposes high taxes on imported cigarettes (Table A3.1, Annex 3). Tobacco imports in all forms are heavily taxed, but the tax rates are particularly high for imported cigarettes, ranging from 220 percent to 476 percent. Such high import taxes effectively function as an import ban on foreign cigarettes.

Domestic smoked tobacco products in Bangladesh are governed by a four-tiered ad valorem price and tax system, reflecting the four cigarette quality categories cited above. The effective tax rate is such that the premium and high segments are more heavily taxed than the lowest segment. Most importantly, biri is taxed at a much lower rate than other product types. Until recently, the effective tax rate for biri was reduced even further by taxing on a government-defined fixed base value that was much lower than the actual retail price (Mansur 2015).

The cigarette industry is subject to profit taxation like all other enterprises in Bangladesh. However, unlike most other enterprises, which are taxed at 25–35 percent, the cigarette industry pays the highest allowed rate of corporate taxation on profits (47.5 percent). While the main goal here is revenue collection, this arrangement serves indirectly to discourage investments in cigarette production. The main policy instrument to influence cigarette prices is indirect taxation on production. The most recent indirect tax structure for cigarettes is shown in Table 2.²

The government imposes three types of indirect taxes on domestic cigarettes: a uniform value-added (VAT) of 15 percent, a variable supplementary duty (excise tax) that presently ranges from 52 percent to 65 percent, and a health surcharge of 1 percent. Total taxes thus range from 68 percent of retail price for low-quality cigarettes to 81 percent for premium cigarettes. To increase revenues, in FY2016–17, the government merged the medium segment with the high segment classification and adjusted the “dead zones” (basically, price ranges that cannot be used to price cigarettes in practice). The supplementary duty (SD) rate has been periodically adjusted to increase revenues and discourage smoking. The supplementary duty gap between the low and higher segments has also been narrowed (Figure 4).

Bangladesh’s weighted average tax rate for cigarettes is now 71.5 percent, which attests to the government’s commitment to fight cigarette smoking by creating serious price disincentives, while implementing other control measures (warning labels on packaging, restrictions on advertisements, restrictions on promotional activities, and spatial restrictions). Frequent recent increases in cigarette taxes have raised prices substantially for all categories of cigarettes in Bangladesh (Figure 5).

A more contentious policy area is the taxation of biris. Traditionally, these products have been taxed very lightly, based on the faulty logic that biris are consumed by the poor and that high taxes will hurt poor smokers. A strong political lobby also militates against higher

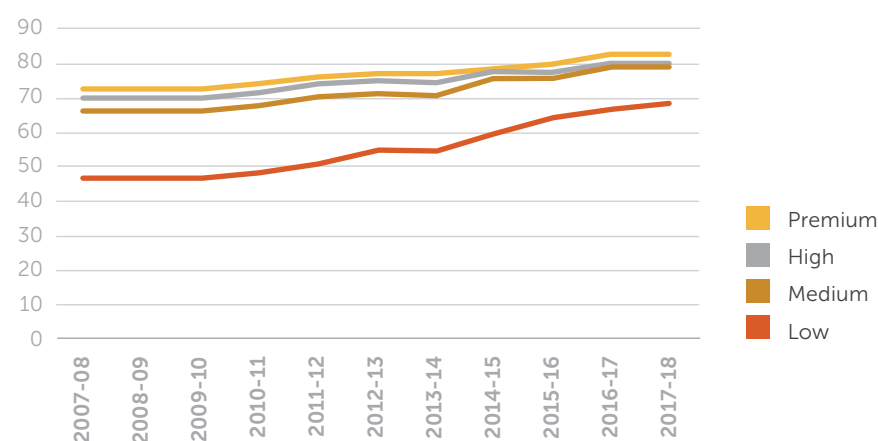
² Data for FY2014/15–FY2017/18 are contained in Annex Tables A3.3 – A3.6, Annex 3.

Table 2. Pricing Slab and Levied Tax for Cigarettes (2017-18)

SEGMENT	RETAIL PRICING SLAB (10S PACK)	SD	VAT	HEALTH SURCHARGE	TOTAL TAX LEVIED
Premium	BDT 70+	65%	15%	1%	81%
High	BDT 45 - BDT 69	63%	15%	1%	79%
Dead Zone	BDT 27.01-44.99				
Low	BDT 27	52%	15%	1%	68%

Source: National Board of Revenue

Figure 4. Trends in Tobacco Taxation (Percentage of Retail Price)



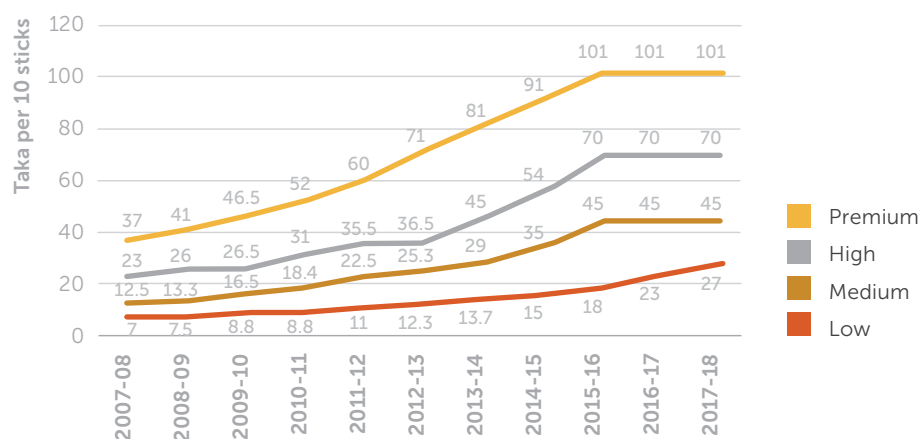
Sources: National Board of Revenue

Table 3. Tax Structure for Biri FY2017-18

TYPE	PACK SIZE	RETAIL PRICE (BDT)	SD	VAT	TAX AMOUNT (BDT)
Without Filter	25 Sticks	12.50	30%	15%	5.60
	12 Sticks	6.00	30%	15%	2.70
	8 Sticks	4.00	30%	15%	1.80
With Filter	20 Sticks	12.00	35%	15%	6.00
	10 Sticks	6.00	35%	15%	3.00

Source: National Board of Revenue

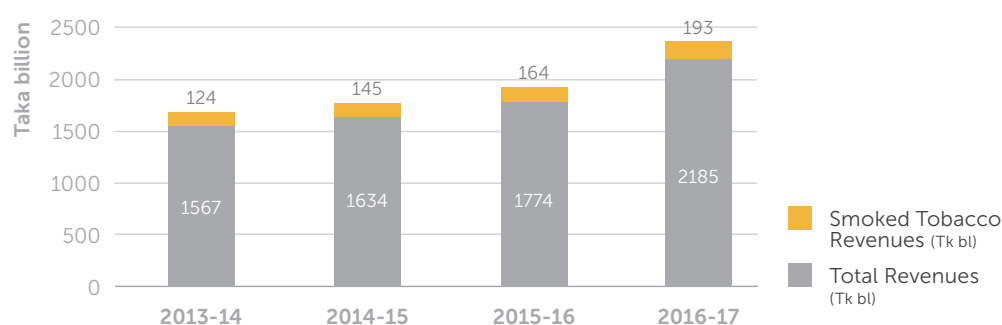
Figure 5. Nominal Price of Cigarettes (Taka per 10 sticks)



Sources: National Board of Revenue

taxes on biri (Ahmed 2013). In FY2017/18 the government enacted a major policy shift by aligning the tax base for biri pricing to the actual retail price, as is done for cigarettes. This policy move will likely increase revenues and discourage biri consumption. The latest round of statutory tax rate structure for biri is shown in Table 3.³ While this progress is laudable, the tax gap between biri and cigarettes remains high. The statutory tax rate for biri is 50 percent for filter and 45 percent for non-filter, as compared with 68-81 percent for cigarettes. Appropriate taxation for biri remains a challenge despite recent advances.

Figure 6. Recent Trend in Tobacco Revenues (Taka Billion, Current Prices)



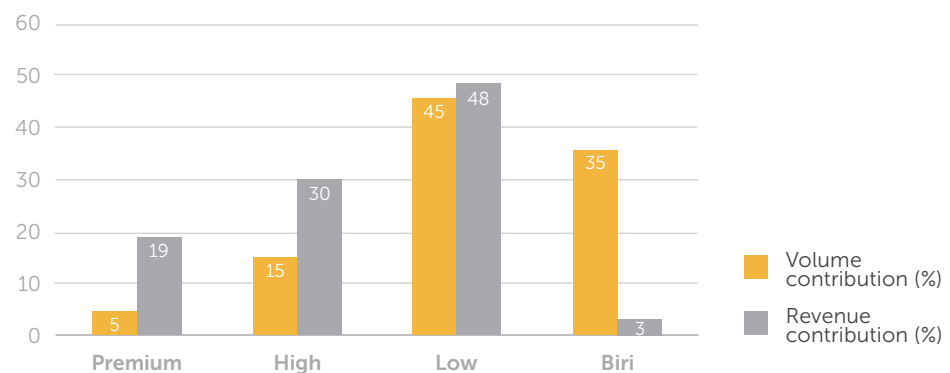
Sources: National Board of Revenue

Tobacco Revenues: Tobacco taxation is an important source of revenues for the government in Bangladesh. Tobacco revenues (excluding profit taxation) surged from Taka 124 billion (\$1.6 billion) in FY2013/14 to Taka 193 billion (\$2.4 billion) in FY2016/17, growing at a

³ Data for FY2014/15 – FY2017/18 are provided in Tables A3.7 – A3.10, Annex 3.

healthy pace of 16 percent per year (9 percent in real terms), which is faster than the 12 percent growth in total revenues (Figure 6). As a result, the share of tobacco in total revenues increased from 7.9 percent to 8.8 percent over the same period. Some 97 percent of the revenues came from cigarettes, and only 3 percent came from biri, even though biri accounted for over 35 percent of the total volume of tobacco smoked (Figure 7).

Figure 7. Sales Volume and Revenue from Tobacco Products



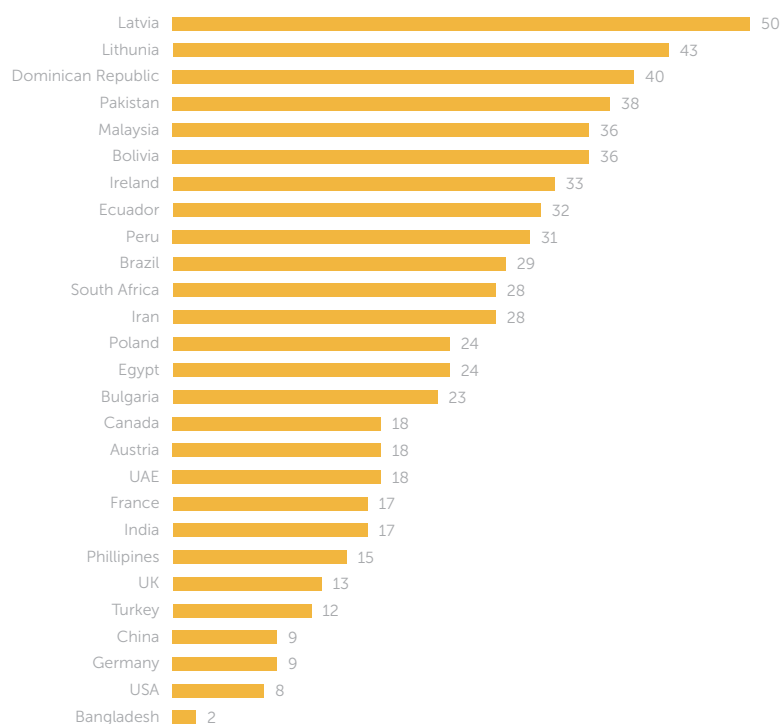
Sources: National Board of Revenue

Illicit Tobacco Trade: Available evidence suggests that the incidence of illicit cigarette trade in Bangladesh is small relative to the global incidence (Figure 8). Bangladesh’s illicit cigarette trade incidence is roughly estimated at about 2 percent of total cigarettes sold in the market, as compared with 50 percent for Latvia, 38 percent for Pakistan, 36 percent for Malaysia and 17 percent for India. Much of this illicit trade (92 percent) is in terms of cigarettes that escape the tax net. Of the remaining 8 percent, some 5 percent are contraband cigarettes (smuggling), while counterfeit products represent 3 percent. The estimated revenue loss from illicit trade is about Taka 8 billion (\$100 million), which is 4 percent of total tobacco revenues.

The illicit trade incidence for biri is not known owing to lack of data. It is likely to be substantially higher than for cigarettes because of the prevalence of home-based, small-scale biri enterprises that may not be in the tax net. Despite the possibly larger volume of illicit biri trade, it does not lead to significant revenue loss presently because of the low effective tax rate for biri. However, the recent reform to align the biri tax base to the actual biri price, along with the projected increase in the biri tax rate to levels similar to those applied to cigarettes, will raise the opportunity cost of illicit biri trade moving forward. Intensified efforts are needed to improve compliance with biri taxation.

The Bangladeshi government has a strong legal foundation for addressing illicit tobacco trade. The laws are a part of the government’s broader policy for controlling all forms of illicit trade and abuse of government stamp papers and trademarks. They cover all aspects of illegal trade including laws against forged stamps, falsified brands, smuggling, and tax evasion.

Figure 8. Incidence of Illicit Tobacco Trade in Selected Countries



Sources: CDC 2016, except Bangladesh. Data for Bangladesh are industry estimates.

The legal framework also provides for stiff penalties and enforcement mechanisms including surveillance, premise raids, seizures, mobile courts, check points in land, air, and sea ports, and surveillance of courier services and mobile phones. The details of the legal framework for control of illicit tobacco trade are discussed in Section 2 below.

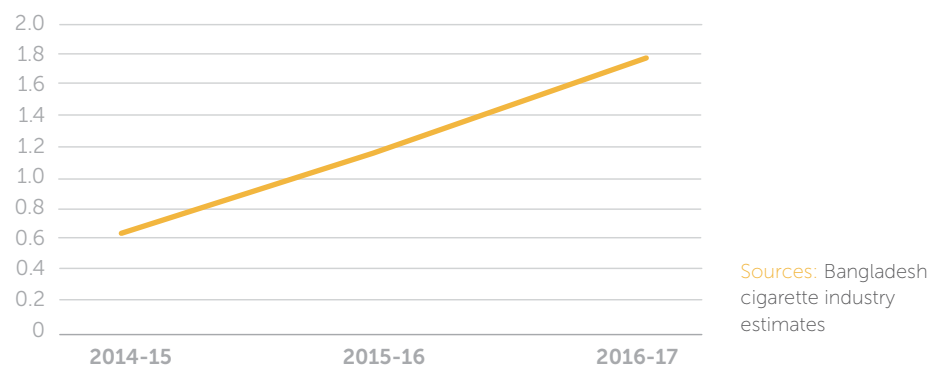
The possible link between illicit tobacco trade and other criminal activities is not considered a substantial law-and-order issue in Bangladesh, since the incidence of cross-border smuggling is small and much of the country's illicit cigarette trade takes the form of tax evasion by firms. In the case of biris, while there could be some tax evasion by registered biri producers, a bigger challenge is the production and sale of biris by small, home-based enterprises, which are not registered with the government. The challenge is representative of those posed by many other small and micro-enterprises that remain unregistered (Ahmed et al. 2018). The main difference between biri enterprises and other small enterprises, however, is that biri enterprises sell a product that causes health damage and therefore need to comply with all the safety laws. Also, while government policy encourages non-tobacco small and micro-enterprises and is therefore less concerned about licensing and registration issues, the same is not true of tobacco enterprises. Hence, much stronger efforts are needed to bring all biri enterprises under the government registration and licensing net.

2. Progress with Illicit Tobacco Trade Control Policies and Enforcement

As noted above, the incidence of illicit cigarette trade in Bangladesh is low, but no data exists for biris. The low incidence of illicit trade in cigarettes is explained by several factors, including the production structure, cooperation between the cigarette manufacturers association and the NBR, effective use of the stamp and banderole system for cigarette taxation, and the government's surveillance efforts. Cigarettes are a large source of government revenues, and as such NBR is particularly vigilant in protecting this revenue source. Since revenues from biris have been negligible so far, the policy attention to tax avoidance regarding biri has been much less intense. As the revenue significance of biri taxation grows, policy engagement to prevent tax evasion will likely improve.

Illicit Trade in Cigarettes: The NBR does not compile data to measure the incidence of illicit trade in cigarettes. However, the tobacco industry makes yearly estimates based on field intelligence data gathered through surveys of retail market outlets. The total number of illicit cigarettes was estimated at 1.5 billion sticks in FY2016/17, which is about 1.8 percent of the total cigarette market for that year. This is small, but the trend is growing (Figure 9). Of the total illicit trade volume, an estimated 5 percent is contraband cigarettes; 3 percent is counterfeit; and 92 percent belongs to the category of illicit whites: cigarettes produced by registered enterprises but which escape taxation through firms' under-reporting of true production.

Figure 9. Incidence of Illicit Cigarette Trade (Percent of Total Market)



The low incidence of smuggling or contraband cigarettes despite the open border with India is a surprising result. Industry experts believe this is partly because of the adequate supply of a large range of well-known brands of cigarettes in Bangladesh. The incidence of counterfeit cigarettes is low due to the vigilance of the Bangladesh Cigarette Manufacturing Association (BCMA), whose individual members gather regular intelligence about smuggling and brand-name violation and report to NBR. The biggest risk is tax evasion, especially as tax rates have

progressively increased. This risk will likely grow further as the tax differentials between low-end and premium products are reduced and eventually eliminated. To counter this, the NBR has entered into a partnership with BCMA to improve tax compliance, which is reinforced by NBR oversight through the administration of stamps and banderoles. This is made feasible by the fact that some 97 percent of the cigarette market share is concentrated among three large producers: the British American Tobacco Company of Bangladesh (BATB), the Dhaka Tobacco Company, owned by the Akij Group, and the Abul Khair Tobacco Company. Of the three, BATB, a multi-national company, accounts for 70 percent of the market.

As in other countries, cigarette manufacturers in Bangladesh argue that taxes are too stiff and have often lobbied against tax increases. However, once the taxes are approved by Parliament and become a law of the land, the BATB has a good track record of compliance with the tax laws. It also has a strong research and monitoring team that does regular marketing research and surveillance based on field visits. Information is regularly shared with NBR, thereby assisting in the implementation of the tobacco tax laws. Nevertheless, there is a need for NBR to conduct regular independent monitoring of the illicit cigarette trade.

Illicit Trade in Biri: In the case of biris, smuggling and counterfeit issues are believed to be negligible. Despite Bangladesh's large border with India, industry experts judge that biri smuggling from India is not a major issue for two reasons. First, biri production in Bangladesh is very cheap. Secondly, the biri leaf used in India, known as tendu leaf, is generally not preferred by Bangladeshi consumers.

However, while biri smuggling may not pose a significant threat, tax compliance regarding biri could be a major challenge for Bangladesh. Unlike for cigarette production, where manufacturing units and production are centralized and controlled by the three large registered manufacturing companies, biri production is disseminated across numerous small production units that are not all registered with the government, substantially complicating oversight and enforcement.⁴ Assessing tax compliance for biri manufacturing is difficult, given the dearth of relevant data. However, historically, biri prices and the corresponding tax rate were very low until the biri pricing and taxation reform in July 2017. Thus, the incentive for tax avoidance by organized biri manufacturers was minimal. The story is different for the unregistered small biri manufacturers. To bring these enterprises into the tax net, the government made biri tax compliance easy by allowing manufacturers to buy the banderole used for biri taxation from post offices. Despite such efforts, the incidence of tax avoidance could grow with the latest reform, as the biri tax rate is now significant.

Locational Aspects of Illicit Trade: Industry research shows that much of the illicit cigarette trade in terms of tax evasion occurs in the northern districts of Bangladesh. Almost 50 percent of tax-not-paid factories are in the northern region, producing 85 percent of all tax-not-paid brands. This intelligence finding should help NBR improve its tax administration.

⁴ Two large cigarette manufacturing companies, the Akij Group and the Abul Khair Tobacco Company, also have a large stake in biri manufacturing, controlling an estimated 50 percent of biri production in Bangladesh

To the extent that these factories also produce biri, this will also strengthen biri tax administration. However, while the early intelligence reports are valuable, the true distribution of biri factory locations remains unknown and requires a special-purpose survey.

Use of Stamps and Banderoles for Illicit Tobacco Control: Stamps and banderoles are the two main instruments used for controlling the illicit tobacco trade and reconciling with the tax revenue collected. In Bangladesh, stamps and banderoles are all printed at the Government Security Printing Press in Dhaka. Both are used for cigarette packets, while for biri, only banderoles are used. The tobacco companies producing cigarettes take upfront delivery of the banderole and stamp sheets from the Security Printing Press based on their production projections. These are distributed free of charge. The companies are allowed a maximum 1 percent wastage on the banderoles and stamps for reconciliation with the production and tax revenue collected. In contrast, biri producers take delivery of the banderoles from Post Offices. The producers buy these banderoles as a tax levy on the production of biris. The price paid for the banderole is the final tax obligation for biri manufacturers, as the NBR does not have the capacity to monitor and cross-check with the true volume of biri production. This approach to biri taxation aims to simplify tax compliance for biri manufacturers.⁵

The cigarette stamp and banderole system works well, with a small incidence of abuse relating to illicit whites and counterfeit cigarettes. The banderole system used for taxing biris is less effective. Due to low revenue yields from biris, the quality of the biri banderoles is low, making them less secure. Along with the potential for forgery of biri banderoles, there are reported instances of torn legal biri banderoles being glued and reused in rural areas. The vigilance of both the government and the biri industry in maintaining the integrity of the biri banderole system is relatively lax, as compared with the stricter standards of the cigarette industry.

It is illegal in Bangladesh to sell cigarettes without the appropriate banderole. The VAT office tries to ensure that the number of banderoles that manufacturers obtain from the secure printing press matches the number of cigarette packets actually produced. For this, they have a dedicated officer at the factory. VAT officials collect taxes based on actual production going out of the factory gate, where a VAT official is present and signs off on the chalan (paper document). To further ensure traceability, VAT officials also check each truck consignment once it departs from the factory premises to see that the number of packets/cartons matches the invoice. At a subsequent road junction, there is another level of checking by VAT officials, who again verify the transported tobacco products against the chalan that had been issued at the factory gate. Later, the total tax revenue collected is reconciled with the stamps and banderoles that each producer has received, allowing for the permissible 1 percent wastage. This is an elaborate and secure cross-checking system that works well, except in some instances of collusive behavior of NBR staff and the cigarette manufacturer.

⁵ Additional details concerning the application of stamps and banderoles in Bangladesh are provided in Annex 4.

Policies, Strategies, Laws, and Reforms Undertaken to Control Illicit Tobacco Trade

As noted in Part 1, Bangladesh has made substantive efforts to control tobacco use as well as illicit tobacco trade. The 56th World Health Assembly unanimously adopted the Framework Convention on Tobacco Control (FCTC) in May 2003, and Bangladesh was the first country to sign the Convention. The FCTC entered into force and became part of international law on 27 February 2005 after ratification by 40 countries. Bangladesh enacted a Tobacco Control Law in 2005 in accordance with some of the provisions of the FCTC. The country's anti-tobacco laws have been progressively strengthened, and implementation has been good.

To implement the 2005 Law, the National Strategic Plan of Action for Tobacco Control (NSPATC) 2007-2010 was prepared and adopted by the Ministry of Health. The Strategic Plan calls for partnership-building to strengthen collaboration between the Ministry of Health and Family Welfare and other ministries, including Finance, Commerce, Home, Law, Foreign Affairs, and Information. Subsequently, the incorporation of NSPATC in the country's Sixth Five Year Plan further reinforced Bangladesh's momentum in tackling the smoking problem.

The measures outlined under the Strategic Plan to control the illicit trade of tobacco products included:

- » Control of smuggling, which includes adopting appropriate measures to ensure that all packages of tobacco products sold or manufactured carry the necessary markings, such as prominent tax stamps, easily visible local language (Bengali) warnings, country of origin and country of destination, and product information that will allow the products to be effectively tracked and traced. Smuggling control measures also include the aggressive enforcement and consistent application of tough penalties to deter smugglers. All persons engaged in the business of manufacturing, importing, exporting, wholesale, storage and transport of tobacco products should be licensed.
- » Control of illicit manufacturing and counterfeiting.
- » Monitoring and collecting data on cross-border trade in tobacco products, including illicit trade.
- » Exchange of information among related departments such as tax, customs, and law enforcement agencies and local authorities, as well as among countries of the region.
- » Development and enforcement of collaborative interventions with neighboring countries to regulate tobacco products and reduce the illegal cross-border trade, promotion, and advertising of tobacco products.

Actions proposed to implement the measures/goals of the Strategic Plan included the following:

- » Establishment of a national tobacco committee and enforcement of national legislation.

- » Setting appropriate price and tax policies.
- » Protection from exposure to secondhand smoke.
- » Prohibition of all forms of advertisement, promotion, and sponsorship.
- » Education, communication, training, and public awareness.
- » Promotion of cessation of tobacco use and adequate treatment for tobacco dependence.
- » Ban on sale of tobacco products to and by minors.
- » Support for laboratory analysis of tobacco products for tobacco product regulation and disclosures.
- » Packaging and labeling of tobacco products.
- » Research, surveillance, and exchange of information.
- » Control of illicit trade in tobacco products.
- » Partnership building for tobacco control.
- » Identification and mobilization of financial resources.

Laws and Regulations to Control Illicit Tobacco Trade: To support these actions, the Bangladeshi government has created a variety of legal and regulatory mechanisms. Some impose stringent requirements on the packaging and distribution of tobacco products, for example. Tobacco laws are backed by heavy penalties and work synergistically with tax tools, including VAT, supplementary duty, health surcharge, and customs duty. The overall results have been encouraging, with a substantial reduction in the incidence of tobacco use and an increase in revenues.

Penalties for Violation of Tobacco-Related Laws: Under the prevailing Tobacco Control Laws, authorized officers will be able to enter and inspect any public place or mode of transport as defined by the law and expel or remove any person violating the anti-smoking law. Officers can also destroy or seize illegal tobacco products. This violation is a cognizable offence. Thus, police can arrest those violating the law and produce them in court. In addition, there are specific laws to deter activities such as smuggling, the production of counterfeit tobacco products, violating customs prohibitions, and non-payment of duties. Tobacco smuggling can lead to jail terms of from one to seven years. Different levels of fines can also be imposed by the courts. Violation in paying VAT or other duties also carries penalties.

The following are criminal offenses punishable under the Penal Code:

- » Using a false trademark to mislead consumers about the origin of goods
- » Counterfeiting a trademark used by another enterprise.

The punishment for using a false trademark is imprisonment for up to one year, or a fine, or both. The punishment for counterfeiting is imprisonment for up to two years, or a fine, or both. The courts also have the power to set the prison term and the amount of any fine. In

In addition, the Penal Code identifies several activities as criminal offenses and sets out various enforcement measures available to rights holders. Two such offenses, and their punishments, are as follows:

- » Making or possessing any instrument for counterfeiting a trademark – the punishment for this offence is imprisonment for up to three years, or a fine, or both;
- » Selling, exposing, or possessing for sale or any purpose of trade or manufacture any goods bearing a counterfeit mark – the punishment for this offence is imprisonment for up to one year, or a fine, or both.

In cases of counterfeiting, a rights holder may file a criminal complaint with the police. If the complaint is genuine, the case then goes to trial before a court. In addition, police officials may launch raids to seize counterfeit and pirated goods and take additional legal and enforcement actions. All criminal cases relating to false trademarks or counterfeiting are tried by a magistrate's court (first or second class, or a metropolitan magistrate in an urban area). Any appeal against the magistrate's order must be made to a district magistrate or session judge. Remedies available in criminal actions include the following:

- » Raids on the premises where the counterfeit goods are stored;
- » Seizure of the goods;
- » Destruction of the counterfeit goods; and/or
- » Imposition of penalties on the infringer.

Administrative Arrangements for Implementation of Tobacco Policy

The government recognizes that tobacco policy administration is a multi-sectoral task requiring coordination among many agencies at national and district levels. Administrative arrangements are summarized in Table 4.

Four ministries -- the Ministry of Health (MoH), the Ministry of Finance (MoF), the Ministry of Agriculture, and the Ministry of Home -- and the Cabinet Division are involved with the implementation of tobacco policy. The MoH and MoF are the two key coordinating ministries.

Ministry of Health: The MoH develops medium-term tobacco control strategies, policies, and programs. It is also responsible for overall coordination, implementation, and monitoring of non-tax related tobacco control programs and policies. The National Tobacco Control Cell (NTCC) was established within the MoH in 2007. The NTCC has become the national hub for the coordination of tobacco control activities and a referral and support center for all tobacco control stakeholders, including NGOs, in Bangladesh.

To help the MoH develop and implement tobacco-related strategies and policies, the government has set up several multi-sectoral bodies. At the national level, the government established the National Task Force for Tobacco Control (NTFTC). All relevant government

Table 4. Tobacco Policy Administration in Bangladesh

MINISTRY	RELEVANT DEPARTMENT	ENFORCING DEPARTMENT(S)	RESPONSIBILITY
Ministry of Home	Border Guard Bangladesh	Coast Guard & BGB	Keep check of smuggled products in land/maritime boundaries
	Police Administration	Police	On ground enforcement against any non-compliance
		Rapid Action Battalion Armed Police Battalion	
Ministry of Finance	National Board of Revenue	VAT & Customs Intelligence	Identify and investigate revenue shortfalls
		VAT Implementation	Tax stamp, banderole check
		VAT Policy	Any policy creation / amendment
		All 13 VAT Commissionerate	On the ground revenue authorities. Right to enforce if any loopholes related to revenue collection found
		Customs Intelligence Cell Customs Intelligence & Investigation Directorate	Keep check of smuggled products in various entry points
Ministry of Agriculture	Department of Agriculture & Extension	All custom houses	
			Keep check of practices related to cultivation
Ministry of Health	National Tobacco Control Cell (NTCC)		Develop Tobacco control policies and check compliance to TCA
Cabinet Division	Divisional Commissioner	Magistrates	Enforcement against TCA non-compliance and ensure legit trade and commerce in relevant division/district
	Deputy Commissioner		

institutions, NGOs, legal and media organizations, and international partners that could influence tobacco control policies are represented here. The NTFTC serves as the overarching coordinating and supervising body that provides oversight to the NTCC in the development and implementation of tobacco control laws. On the implementation front, the NTCC is supported by two local-level task forces – one at the District (Zila) level and the other at the sub-district (Upazila) level. These local-level task forces are innovative mechanisms for low-cost delivery of tobacco control policies at the consumer level. When developed to their full potential and adequately funded, they may contribute crucially to further strengthening the government’s tobacco control administration (Jackson-Morris et al. 2015).

The combination of the NTCC and the three task forces (one at the national level and two at local level) provides a solid institutional foundation for tobacco control in Bangladesh.

The Ministry of Finance National Board of Revenue: The MoF's National Board of Revenue (NBR) is the lead agency for tobacco taxation and pricing policies. Tobacco taxation in Bangladesh is governed by the country's 1991 Value-Added Tax (VAT) Law. There is no separate law for tobacco taxation per se, and there are no subnational tobacco taxes. Tobacco tax rates are periodically reviewed in the context of the annual national budget cycle. The enforcement of tobacco tax is carried out by a VAT Commissionerate and its field offices, namely Divisions and Circles.

The NBR customs unit monitors cross-border movements of goods and services, including tobacco. Air and sea ports are well monitored with modern equipment to control smuggling. There are allegations of customs abuses in clearance of air and sea port cargoes, but these are governance issues for the customs system as a whole that require constant monitoring. The land border check-ports are less well equipped and staffed. Also, Bangladesh's land border is large, open, and nearly impossible to oversee fully, creating the potential for tobacco smuggling via land routes.

Enforcement of Tobacco Laws through the Mobile Court System: The mobile court drive is an exceptional element of the judiciary system in Bangladesh. It is being used for rapid dispensation of justice in certain non-criminal cases, including the violation of anti-tobacco laws (for example, smoking in public places or displaying tobacco advertisements). On-the-spot actions are taken, such as removing billboards containing tobacco product advertisements and removing other tobacco advertising materials from locations such as fast-food corners, sports facilities, and restaurants. When tobacco advertisements are targeted, an empowered mobile court magistrate can try the case immediately, ensure removal of the offending materials, and punish the perpetrators as per the law. Members of law enforcement agencies, including the police, provide the magistrate with necessary support.

Under the powers of the 2005 Tobacco Control Act, the Deputy Commissioners of different Zillas (Districts) are authorized to conduct mobile courts within their jurisdictions to apprehend any violation of tobacco-related legislation, including retail-level selling of illicit tobacco. But these efforts are conducted sporadically, based on the availability of budgetary resources. The NTCC head has informed that a part of the resources now being raised as Health Surcharge will be used to fund such mobile court operations at regular intervals. In a recent order, the Cabinet Division has asked the Deputy Commissioners to regularly hold mobile courts in their Districts and send monthly reports to the NTCC.

The NTCC head believes that one of the key enforcement challenges in stopping the illicit tobacco trade is to target small retail outlets in rural and urban areas. Cigarettes, biris, and SLT are largely sold to consumers in small shops and tea stalls across the country without any licensing needs. Had there been designated tobacco selling points, then much of the illicit tobacco trade would disappear. The NTCC head stated that, as a pilot initiative, the

NTCC is working with the Mayor of Rangpur to define a limited number of designated and licensed tobacco retailers across the city. If the pilot works, then the NTCC will expand this effort in other parts of the region. As noted earlier, a large part of Bangladesh's illicit tobacco trade is concentrated in the greater Rangpur region.

3. Reform Agenda to Control Illicit Tobacco Trade

Tobacco control in Bangladesh, including the control of illicit trade, offers a positive story. The country's progress in reducing the use of tobacco is encouraging. Adoption of laws, regulations, and taxation policies is consistent with international good practice. Of particular note, the average tax share of retail cigarette prices in Bangladesh is now 71.5 percent. Despite this positive track record, a large unfinished agenda must be addressed as Bangladesh moves ahead with its tobacco control agenda. Key reform priorities are discussed below.

- » **Monitor biri production and distribution:** The monitoring of biri production and distribution presents a major challenge for Bangladesh. Knowledge on biri production, the geographical distribution of factories, and compliance with tax laws remains weak. The recent reforms of biri pricing and taxation have now raised the stakes for potential revenue gains and for reduction of those gains through tax evasion revenue losses. The government could improve the security of the biri banderole in a similar manner as it has done for cigarettes. The monitoring of biri banderole use by posting NBR staff in all factories may be difficult, owing to the wider dissemination of biri manufacturing. However, several steps can be taken to strengthen the biri banderole system. First, NBR staff could potentially be posted in larger production units managed by the major biri producers. Second, the government potentially could encourage the formation of a Biri Manufacturers Association and encourage manufacturers to self-police the system. Third, the pilot program being run in Rangpur to monitor the sale of tobacco products in retail shops might be studied and developed for replication in other major cities. In addition, research could enable a better understanding of the distribution of biri manufacturing across the country, the industry's ownership structure, total production, the marketing chain, and illicit trade issues.
- » **Monitor both inputs and outputs to prevent tax evasion:** While the government needs to continue enforcement against illegal tobacco products at the different manufacturing points as well as at the retail level, officials should also increase their vigilance in monitoring tobacco sourcing. Cigarettes and biris require processed tobacco, and processed tobacco can only be obtained in Bangladesh from a few Green Leaf Threshing Plants (GLTPs) run by the large cigarette and biri manufacturers. Ensuring effective accountability around inputs and outputs will help unearth processed tobacco leakage that may be flowing to the manufacturers of illegal cigarettes and biris.

- » **Strengthen regional VAT offices:** The regional VAT field offices and the customs intelligence administration are two critical NBR agencies for the control of illicit tobacco trade. Given the concentration of illicit tobacco trade in the northern part of Bangladesh, the related regional Commissionerates of Rajshahi and Rangpur need to be strengthened to improve tax compliance and monitoring. Regular progress reports on enforcement efforts in the northern districts should be required, along with evidence of implementation progress.
- » **Strengthen local-level task forces:** Policy makers have begun to test the innovative idea of establishing low-cost implementation task forces at the local level to implement tobacco laws, including those concerning illicit trade. This approach has potential but would need to be fully developed, including through allocation of resources. Support to conduct regular mobile court operations also would seem to hold potential to strengthen tobacco control at the local level.
- » **Develop and publish a database on the incidence of illicit tobacco trade and actions taken:** Presently there is no reliable NBR database on the incidence of illicit tobacco trade. This gap should be addressed systematically. This should involve going beyond industry sources to develop independent estimates of illicit tobacco trade. The government should supplement industry illicit trade data with its own efforts to estimate illicit cigarette trade. Regarding biri, the estimated data on production based on revenue yields and prices can be strengthened and supplemented by the findings of the proposed survey-based research on biri production, consumption, and distribution. The reconciliation of the survey data with the revenue data can then provide an estimate of illicit biri trade. The NBR takes many actions to enforce compliance with tobacco tax laws. The kinds of steps taken, the volume of illicit tobacco products involved, and the penalties imposed for non-compliance should be documented and published on the agency's website.
- » **Ratify the Illicit Tobacco Trade Protocol:** As noted, Bangladesh was the first country to sign the FCTC. Consistent with its significant achievements in the areas of tobacco control, Bangladesh should sign and ratify the Illicit Tobacco Trade Protocol.

References

- Ahmed, Nasiruddin. 2013. "Tobacco Taxation in Bangladesh: Political and Administrative Constraints". Power point presentation made to 15th World Conference on Tobacco or Health 2012 Singapore, March 23, 2012.
- Ahmed, Nasiruddin. 2010. "Tobacco Taxation and Evasion in Bangladesh". Power Point presentation, Shenzhen, China, August 20, 2010.
- Ahmed, Sadiq, Khurshid Alam and Bazlul Khondker. 2018. *Faster Development of the Micro, Small and Medium Enterprises: Role of Innovative Financing Solutions*. Draft Report Prepared for the World Bank, Policy Research Institute of Bangladesh, Dhaka.
- American Cancer Society and Vital Strategies. 2018. The Tobacco Atlas 2018 <https://tobaccoatlas.org/>
- British American Tobacco (BAT). 2018. "The global market: Trends affecting our industry". www.bat.com/group/sites/UK. Downloaded March 26, 2018.
- Centers for Disease Control and Prevention (CDC). 2016. *Preventing and Reducing Illicit Tobacco Trade in the United States*. www.cdc.gov/tobacco/stateandcommunity/pdfs/. Downloaded March 26, 2018.
- Global Adult Tobacco Survey, 2017. Fact Sheet for 2017 Survey & 2009/2017 Comparison Fact Sheet (last updated on August 7, 2018). <http://www.searo.who.int/bangladesh/gatsbangladesh2017fs14aug2018.pdf> Accessed on August 20, 2018.
- ITC Project. 2014. *Tobacco Price and Taxation Policies in Bangladesh: Evidence of Effectiveness and Implications for Action*. University of Waterloo, Waterloo, Ontario, Canada, May 2014.
- Jackson-Morris, Angela M., Ishrat Chowdhury, Valerie Warner and Kayleigh Bleymann. 2015. "Multi-Stakeholder Taskforces in Bangladesh — A Distinctive Approach to Build Sustainable Tobacco Control Implementation". *International Journal for Environmental Research and Public Health* 2015, 12, 474-487.
- Mansur, Ahsan 2015. *A Review of Cigarette and Biri Pricing and Taxation in Bangladesh*. Policy Research Institute (PRI), Dhaka.
- Nargis, N., U.H. Ruthbah, A.K.M. Ghulam Hussain, G.T. Fong, I. Huq, and S.M. Ashiquzzaman. 2014. "The price sensitivity of cigarette consumption in Bangladesh: Evidence from the International Tobacco Control (ITC) Bangladesh Wave 1 (2009) and Wave 2 (2010) Surveys". *Tobacco Control*, 23, i39-i47.
- World Health Organization (WHO). 2009. *Global Adult Tobacco Survey: Bangladesh Report 2009*. Dhaka Country Office for Bangladesh. Available at: www.who.int/entity/tobacco/surveillance/global_adult_tobacco_survey_bangladesh_report_2009.pdf
- World Health Organization (WHO). 2017. *Global Tobacco Epidemic 2017. Bangladesh Country Profile*. http://www.who.int/tobacco/surveillance/policy/country_profile. Downloaded March 27, 2018
- World Health Organization (WHO). 2018. "Making a difference: Tobacco Control in Bangladesh" <http://www.searo.who.int/bangladesh/enbantobaccosuccess/en/> Downloaded March 27, 2018

Annexes

Annex 1. List of Non-Tax Tobacco Control Laws

English versions of all tax laws and the implementation of these laws in the three major areas relating to anti-smoking strategy -- smoke free places; advertising, promotion and sponsorships; and packaging and labeling-- are available and can be downloaded from the following website: <https://www.tobaccocontrolaws.org/legislation/country/bangladesh/laws>

Table A1.1. Bangladesh Non-Tax Tobacco Control Laws

SL. NO	EFFECTIVE DATE OF LAW	NAME OF LAW / RULE
1.	May 1, 1890	Article 110 of the Railways Act, 1890 (Act No. IX 1890)
2.	February 1, 1919	The Juvenile Smoking Act, 1919
3.	March 12, 2005	Smoking and Using of Tobacco Products (Control) Act, 2005
4.	May 29, 2006	Smoking and Using of Tobacco Products (Control) Rules, 2006
5.	May 2, 2013	Smoking and Tobacco Products Usage Control (Amendment) Act, 2013 (Act No. 16 of 2013)
6.	March 12, 2015	Smoking and Tobacco Products Usage (Control) Rule, 2015 (S.R.O. No 58).
7.	March 12, 2015	Ministry of Health and Family Welfare Pictorial Health Warnings (Issued pursuant to Smoking and Tobacco Products Usage (Control) (Amendment) Act, 2013 and Smoking and Tobacco Products Usage (Control) Rule, 2015
8.	July 4, 2017	Ministry of Health and Family Welfare, National Tobacco Control Cell, Public Notice

Source: Ministry of Health

Annex 2. Contents of Non-Tax Tobacco Control Laws

Table A2.1. Links of Law/Rule

SL. NO	EFFECTIVE DATE OF LAW	LINKS OF LAW / RULE
1.	May 1, 1890	<i>Article 110 of the Railways Act, 1890 (Act No. IX 1890)</i>
2.	February 1, 1919	<i>The Juvenile Smoking Act, 1919</i>
3.	March 12, 2005	<i>Smoking and Using of Tobacco Products (Control) Act, 2005</i>
4.	May 29, 2006	<i>Smoking and Using of Tobacco Products (Control) Rules, 2006</i>
5.	May 2, 2013	<i>Smoking and Tobacco Products Usage Control (Amendment) Act, 2013 (Act No. 16 of 2013)</i>
6.	March 12, 2015	<i>Smoking and Tobacco Products Usage (Control) Rule, 2015 (S.R.O. No 58).</i>
7.	March 12, 2015	<i>Ministry of Health and Family Welfare Pictorial Health Warnings (Issued pursuant to Smoking and Tobacco Products Usage (Control) (Amendment) Act, 2013 and Smoking and Tobacco Products Usage (Control) Rule, 2015</i>
8.	July 4, 2017	<i>Ministry of Health and Family Welfare, National Tobacco Control Cell, Public Notice</i>

Annex 3. Analytical Tables and Graphs

Table A3.1. Trend of Cigarette and Biri Production (billion sticks)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Premium	2.9	3.3	4.1	4.4	5.2	4.2	3.8	4.1	4	4.4
High	7.5	6.8	9.2	7	8.1	8.1	8.8	8	4.6	4.5
Medium	11.7	18.8	19.2	19.9	19.4	14.6	16.8	12.5	9.4	8.8
Low	1.4	13.7	33.6	41.5	49.4	39.7	50.3	58.1	65.9	66.8
Total Cigarette	23.5	42.7	66	72.8	82.1	66.6	79.7	82.7	83.8	84.5
Biri	35.3	46.3	63.4	67.2	72.8	44.4	46.8	44.5	43.2	43.5
Total Cigarette & Biri	58.8	89	129.4	140	154.9	111	126.5	127.2	127	128

Source: National Board of Revenue

**Table A3.2. Import and Domestic Taxes on Tobacco and Tobacco-related Products
FY2017/18**

HS CODE	HARMONIZED DESCRIPTION	TARIFF ON IMPORTS							TARIFF ON DOMESTIC PRODUCTION		NPR
		CD	SD	VAT	RD	AIT	ATV	TTI	SD	VAT	
2401.10.00	Tobacco not stemmed/ stripped	25	60	15	3	5	4	150.897	0	0	135.520
2401.20.00	Tobacco partly or wholly stemmed/ stripped	25	60	15	3	5	4	150.897	0	15	104.800
2401.30.00	Tobacco refuse	25	60	15	3	5	4	150.897	0	15	104.800
2402.10.00	Cigars, cheroots & cigarillos, containing tobacco	25	350	15	3	5	4	596.585	0	15	476.000
2402.20.00	Cigarettes containing tobacco	25	350	15	3	5	4	596.585	65	15	249.091
2402.90.00	Cigars, cheroots, cigarillos and cigarettes, of tobacco substitutes	25	150	15	3	5	4	289.214	35	15	137.037
2403.11.00	Smoking tobacco, ...substitutes in any proportion: Water pipe tobacco specified in Subheading Note 1 to this Chapter	25	150	15	3	5	4	289.214	0	15	220.000
2403.19.00	Smoking tobacco, whether or not containing tobacco substitutes in any proportion: Other	25	150	15	3	5	4	289.214	0	15	220.000
2403.91.00	"Homogenised" or "reconstituted" tobacco	25	150	15	3	5	4	289.214	0	15	220.000
2403.99.00	Other manufactured tobacco/tobacco substitutes	25	150	15	3	5	4	289.214	100	15	60.000
4802.54.10	Yellow base paper imported by VAT registered cigarette manufacturing industries of weighing less than 40 g/m ²	25	10	15	3	5	4	74.054	0	15	40.800
4813.10.10	Cigarette paper in the form of booklets or tubes: Imported by VAT registered tobacco products manufacturing industries	25	100	15	3	5	4	212.371	20	15	113.333

Table A3.2. Import and Domestic Taxes on Tobacco and Tobacco-related Products
 FY2017/18, Cont.

HS CODE	HARMONIZED DESCRIPTION	TARIFF ON IMPORTS							TARIFF ON DOMESTIC PRODUCTION		NPR
		CD	SD	VAT	RD	AIT	ATV	TTI	SD	VAT	
4813.10.90	Cigarette paper in the form of booklets or tubes: Other	25	100	15	3	5	4	212.371	20	15	113.333
4813.20.10	Cigarette paper in rolls of a width <=5 cm: Imported by VAT registered tobacco products manufacturing industries	25	100	15	3	5	4	212.371	20	15	113.333
4813.20.90	Cigarette paper in rolls of a width <=5 cm: Other	25	100	15	3	5	4	212.371	20	15	113.333
4813.90.10	Cigarette paper: Other: Imported by VAT registered tobacco products manufacturing industries	25	100	15	3	5	4	212.371	20	15	113.333
4813.90.90	Cigarette paper: Other: Other	25	100	15	3	5	4	212.371	20	15	113.333
3824.99.40	Bottle/Refill used in Electronic Nicotine Delivery System (ENDS)	25	100	15	3	5	4	212.371	0	15	156.000
8543.70.50	Other machines and apparatus: Electronic Nicotine Delivery System (ENDS)	25	100	15	3	5	4	212.371	0	15	156.000

Source: National Board of Revenue (NBR)

Notes: CD= Custom Duty; SD = Supplementary Duty; VAT = Value Added Tax; RD= Regulatory Duty; AIT = Advance Income Tax; ATV= Advanced Trade VAT; TTI= Total Tax Incidence; NPR= Nominal Protection Rate;

Table A3.3. Pricing Slab & Levied Tax for Cigarettes FY2014-15

SEGMENT	PRICING SLAB (10s PACK)	SD	VAT	HEALTH SURCHARGE	TOTAL TAX LEVIED
Premium	BDT 90 & Above	61%	15%	1%	77%
Dead Zone	BDT 55-89				
High	BDT 50 - BDT 54	61%	15%	1%	77%
Dead Zone	BDT 36-49				
Medium	BDT 32 - BDT 35	60%	15%	1%	76%
Dead Zone	BDT 17-32				
Low	BDT 15 - BDT 16.5	43%	15%	1%	59%

Source: National Board of Revenue (NBR)

Table A3.4. Pricing Slab & Levied Tax for Cigarettes FY2015-16

SEGMENT	PRICING SLAB (10s PACK)	SD	VAT	HEALTH SURCHARGE	TOTAL TAX LEVIED
Premium	BDT 70+	63%	15%	1%	79%
High	BDT 44 - BDT 69	61%	15%	1%	77%
Dead Zone	BDT 42.01-43.99				
Medium	BDT 21- BDT 42	60%	15%	1%	76%
Dead Zone	BDT 19-20				
Low	BDT 18	48%	15%	1%	64%

Source: National Board of Revenue (NBR)

Table A3.5: Pricing Slab & Levied Tax for Cigarettes FY2016-17

SEGMENT	PRICING SLAB (10s PACK)	SD	VAT	HEALTH SURCHARGE	TOTAL TAX LEVIED
Premium	BDT 70+	65%	15%	1%	81%
High	BDT 45 - BDT 69	63%	15%	1%	79%
Dead Zone	BDT 23.01-44.99				
Low	BDT 23	50%	15%	1%	66%

Source: National Board of Revenue (NBR)

Table A3.6. Pricing Slab & Levied Tax for Cigarettes FY2017-18

SEGMENT	PRICING SLAB (10s PACK)	SD	VAT	HEALTH SURCHARGE	TOTAL TAX LEVIED
Premium	BDT 70+	65%	15%	1%	81%
High	BDT 45 - BDT 69	63%	15%	1%	79%
Dead Zone	BDT 27.01-44.99				
Low	BDT 27	52%	15%	1%	68%

Source: National Board of Revenue (NBR)

Table A3.7. Tax Structure for Biri FY2014-15

TYPE	PACK SIZE	TRUNCATED TARIFF VALUE	SD	VAT
Without Filter	25 Sticks	4.27	25%	15%
	12 Sticks	2.05	25%	15%
	8 Sticks	1.37	25%	15%
With Filter	20 Sticks	4.64	30%	15%
	10 Sticks	2.32	30%	15%

Source: National Board of Revenue (NBR)

Table A3.8. Tax Structure for Biri FY2015-16

TYPE	PACK SIZE	TRUNCATED TARIFF VALUE	SD	VAT
Without Filter	25 Sticks	4.91	25%	15%
	12 Sticks	2.36	25%	15%
	8 Sticks	1.58	25%	15%
With Filter	20 Sticks	5.34	30%	15%
	10 Sticks	2.69	30%	15%

Source: National Board of Revenue (NBR)

Table A3.9. Tax Structure for Biri FY2016-17

TYPE	PACK SIZE	TRUNCATED TARIFF VALUE	SD	VAT
Without Filter	25 Sticks	7.10	30%	15%
	12 Sticks	3.40	30%	15%
	8 Sticks	2.25	30%	15%
With Filter	20 Sticks	7.75	35%	15%
	10 Sticks	3.85	35%	15%

Source: National Board of Revenue (NBR)

Table A3.10. Tax Structure for Biri FY 2017-18

TYPE	PACK SIZE	RETAIL PRICE (BDT)	EXCISE	VAT
Without Filter	25 Sticks	12.50	30%	15%
	12 Sticks	6.00	30%	15%
	8 Sticks	4.00	30%	15%
With Filter	20 Sticks	12.00	35%	15%
	10 Sticks	6.00	35%	15%

Source: National Board of Revenue (NBR)

Annex 4. The Functioning of Tobacco Stamps and Banderoles in Bangladesh

Stamps and banderoles are the two instruments used for controlling illicit tobacco trade and to reconcile with the tax revenue collected. These are all printed at the Government Security Printing Press in Dhaka. Stamps and banderoles are both used in the case of cigarette packets, while for biri only banderoles are used.

The tobacco companies producing cigarettes take upfront delivery of the banderole and stamp sheets from the Security Printing Press based on their production projections. On the other hand, the banderoles for biri producers are distributed through the Post Offices, since a substantial amount of biri is produced in remote areas in homesteads and cottage-level industry. The stamps and banderoles for cigarette companies are distributed free of charge. The cigarette companies are allowed a maximum 1 percent wastage on the banderoles and stamps for reconciliation with the tax revenue collected. For biris, the banderoles must be purchased at the specified tax value. These are final tax obligations for biri manufacturers,

since the NBR does not have the infrastructure to monitor biri production among the large number of small-scale biri producers.

The stamps and banderoles have built-in security features. The security features are not usually visible to the naked eye but can be detected by tax officials using special hand-held instruments. One feature on the banderole used on cigarette packets is a small rectangular piece of silver colored foil. The paper used for printing stamps and banderoles for cigarette packets is of better quality than the banderoles for biris.

For cigarettes, false stamps and banderoles are uncommon because of higher production quality and security features. However, industry officials point out that the legally produced banderole could be un-glued through a warming process and reused on illicit white and counterfeit cigarettes. In the case of biris, the forging of banderoles is easier owing to low quality. The use of forged banderoles and reused banderoles is more common, and it is extremely difficult to monitor with retailing taking place in millions of wayside small shops across the country. The reuse of stamps and banderoles on illicit white and counterfeit cigarettes is facilitated by the fact that many people buy single sticks and retailers then can remove the stamp or banderole through warming and sell it to those marketing counterfeit cigarettes.

Cigarette Boxes: There are two types of boxes used for retailing cigarettes. These are what are termed in the industry (a) hinge-lid packs, and (b) shell and slide packs. The hinge-lid pack cigarettes are opened at the top after the cellophane cover is taken off. The shell and slide pack, on the other hand is opened by opening the lid after the cellophane cover is removed and then sliding out the cigarettes by pushing them out of the shell. In the case of cigarettes, hinge-lid packs are increasing in popularity and now account for 95 percent of packets sold. Thus, for cigarettes, stamps are the most important means of tobacco trade control. The number of cigarette sticks in a packet and the cigarette quality as pre-determined by NBR (Premium, High, and Low) are clearly printed on stamps and banderoles on cigarette packs. The packets can contain 10 or 20 sticks.

Stamps are used only on hinge-lid packets. The stamps are placed at the point where the lid is flipped open so that the stamp tears out while opening. Stamp colors vary for different cigarette segments.

Banderoles are only used on shell and slide cigarette packs. The banderoles are longer and placed on one side and extended to top and bottom ends of the packets. When displaced to remove the cigarettes, the banderole breaks.

Biri boxes and packs: Biri is sold in three forms – (a) hinge-lid packs, (b) shell and slide packs, and (c) paper-wrapped packs (Mutha Biri in local language). The hinge-pack is used for filter-tipped biri sold as handmade cigarettes. Even for the hinge-lid type pack, only a banderole is used. It is pasted on the side and extended to the top and bottom of the box. The banderoles are similarly fixed on shell and slide and paper-wrapped biri packs. The banderoles are of three different colors for the three types of packaging used. The number of biris in each pack is stamped. Packs can contain 20, 22, or 25 biris.

Cigarette Tax Collection: The VAT officials collect taxes based on actual production going out of the factory gate, where a VAT official is present and signs off on the chalan (paper document). At a subsequent road junction, there is another level of checking by VAT officials who again verify vehicle contents against the chalan issued at the factory gate. Later, the total tax revenue collection is reconciled with the stamps and banderoles that each producer has received, allowing for the 1 percent permissible wastage.

Biri Tax Collection: Operates through the value of biri banderoles sold at Post Offices.

INDONESIA

15

INDONESIA:

Tackling Illicit Cigarettes

Abdillah Ahsan¹

Chapter Summary

Indonesia exhibits a high prevalence of smoking among adults. Indeed, among adult men, the rate of tobacco use is the highest in the world. Among Indonesian smokers, 95 percent use kretek, a tobacco and clove cigarette that is produced domestically. The biggest machine-made kretek (sigaret kretek mesin) producer, who also sells the most expensive cigarette in the market, has a 63 percent market share. This highlights that most smokers can still afford the most expensive brand. Cigarettes are affordable in Indonesia.

Although the government of Indonesia has not ratified the Framework Convention on Tobacco Control (FCTC), it already implements some tobacco control policies. It relies on a specific multitiered tobacco product excise system that protects domestic, especially kretek, producers, but also fosters a wide range of prices. However, the affordability of cigarettes represents a public health challenge: public health is deteriorating because cigarettes are inexpensive.

There are three types of taxation on cigarettes: the excise tax, the value-added tax, and local cigarette taxes. While the excise tax is aimed at controlling consumption, local cigarette taxes are effectively designed to increase the revenue of local governments.

The average excise tax rate is 49.1 percent of the retail price, which is below the 70 percent recommended by the World Health Organization (WHO). The value-added tax is 9.1 percent

¹ Faculty of Economics and Business, Universitas Indonesia

of the retail price, and the local cigarette tax is 10 percent of the excise tariff. Combined, the average total tax burden on a cigarette is around 62.7 percent of the retail price. Although this seems quite high, the cost is so low that even primary-school students can afford to buy cigarettes using their daily school allowance. (Individual cigarettes are widely offered for sale.)

The illicit trade in cigarettes nonetheless increases cigarette consumption, because the price is even lower as a consequence of the tax evasion. The greater cigarette consumption threatens public health and government revenue.

The Indonesian tobacco industry is tolerant of current public policy making on cigarettes. It often points to the illicit trade in cigarettes in arguing for lower tobacco excise taxes.

Indonesia has comprehensive excise regulations that govern many aspects of excise administration. The enthusiasm for local autonomy has created avenues for the enforcement of regulations on illegal cigarettes because local governments are also mandated to carry out some enforcement of two fiscal mechanisms, tobacco excise revenue sharing and the local cigarette tax. The government has used excise stamps for cigarettes since 1950. The security features of the excise stamps are quite difficult to counterfeit. The inclusion of the successful supervision of the trade in illegal excise goods in working contracts and key performance indicators since 2017 has had a positive impact on the enforcement activities of the Directorate General of Customs and Excise (DGCE) on illegal cigarettes. The DGCE, which is under the Ministry of Finance, runs the High-Risk Excise Control Program, a flagship program under the Customs and Excise Strengthening Reform Program launched by the Ministry of Finance in December 2016.

Domestic free trade zones (FTZs) have generated challenges in the enforcement of regulations on illegal cigarettes because cigarette production and trade in the FTZs are exempted from excise duties. The problem arises because non-FTZ areas are becoming exposed to the cigarette trade in the FTZs. The DGCE has explained that, if there were no excise exemption in the FTZs, then their burden of enforcement would decrease by 40 percent.

As a result of the reform in the excise tax and enforcement, the number of enforcement operations aimed at illegal cigarettes has increased by a factor of almost four, from 996 operations in 2014 to 3,950 in 2017. The estimated share of the domestic illicit trade in the total cigarette market thus shrank from 12.1 percent in 2016 to 7.0 percent in 2018. The decline is evidence that raising the tobacco excise tariff in 2016–18 and accompanying this with enforcement has been an effective reform.

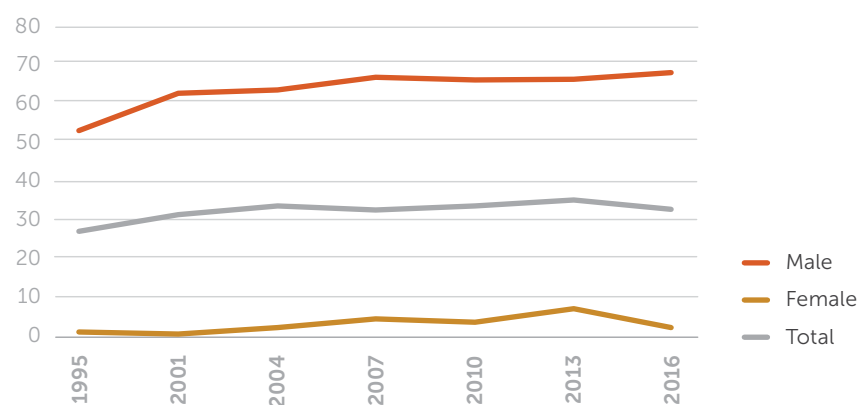
For the future, the institutional capacity of the excise administration in the DGCE should be enhanced. Moreover, raising the tobacco tax and the price of cigarettes would help significantly reduce the affordability and consumption of cigarettes. The tobacco excise system should also be simplified to reduce the incentives for illegal cigarette activities.

1. Background

Tobacco Use in Indonesia

The prevalence of smoking among adults in Indonesia rose from 27.0 percent to 32.8 percent over the period 1995–2016 (Figure 14.1). However, from 2013 to 2016, it declined from 36.3 percent to 32.8 percent. The prevalence of smoking among adult men exhibited a rising trend, from 53.4 percent in 1995 to 68.1 percent in 2016. This is among the highest prevalence rates globally.

Figure 1. Smoking Prevalence among Adults (15+), by Sex, Indonesia, 1995–2016



	1995	2001	2004	2007	2010	2013	2016
Male	53.4	62.2	63.1	65.6	65.8	66.0	68.1
Female	1.7	1.3	4.5	5.2	4.1	6.7	2.5
Total	27.0	31.5	34.4	34.2	34.3	36.3	32.8

Source: Zheng et al. 2018.

Note: Tobacco use includes daily and occasional cigarette smoking and tobacco chewing.

Most Indonesian smokers (74.2 percent) begin smoking at between 10 and 19 years of age (Table 14.1). The share of new smokers among the 10–14 age group almost doubled, from 9.0 percent to 17.3 percent, in 1995–2013. Indonesia has recently begun to register a demographic dividend. The proportion of the productive-age population is large and will peak in 2030–35, when the dependency ratio will be at its lowest. The rise in young smokers can potentially ruin the benefits of the demographic dividend. The future burden of disease related with tobacco use can compromise the potential improvement in welfare.

Table 1. Age at First Use of Tobacco, Adults (Ages ≥ 15), Indonesia, 1995–2013

AGE	1995	2001	2004	2007	2010	2013
5–9	0.6	0.4	1.7	1.9	1.7	1.5
10–14	9.0	9.5	12.6	16.0	17.5	17.3
15–19	54.6	58.9	63.7	50.7	43.3	56.9
20–24	25.8	23.9	17.2	19.0	14.6	16.3
25–29	6.3	4.8	3.1	5.5	4.3	4.4
30+	3.8	2.6	1.8	6.9	18.6	3.6

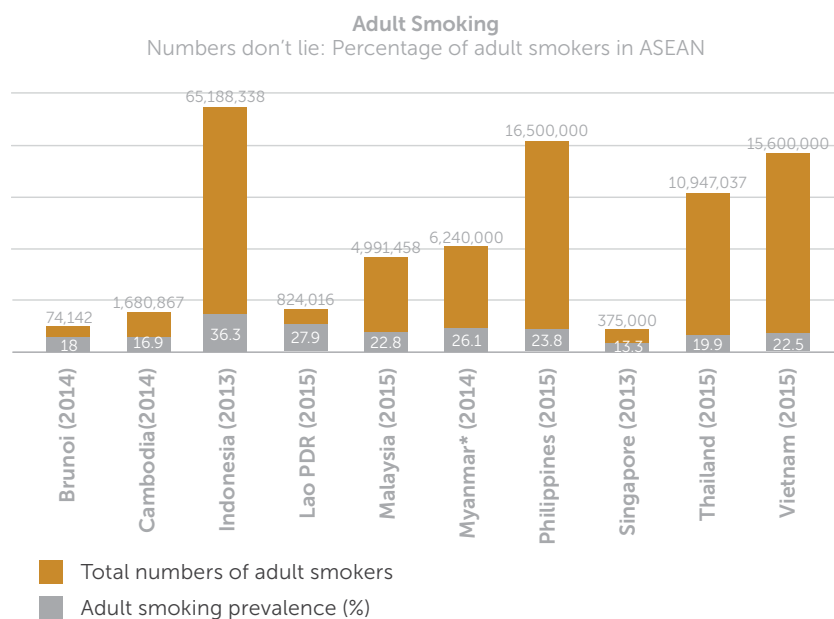
age cohort, %

Source: TCSC 2015.

Note: Tobacco use includes daily and occasional cigarette smoking and tobacco chewing.

The number of smokers in Indonesia in 2013 was 65.2 million (Figure 14.2). Indonesia accounts for the highest number of smokers in the region. This is because of the large share of adult smokers among the large population. The prevalence of smoking among adults in Indonesia is the highest in the region (36.3 percent). The high smoking prevalence and the large size of the population have drawn multinational tobacco corporations to enter the cigarette market in Indonesia.

Figure 2. Adult Smoking Prevalence and Total Number of Smokers, ASEAN Countries



Source: Lian and Dorotheo 2016.

Note: ASEAN = Association of Southeast Asian Nations.

The number of deaths attributed to tobacco was 230,862 in 2015. The macroeconomic losses associated with tobacco use consist of four components, as follows: expenditure for the purchase of cigarettes; lost disability-adjusted life years; productive years lost to morbidity, disability, and premature mortality; and medical expenditures associated with tobacco-attributable disease. In 2015, the total macroeconomic losses caused by tobacco use in Indonesia have been estimated at US\$45.9 billion (Kosen et al. 2017).

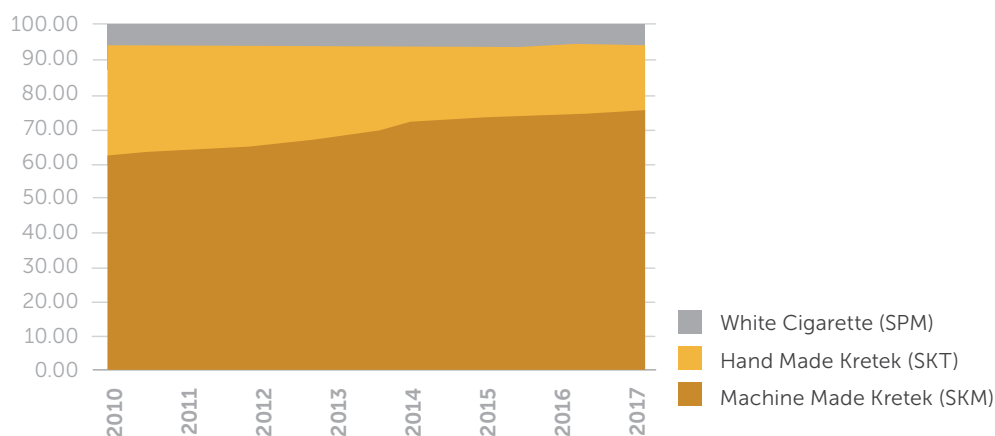
Market Share and Consumer Preferences

In Indonesia, there are three types of cigarettes: machine-made kretek (sigaret kretek mesin), hand-rolled kretek (sigaret kretek tangan, which contains tobacco and clove), and white (tobacco-only) cigarettes (sigaret putih mesin). Kretek is a cigarette consisting of tobacco, clove, and other ingredients. It is domestically produced in Indonesia. In 2010–17, there was a shift in market share toward machine-made kretek (Figure 14.3). This market share rose from 62.3 percent in 2011 to about 74.8 percent in 2017. At the same time, the market shares of hand-rolled kretek and white cigarettes were shrinking. The market share of the former fell from 31.4 percent to 20.2 percent in 2010–17. The market share of white cigarettes (mostly international brands) dropped from almost 6.3 percent to a little less than 5.0 percent over the same period. This has several implications. First, the cigarette industry in Indonesia has recently become more capital intensive. Hence, the industry demand for labor will fall because of the substitution effect between labor and machines. Second, the greater concentration on machine-made kretek will mean that the industry can sell more cigarettes more efficiently, thereby raising their profits significantly. This situation represents a public-health threat.

Because of the Ministry of Finance regulation on tobacco excise, the cigarette industry is stratified by type of cigarette, production group, and minimum price group. The three types of cigarettes are white cigarettes, hand-rolled kretek, and machine-made kretek. The two production groups of machine-made cigarettes (both white and kretek) are defined as: (1) below 3 billion and (2) above 3 billion individual cigarettes a year. There are four production groups for hand-rolled kretek: below 25 million, 25 million–100 million, 100 million–2 billion, and above 2 billion individual cigarettes a year. The last category, the minimum price group, depends on Ministry of Finance decisions, so that there are one or more price groups in each excise tier.

This stratification system was launched around the time of Indonesian independence in 1945. The government has maintained the system, with some modification, ever since. The system is designed to protect domestic and kretek producers in the face of competition from multinational cigarette corporations. However, from a public-health perspective, the tiered excise system creates wide price discrepancies, thereby hindering the effectiveness of tobacco price increases in controlling consumption (Fiscal Policy Board 2016).

Figure 3. Market Shares, by Type of Cigarette, Indonesia, 2010–17



	2010	2011	2012	2013	2014	2015	2016	2017
White Cigarette (SPM)	6.28	5.87	6.08	5.99	5.71	5.77	5.47	4.98
Hand Made Kretek (SKT)	31.41	30.37	28.63	25.43	21.67	20.88	20.72	20.23
Machine Made Kretek (SKM)	62.31	63.75	65.29	68.58	72.62	73.35	73.82	74.79

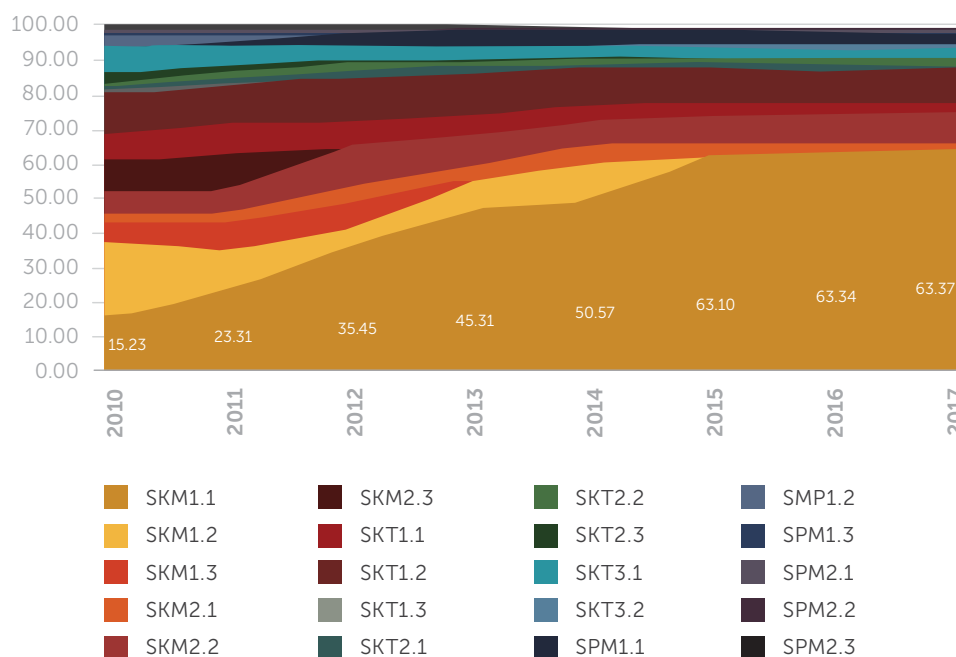
Sources: Zheng et al. 2018.

The cigarette industry in Indonesia is becoming more concentrated on the largest production group of machine-made kretek, more than 3 billion units per year (machine-made kretek 1) (Figure 14.4). This group has a 63.4 percent market share and the highest price. The other type of cigarette producers who have a dominant market share are hand-rolled kretek production group 1 and price group 2 (hand-rolled kretek 1.2) and machine-made kretek production group 2 and price group 2 (machine-made kretek 2.2). These cigarettes also have a relatively higher price. This is an anomaly, given that products at higher prices typically draw lower demand.

The Status of Tobacco Control Policies

Indonesia is the only country in Asia that has not ratified the Framework Convention on Tobacco Control (FCTC). The government has nonetheless implemented some degree of tobacco control, such as the national tobacco control roadmap, tobacco taxation, graphic health warnings, a limited ban on tobacco advertising, and local regulations on smoke-free areas in public places (Table 14.2).

Figure 4. Cigarette Market, by Type, Production Group, and Price Group, Indonesia, 2010–17



Sources: Zheng et al. 2018.

Indonesia's Tobacco Tax Policies

Indonesia imposes three types of taxes on tobacco products: the tobacco excise tax, the value-added tax, and the local cigarette tax. As noted above, the tobacco excise system is brand-specific and multi-tiered, based on the type of the product, the production group, and the minimum price group (Table 14.3). This complicated system creates wide price gaps that hinder the effectiveness of increasing tariffs and prices to reduce consumption. The system also creates complicated administrative requirements and generates incentives for illicit cigarette activities through the production of counterfeit excise stamps. However, the government raises the excise tariff and the minimum retail price on cigarettes every year at a rate greater than the inflation rate, and it thus decreases the affordability of cigarettes (Zheng et al. 2018). The government also plans to simplify the multitiered system from 10 tiers in 2018 to five tiers in 2021. The maximum allowable excise tariff is 57 percent of the retail price (Law No. 39 year 2007), and the 2017 excise tariff averaged 49.1 percent of the retail price (Ministry of Finance 2016). The second tax on tobacco products is the value-added tax. In 2017, the tariff was at 9.1 percent of the retail price. The third tax on cigarettes is the local cigarette tax implemented in 2014. The rate is at 10.0 percent of the excise tariff. Therefore, the average total tax burden on tobacco products is 62.7 percent of the retail price.

Table 2. Status of Tobacco Control, Indonesia, 2018

TOBACCO CONTROL POLICY	STATUS	REGULATION
Framework Convention on Tobacco Control	Not signed; not ratified	
National tobacco control roadmap	The policy target is to decrease smoking prevalence by 1 percent a year (2015–19) and decrease prevalence by 10 percent in 2024 relative to 2013 (from 36 percent to 26 percent).	Ministry of Health Regulation No. 40 year 2013 on Roadmap of Controlling the Health Impact of Tobacco Use
Tobacco tax	Multitiered excise system (10 tiers) based on type of product, production scale, and price range. The system hinders the effectiveness of tobacco excise policy to reduce tobacco use because it encourages downward substitution. The government also levies local taxes and value added taxes on cigarettes. The average excise tariff is 49 percent of the retail price, compared with the WHO recommendation of 70 percent. The local tax tariff is 10 percent of the excise tariff (4.9 percent of the retail price). The value added tax is 9.1 percent of the retail price.	Tobacco excise: Ministry of Finance Regulation No. 146/PMK.010/2017 Tobacco Product Excise Tariff
Tobacco advertising, promotion, and sponsorship ban	Limited ban on tobacco advertising on television. The ban allows advertising from 9.30 pm, when adolescents may still be watching, to 5 am local time. There is an increasing trend toward a ban on local outdoor tobacco advertising.	Government Regulation No. 109 year 2012 on Health Protection of Addictive Substances in the form of Tobacco Use. Several cities have issued local government regulations to ban outdoor tobacco advertising, for example, Jakarta Province, Bogor City, and Pekalongan City
Graphic health warnings	Graphic health warnings cover 40 percent of each pack of cigarettes (since 2014).	Government Regulation No. 109 year 2012 on Health Protection of Addictive Substances in the form of Tobacco Use
Smoke-free areas	It is mandatory for local governments to make public places smoke free by issuing local government regulations.	Government Regulation No. 109 year 2012 on Health Protection of Addictive Substances in the form of Tobacco Use

Source: World Bank analysis.

Note: WHO = World Health Organization

Although this rate seems quite high, making cigarettes less affordable, the majority of Indonesians can still afford to buy cigarettes. Indeed, the most-sold cigarette group is the one sold at the highest price. Based on the Ministry of Finance regulation, the minimum price of cigarettes ranges from Rp 4,800 (US\$0.34) to Rp 15,120 (US\$1.08) per pack of 12. The regulation allows cigarettes to be sold individually. Even primary-school children ages 7–12 can afford cigarettes, because their daily allowance averages Rp 10,000, which is sufficient to buy seven of the most expensive cigarettes (Susanto 2017).

Table 3. Tobacco Excise System, Indonesia, 2017–18

TYPE OF CIGARETTE	PRODUCTION GROUP	2017			2018		
		TIERS, NUMBER	MINIMUM RETAIL PRICE	EXCISE TARIFF, RP	TIERS, NUMBER	MINIMUM RETAIL PRICE	EXCISE TARIFF, RP
Machine-made kretek	1 (3 billion units or more)	1	1,120	530	1	1,120	590
	2 (less than 3 billion)	2	820	365	2	895	385
		3	655	335	3	715	370
White cigarettes	1 (3 billion and more)	4	1,030	555	4	1,130	625
	2 (less than 3 billion)	5	900	330	5	935	370
		6	585	290	6	640	355
Hand-rolled kretek	1 (2 billion or more)	7	1,215	345	7	1,260	365
		8	860	265	8	890	290
	2 (500 million–2 billion)	9	730	165	9	470	180
		10	470	155			
	3 (25 million–500 million)	11	465	100	10	400	100
	3B (below 25 million)	12	400	80			

Source: Ministry of Finance 2016, 2017a.

The Context of the Illicit Trade in Cigarettes

Indonesia is an archipelago of more than 10,000 islands. This is a challenge for law enforcement because of the wide area to be monitored. However, more than 60 percent of the population live on Java, where most of the tobacco industry is also located, in East Java, Central Java, and West Java. The cigarette market is dominated by kretek, a tobacco and clove cigarette, that is mainly produced domestically. The market share for kretek (machine-made or hand rolled) is 95 percent (Zheng et al. 2018). Hence, the demand for international white, tobacco-only cigarettes is low. This implies that the demand for smuggled white cigarettes is also low, but there could be high demand for illegal domestically produced kretek cigarettes.

Based on Ministry of Finance definitions, there are six types of illegal domestic cigarettes in Indonesia, as follows: unpacked cigarettes, cigarettes packed without excise stamps, cigarettes packed with forged or otherwise counterfeit excise stamps, cigarettes packed with excise stamps with incorrect business excise identification numbers, cigarettes packed with wrong designations, and cigarettes packed with used excise stamps (Ahsan et al. 2014). Another identifier of illegal cigarettes is the lack of a graphic health warning, which has been mandatory for every pack of cigarettes sold in Indonesia since June 24, 2014.

The regulations related to illicit cigarettes are listed in the Excise Law, No. 11 year 1995, and the revision, Law No. 39 year 2007. The responsible institution is the DGCE. After Indonesia's reformasi era (1998), local governments enjoyed greater power and autonomy, including enforcement in the illicit trade in cigarettes. Because of the tobacco excise revenue-sharing mechanism, the central government mandated that local governments contribute to the enforcement exercise on illicit cigarettes in their jurisdictions. Moreover, the DGCE, in enforcing regulations, may request assistance from the police and army. If such a request is made, the institution receiving it must fulfill the request (Law No. 39 year 2007, article 34).

The tobacco industry is readily accepted as a partner in the public policy-making process in Indonesia. It is still perceived as an important stakeholder. The excise law even states that the government must consider the aspirations of the tobacco industry in determining any increase in the tobacco excise tariff. While the interference of the tobacco industry in public policy making may be strictly prohibited in other parts of world, it is mandated in Indonesia by the current excise law (Law No. 39 year 2007, article 5). The tobacco industry often lobbies against raising the tobacco excise tax by referencing the need to inhibit the market for the less-expensive illicit cigarettes.

2. The Reform in Tackling Illicit Cigarettes

The Legal Framework

The approach adopted by the government to reduce the illicit trade in cigarettes is mainly embodied in Law No. 11 year 1995 and the partial revision in Law No. 39 year 2007. The former is a comprehensive law on excise collection and enforcement. It consists of 14 provisions (Table 14.4). This case study explores the regulations on illicit cigarettes contained in these laws and other government directives. It examines regulations on licensing, bookkeeping and monitoring, point-of-tax collection, excise-free and exemption facilities, restrictions on sales of tobacco products, details about cigarette production plants, and sanctions.

LICENSING

The government requires every factory owner, warehouse owner, importer, distributor, and retailer of excised goods to have a special license, the business excise identification number for excised goods producers. However, a special license is not required of distributors and retailers of tobacco products. The requirement only applies for ethyl alcohol and alcoholic beverages (Law No. 39 year 2007, article 14). The government can revoke the license for any one of eight reasons: no activity for one year; licensing requirements are no longer being met; the license holder no longer legally represents a legal entity or an individual who resides outside Indonesia; the license holder has been declared bankrupt; the license holder has not fulfilled the provisions laid out in paragraph (3), on inheritance of the license; the license holder has been sentenced for violating the provisions of this law; and the license

Table 4. Legal Provisions, Law No. 11 Year 1995 on Excise

NO.	TITLE	DESCRIPTION
1	General rule	General definitions used in the law
2	Excise goods, tariffs, and reference prices	Type of excise goods, tariffs, and reference prices
3	Payment and special facility	Procedure for payment and special facilities
4	Billing, refunds, and expiration	Administration and regulations on billing, refunds, and expiration
5	Licensing	Regulation on licensing
6	Bookkeeping and enumeration	Detailed procedures on recording and enumeration by the relevant authorities
7	Warehouse	Regulations on warehousing
8	Inflow, release, transportation, and trade	Regulations on inflow, release, transportation, and trade
9	Prohibition	Details on prohibition related to excise administration
10	Mandated authority in excise enforcement	Span of authority in excise enforcement by various institutions
11	Objection, appeals, and lawsuits	Procedures for objections and appeals
12	Criminal provision	Details on the criminal provision and sanctions
13	Investigation	Regulations and procedures in investigation
14	Other	

Source: World Bank analysis of Law No. 11 year 1995, on excise.

holder violates the provisions of article 30, the prohibition of production other than as stated in the license.

BOOKKEEPING AND MONITORING

Factory owners and warehouse owners involved with excised goods, including tobacco products, must register, in an inventory book, any product that has been produced at the factory, has entered the factory, or has been removed from the factory. Factory owners must periodically notify the head of the local Customs and Excise Office of details about their output (article 14). Factory owners and warehouse owners who do not record goods as required are liable to an administrative fine equal to the excise value that has not been recorded (article 16).

A customs and excise officer may at any time monitor the excised goods, including tobacco products, in the factory or warehouse. The owner of the factory and storage building must provide the officer with any equipment needed for the monitoring process (Law No. 11 year 1995, article 20). If the quantity of a product found during the monitoring process is less than the amount specified in the accounts, the factory or warehouse owners may be entitled to

receive a maximum 10 percent rebate (article 21). In the factory, import facility, or retail sales location where excise stamps are affixed, used excise stamps and used packs of cigarettes with excise stamps in good condition may not be stored (Law No. 39 year 2007, article 32).

POINT-OF-TAX COLLECTION

On domestically produced cigarettes, the excise tariff must be paid when the goods are released from the factory or warehouse. On imported cigarettes, the excise tariff must be paid when the product is imported for final consumption. The excise may be paid without affixing an excise stamp or the stamp may be affixed after the payout. If the payment of the excise tariff is associated with affixing the excise stamp, then the stamp must be affixed in accordance with the provisions of the law; otherwise, the tariff shall be considered unpaid (Law No. 39 year 2007, article 7).

EXCISE-FREE AND EXEMPTION FACILITY

An excise-free facility indicates that an excise tax is still levied on the tobacco product, but the owners do not have to pay the excise tariff if they meet certain conditions. There are five conditions under the excise-free facility, as follows: if the product is to be transported to locations outside the customs area, if it is exported, if the product enters a factory or warehouse, if it is used as a raw material or auxiliary material for the production of other final excised goods, and if it has been destroyed or damaged before being released from the factory, or warehouse, or prior to import approval (Law No. 39 year 2007, article 8).

An excise exemption may be granted on excise goods, tobacco products included, if these meet one of six conditions, as follows: if they are used as raw materials or auxiliary materials in the production of nonexcised final products; if they are used for scientific research and development; if they are to be used for the purposes of representatives of foreign governments or their officers who are assigned to Indonesia and based on reciprocal principles; if they are carried by passengers, transport crews, border crossers, or on consignment from abroad in specified amounts; if they are used for social purposes, for example, for disaster relief; and if they are being sent to bonded areas, that is, special areas set aside mainly for processing export goods (Law No. 39 year 2007, article 9). The maximum amount of excise exemptions on tobacco products per traveler is 200 cigarettes, 25 cheroots, or 100 grams of shredded tobacco or other tobacco product (Ministry of Finance Regulation No. 188/PMK.04/2010, article 9).² For transport crews, the maximum amount of excise exemptions on tobacco products is 40 cigarettes, 10 cheroots, and 40 grams of shredded tobacco or other tobacco product (Ministry of Finance Regulation No. 188/PMK.04/2010, article 11).

² Peraturan Menteri Keuangan Republik Indonesia No. 188/PMK.04/2010 tentang Impor Barang yang Dibawa oleh Penumpang, Awak Sarana Pengangkut, Pelintas Batas dan Barang Kiriman (Ministry of Finance Republic Indonesia Regulation No. 188/PMK.04/2010 on Import Goods Bring by Passenger, Crew, Border Crosser and Shipment Goods).

RESTRICTIONS ON THE SALE OF TOBACCO PRODUCTS

There is no prohibition on the sale of tobacco products over the Internet or in duty-free shops. However, the sale of tobacco products through vending machines, the sale of tobacco products to minors ages under 18, and the sale of tobacco products to pregnant women is prohibited (Government Regulation No. 109 year 2012, article 25).³

REGULATIONS ON PRODUCTION AND STORAGE PLANTS

Before applying for a business excise identification number (Nomor Pokok Pengusaha Barang Kena Cukai), a factory owner or importer must submit an application to the DGCE for an inspection of the location, building, or place of business. The location, building, or places of business where the tobacco products are manufactured or stored must comply with four provisions (Ministry of Finance Regulation No. 200/PMK.04/2008, article 3), as follows.⁴ First, the building must not be directly connected to other buildings or areas that are not part of the factory for which permission is sought. Second, the building must not be directly contiguous with or in a residential area. Third, the building must be adjoined to and accessible from public roads. Fourth, the building must have an area of at least 200 square meters (2,150 square feet). This regulation makes cigarette production more difficult and is considered a tool to control tobacco production.

SANCTIONS

There are two types of enforcement mechanisms regarding illicit cigarettes, administrative provisions and criminal provisions. The administrative enforcement provisions are associated with penalties involving only the payment of fines. The criminal enforcement provisions are associated with penalties involving imprisonment or the payment of fines. The criminal provisions are contained in Law No. 11 year 1995 on the excise tax and the revision Law No. 39 year 2007 (Table 14.5).

THE GOVERNANCE AUDITING AND INSPECTION PROCESS

All municipal, provincial, and national government units are subject to internal audit and inspection, including the DGCE in enforcing regulations on illicit cigarettes. The internal inspections are conducted by the government internal control officers through audits, reviews, evaluations, monitoring, and other supervisory activities (Government Regulation No. 60 year 2008, article 48).⁵ The internal government supervisory officers include

³ Peraturan Pemerintah Republik Indonesia No. 109 tahun 2012 tentang Pengamanan Bahan yang Mengandung Zat Adiktif Berupa Produk Tembakau bagi Kesehatan (Republic Indonesia Government Regulation No. 109 year 2012 on Health Protection of Addictive Substances in the form of Tobacco Use).

⁴ Peraturan Menteri Keuangan Republik Indonesia No. 200/PMK.04/2008 tentang Tata Cara Pemberian, Pembekuan, dan Pencabutan Nomor Pokok Pengusaha Barang Kena Cukai untuk Pengusaha Pabrik dan Importir Hasil Tembakau (Republic of Indonesia Ministry of Finance Regulation No. 200/PMK.04/2008 on Procedure of Getting, Freezing and Revoking Identity Number for Tobacco Product Owner and Importer).

⁵ Peraturan Pemerintah Republik Indonesia No. 60 Tahun 2008 Tentang Sistem Pengendalian Intern Pemerintah (Republic Indonesia Government Regulation No. 60 year 2008 on Government Internal Controlling System).

Table 5. Examples of Criminal Provisions, Excise Law No. 39 Year 2007

ARTICLE	STATEMENT
50	Any person without a license, as provided in article 14, who is running a factory or a storage facility or who imports excisable goods that require the payment of affixed excise stamps and who thereby causes losses to the state shall be subject to imprisonment of no more than five years and a fine of no less than 2 times and no more than 10 times the excise value that should have been paid.
54	Anyone offering, delivering, selling, or providing for sale any excisable goods that is not packaged for retail sale or to which an excise stamp has not been affixed, as provided for in article 29, paragraph (1), shall be subject to imprisonment of at least one year and at most five years and (or) a fine of at most 10 times the excise value that should have been paid.
58	Anyone offering, selling, or trading excise stamps to unauthorized persons or buying, receiving, or using excise stamps to which they are not entitled shall be subject to imprisonment of at least one year and at most five years and (or) a fine of at most 10 times the amount of the excise that should have been paid.

Source: Law No. 39 year 2007, on the excise.

representatives of the Government Internal Financial Audit Board, the Inspectorate General, and other internal auditors and control personnel, such as provincial inspectorates and district or city inspectorates (Government Regulation No. 60 year 2008, article 49). All government units are also subject to external supervision by the Financial Audit Board and the Corruption Eradication Commission.

INTERNATIONAL COLLABORATION TO TACKLE THE TRADE IN ILLICIT CIGARETTES

As a member of the Association of Southeast Asian Nations, Indonesia cooperates with other countries in the region in tackling the trade in illicit cigarettes. Border security is coordinated among the countries of the regional association, for example. Indonesia is also active in the annual meeting of the Association of Southeast Asian Nations Forum on Taxation, discussing many taxation issues, including illicit cigarettes.

The Institutional Framework

The leading institution on illicit cigarette regulation and enforcement is the DGCE. The DGCE has a dedicated directorate for enforcement and prevention to make sure that all regulations on the excise tax are followed by all stakeholders. If needed, the DGCE may request assistance from the police and army (Law No. 39 year 2007, article 34).

Local, municipal, and provincial governments are also involved in enforcement in the illicit trade in cigarettes. Under Indonesia’s tobacco excise revenue-sharing mechanism, 2 percent of the tobacco excise revenue going to the central government is transferred to provinces that produce tobacco and cigarettes. Recently, 17 provinces were receiving these funds. The funds may only be used by the local governments for five activities (Law No. 39 year 2007, article 66A), as follows: quality improvements in raw materials, industrial development and monitoring, development of the social environment, implementation of the regulations on the excise tax, and eradication of illegal excised goods.

Five activities are aimed at the eradication of illegal excised goods, especially cigarettes. First, the collection of information on tobacco products on which counterfeit excise stamps have been affixed during distribution or at the point of sale. Second, the collection of information on tobacco products on which excise stamps have not been affixed during distribution or at the point of sale. Third, the collection of information on tobacco products on which excise stamps have been affixed during distribution or at the point of sale that bear incorrect names or business excise identification numbers. Fourth, the collection of information on tobacco products on which excise stamps have been affixed that bear an incorrect category designation, such as a stamp indicating a product is hand-rolled kretek, though the product is machine-made kretek, during distribution or at the point of sale. Fifth, the collection of information on tobacco products on which previously used excise stamps have been affixed during distribution or at the point of sale.⁶

Local governments that have received these funds must carry out these activities at least twice a year. In conducting these activities, the heads of the local governments must cooperate and coordinate with the head of the local DGCE office (Ministry of Finance Regulation No. 222/PMK.07/2017, article 10).

The other avenue taken by local governments in enforcing the regulations on illegal cigarettes is the local cigarette tax mechanism. Since 2014, the government has applied a local cigarette tax mandated by Law No. 28 year 2009 on local taxes and retribution. This local tax earmarks 50 percent of the revenue for public health, law enforcement on the illicit trade in cigarettes, and the establishment of smoke-free areas. Every local government in Indonesia received this local cigarette tax revenue based on the size of the population. However, because this is provincial tax revenue, the central government, the Ministry of Finance in this case, does not provide detailed guidance on using the funds for enforcement.

The Technological Solution

The DGCE has long been using excise stamps as fiscal markers for tobacco products and alcohol. All tobacco products that are domestically produced or imported must bear an excise stamp on the packaging. This regulation was introduced on July 1st, 1950, under Government Regulation No. 2 year 1950, which was a revision of the Dutch colonial tobacco excise regulation. To prevent forgery, the government has added features to the excise stamps that were difficult to falsify.⁷ These features include information on the type of cigarette production, the excise tariff, and the fiscal year; the garuda bird symbol (a legendary bird); a banderol with the price, the number of cigarettes, and a slogan, "Cukai Hasil

⁶ Smokers can resell used excise stamps that are in good condition. They merely remove the stamp carefully from the pack and then sell it to another cigarette producer, who benefits to the extent that the used excise stamp is less expensive.

⁷ Peraturan Direktur Jenderal Bea dan Cukai No. PER-29/BC/2017 tentang Bentuk Fisik dan atau Spesifikasi Desain Pita Cukai Hasil Tembakau dan Pita Cukai Minuman yang Mengandung Etil Alkohol tahun 2018 (Directorate General Customs and Excise Regulation No. PER-29/BC/2017 about Design Specification of Excise Stamp for Tobacco Product and Alcoholic Beverages 2018).

Tembakau Indonesia” (Indonesia, excise on tobacco product); and the logo of the DGCE. The regulation established government stamps of distinct colors according to the rate of the excise. Thus, green represented a 30 percent excise; black, 40 percent; and dark blue, 50 percent. However, the color is changed every year, and colors are also added to the stamp depending on the type of cigarette (Directorate General Excise and Customs Regulation No. 29 year 2017). In 2018, the DGCE used five colors to represent the cigarette type, as follows:

- » Blue, combined with orange: machine-made kretek, white cigarettes, hand-rolled kretek, group 1
- » Red, combined with orange: machine-made kretek, white cigarettes, hand-rolled kretek, group 2
- » Purple, combined with red: hand-rolled kretek, group 3
- » Gray, combined with green: shredded tobacco, cigarettes wrapped in corn leaf, and rhubarb cigarettes
- » Gray, combined with orange: imported tobacco products

The DGCE also produced stamps of different sizes. There are three series by stamp size, as follows:

- » Series 1: 0.8 centimeters wide and 11.4 centimeters in length
- » Series 2: 1.3 centimeters wide and 17.5 centimeters in length
- » Series 3: 1.9 centimeters wide and 4.5 centimeters in length

Each excise stamp contains a hologram, a feature that is difficult to forge. The size of the holograms is as follows:

- » Series 1: 0.7 centimeters wide
- » Series 2 and 3: 0.5 centimeters wide

On the hologram were two acronyms BC and RI, which stand for Bea dan Cukai (customs and excise) and Republik Indonesia (Republic of Indonesia), respectively. Excise stamp series 1 and 2 were used for hand-rolled kretek, some white cigarettes, shredded tobacco, cigarettes wrapped with corn leaf, and rhubarb cigarettes. Excise stamp series 3 was used for machine-made kretek, some white cigarettes, and cigars.

The DGCE also issued specially coded stamps for selected producers whose products were prone to be linked to illegal activities because of similar features, as follows:

- » Producers of group 2 who manufactured machine-made kretek and white cigarettes
- » Producers of groups 2 and 3 who manufactured hand-rolled kretek and white cigarettes
- » Producers of shredded tobacco, cigarettes wrapped with corn leaf, and rhubarb cigarettes

To detect whether excise stamps are authentic or counterfeit, DGCE officers use ultraviolet light and a magnifying glass to determine if the stamp contains the microtext “INDONESIA,”

the excise tariff, and the acronym RI, which becomes BC if the stamp is rotated to the left. Under ultraviolet light, the stamp will not glow, but absorb the rays and show images, writing colors, a hexagon symbol, and red fibers.

The track and trace system (TTS) for tobacco products includes monitoring production and tracking the movement of and the trade in tobacco products using the unique identifiers on the tobacco products. The system has not been implemented in Indonesia so far. It is not clear why the government does not require the tobacco industry to pay for as well as implement such a system.

Enforcement Reform in the DGCE

An in-depth interview has been conducted with the DGCE official responsible for enforcement against the illegal cigarette trade to learn what has been done by the DGCE.⁸ The DGCE performance report for 2015–17 and other DGCE materials have also been analyzed. This subsection describes the relevant missions and human resources of the DGCE, a performance contract between the DGCE and the Ministry of Finance, key performance indicators that represent milestones, and the reform of the enforcement mechanism.

THE RELEVANT MISSIONS AND HUMAN RESOURCES OF THE DGCE

There are three missions of the DGCE, namely:

- » To facilitate trade and industry
- » To safeguard the Indonesian border and protect Indonesians from smuggling and other illegal trade (which would thus include law enforcement on the illicit trade in cigarettes)
- » To optimize state revenues from customs and excise taxes

The DGCE has 20 branch offices spread throughout Indonesia. They are located in Aceh, Bali, Banten, Central Java, East Java, East Kalimantan, East Nusa Tenggara, Jakarta (headquarters), Maluku, North Sulawesi, North Sumatra, Papua, Riau, Riau Islands, South Kalimantan, South Sulawesi, West Java, West Kalimantan, West Nusa Tenggara, West Sumatra, and Yogyakarta. In addition, there are 104 Customs and Excise Supervisory and Service Offices and three Main Customs and Excise Service Offices. These are located in Batam, Soekarno-Hatta Airport, and Tanjung Priok Seaport. Currently, 14,169 people work at the head office, regional offices, the main service office, supervisory and services offices, and the operation facilities office. Of the total, 12,219 are men (86.2 percent), and 1,950 are women (13.8 percent).

⁸ The in-depth interview was conducted with the head of the section on tobacco excise enforcement, Directorate of Enforcement and Investigation, DGCE, at the DGCE, Jakarta, on July 13, 2018. See also Ministry of Finance (2016), (2017a), (2017b).

PERFORMANCE CONTRACT AND KEY PERFORMANCE INDICATORS

Through the interview with the chief DGCE officer, it was learned that the reform in illegal cigarette enforcement was marked by a new dedicated key performance indicator on enforcement. The reform was launched in 2017. The key performance indicator was agreed in the performance contract between the DGCE and the Ministry of Finance. The key performance indicator in enforcement is accompanied by information on the target performance to be achieved each year. Before this key performance indicator existed, enforcement activity in DGCE was unplanned and sporadic. DGCE enforcement activities are now better coordinated and more comprehensive nationwide.

The 2016–18 performance contracts between the DGCE and the Ministry of Finance set 14 targets and the corresponding indicators. One target is related to effective law enforcement, and the indicator is the rate at which DGCE investigations are judged complete by the state prosecutor’s office. The effectiveness target is 60 percent (table 14.6).⁹ Illegal cigarette enforcement was part of this target. In 2017, there were two additional indicators related to law enforcement: the winning percentage of appeals in the tax court (the 2017 target was 35 percent) and the percentage of successful supervisions of illegal excised goods, among which the illicit trade in cigarettes is dominant (the target was 70 percent). In 2018, the three indicators of effective law enforcement remained the same, but the targets associated with each indicator were increased. The target for indicator 1, the share of DGCE investigations marked complete by state prosecutors, was 70 percent. For indicator 2, the winning share of appeals in tax court, the target was 38 percent. For indicator 3, the successful supervision of illegal excised goods, the target was 70 percent.

Table 6. DGCE Performance Indicators, Effective Law Enforcement, Indonesia, 2016–18

2016		2017		2018	
INDICATOR	TARGET, %	INDICATOR	TARGET, %	INDICATOR	TARGET, %
DGCE investigation judged complete by state prosecutors	60	DGCE investigation judged complete by state prosecutors	65	DGCE investigation judged complete by state prosecutors	70
		Winning share of appeals in tax court	35	Winning share of appeals in tax court	38
		Successful supervision of illegal excised goods	70	Successful supervision of illegal excised goods	70

Source: Ministry of Finance 2016, 2017a, 2017b.

⁹ The dossier on the investigation of the DGCE is transmitted to the State Prosecutors Office, which is responsible for filing the case with the courts. The prosecutor can mark the DGCE investigation as complete or not complete.

Indicator 3, the successful supervision of illegal excised goods, involves a series of supervision activities on the distribution of tobacco products using market operation schemes. The market operations consist of three programs. First is the monitoring of the banderol price and the market transaction price on products. The difference between the banderol price and the market transaction price determines whether the DGCE undertakes a follow-up action.¹⁰ Second is the distribution of information on the regulations on illegal cigarettes to the public, mainly the cigarette seller and the consumer. Third are enforcement activities such as investigation, seizure, and prosecution on activities related to the trade in illicit cigarettes (Ministry of Finance 2017a).

Planning for supervision activities on illegal excised goods is launched in the beginning of the year and involves consideration of smoking prevalence, the share of smokers in the population, income per capita, the size of the market, the available human resources, and the available budget in each DGCE unit. The implementation of supervision activities is undertaken by DGCE units following reception of a letter of assignment and a letter of enforcement authorization. After transmitting enforcement authorization letters, the DGCE follows up according to several options depending on the context and the nature of the illegal activities. These options are as follows

- » Imposition of an administrative sanction, that is, a fine
- » Investigation
- » Determination whether seized goods are under the control of ownership of the state
- » Blocking the seized goods and closing down the location
- » Recommending an additional audit
- » Reexport of the goods
- » Recommending that excise banderols no longer be provided to relevant suppliers
- » Delegation of the case to other institutions
- » Freezing the business excise identification number
- » Revocation of the business excise identification number
- » Destruction of the seized goods
- » Cancellation of export license
- » Issuance of an authorization letter to a related institution for further action
- » Changing the excise tariff
- » Return of the seized goods to the owner

¹⁰ If the market transaction price, that is, the actual consumer price, is higher by more than 5 percent of the banderol price, then the DGCE will group the product in the upper group of excise tariffs. The market transaction price cannot be lower by more than 15 percent of the banderol price, the price decided by the DGCE based on producer characteristics (type of cigarette and production and price group) and the corresponding tier in the regulation.

In 2017, over 97 percent of the planned supervision activities were carried out during the year by the various DGCE units (Table 14.7). This surpassed the target of 70 percent. This achievement could not be compared with the results during the previous year because 2017 was the first year this indicator was used.

REFORM OF THE ENFORCEMENT MECHANISM

Table 7. Planning and Realization, Supervision Activities on Illegal Excise Goods, 2017

INDICATOR	QUARTER 1	QUARTER 2	TOTAL TO Q2	Q3	TOTAL TO Q3	Q4	YEAR
Plan	10.0	30.0	30.0	60.0	60.0	70.0	70.0
Result	65.4	69.5	69.5	78.6	78.6	97.1	97.1

percent

Source: Ministry of Finance 2017a.

The DGCE organizational reform launched in 2017 was implemented through the Custom and Excise Strengthening Reform Program (Program Penguatan Reformasi Kepabeanan dan Cukai). The program was designed to increase organizational effectiveness in responding to public expectations and supporting national development goals. The program was launched on December 20, 2016, by the Ministry of Finance. It has four main components, as follows:

- » The High-Risk Importer Control Program (Program Penertiban Importir Berisiko Tinggi)
- » The High-Risk Excise Control Program (Program Penertiban Cukai Berisiko Tinggi)
- » The Synergy Program of the DGCE and the Directorate of Taxation
- » The Ease in Doing Business Fostering Program

The objective of the excise control program is to reduce the distribution of and trade in illegal excisable goods, especially cigarettes. Some of the program activities related to tobacco products are the following:

- » The STOP Illegal Cigarette Campaign is conducted through the distribution of information on laws and regulations, STOP Illegal Cigarettes stickers, videos, and other media
- » In-depth follow-up research based on recommendations of regional cigarette control offices
- » Enforcement and post-enforcement activities

There are four challenges facing the program (Ministry of Finance 2017a). First, the increase in the tobacco excise tariff is tending to push up the demand for illegal cigarettes. Second, the target for the maximum share of illegal cigarettes in total consumption is 6.0 percent, but, based on current estimates, the share was 10.9 percent in 2017. Third, other types of

smoking products are rapidly coming on line, such as electronic cigarettes and vape. Fourth, links among the DGCE offices throughout the country require improvement.

The DGCE Directorate of Enforcement and Investigation has developed an action plan to monitor tobacco products. The plan revolves around the following:

- » Supporting massive, coordinated, and nationwide distribution of literature on illegal cigarettes
- » A synchronized enforcement program targeting producers of illegal cigarettes and enforcement of the laws on money laundering
- » Monitoring illegal cigarettes as a key performance indicator
- » The registration of cigarette machines as a mandatory part of the application process for business excise identification numbers
- » Promoting the eventual tobacco industry-wide implementation of the integrated digital inventory system for tobacco

The directorate has also created a special team to monitor full time the compliance with regulations on the excise tax. The team members all have a cross-disciplinary background. The team is responsible for expanding enforcement activities significantly and thereby reducing illegal cigarette consumption. In support of the excise monitoring team, the Ministry of Finance issued Regulation No. 144/PMK.02/2016 on incentives for the excise enforcement team. The regulation is designed to help motivate the team to achieve the goals. The incentive includes a monetary premium, the amount of which depends on the level of achievement of the goals. To improve coordination in excise and custom enforcement activities, the Ministry of Finance has also signed a relevant memorandum of understanding with the army (2017) and the national police (2012) on excise and custom enforcement. The memorandum is aimed at strengthening the enforcement effort by the DGCE, especially in the area of illegal cigarettes.

CHALLENGES IN OPERATIONS AGAINST ILLEGAL CIGARETTES

Operations focusing on points of production and distribution of illegal cigarettes have been carried out by regional and central DGCE offices. The operations have been supported by police and the army. The main challenge facing these operations is the resistance of the people living around the factories. The factory owners incite local residents against the officers. Under these circumstances, operations have usually been canceled. Meanwhile, DGCE officers have begun working closely with local governments to win the hearts of the people. Operations aimed at means of transportation and at points of sale have been easier because there is no resistance from local residents. The officers confiscate illegal cigarettes brought by vehicles and sold in shops without encountering any resistance.

DOMESTIC FREE TRADE ZONES: A CHALLENGE FOR ENFORCEMENT

There are four FTZs in Indonesia: Sabang (Aceh Province) and Batam, Bintan, and Karimun (Riau Islands Province). Within these FTZs, otherwise excisable goods are not subject to duties, value-added taxes, or excise taxes. This is clarified in Law No. 36 year 2000, article 1:¹¹

Free Trade Zone and Free Seaport are an area within the territory of Republic of Indonesia separated from the customs area so that it is free from imposition of import duty, value-added tax, sales tax on luxury goods, and excise.

The law thus establishes that the production of and trade in cigarettes in the FTZs are not subject to excise. Cigarettes produced and distributed in the FTZs are exempted from the excise stamp. The price is therefore much lower. The problem is that the cigarettes leak out of the FTZs. The cigarettes become illegal because the packs bear no excise stamps. This obliges the DGCE to undertake extra effort in supervising and enforcing cigarette control activities. If the government were to remove the reference to the excise tax in Law No. 36, article 1, the overall burden of the DGCE with respect to illegal cigarettes would be reduced by around 40 percent.¹²

3. Result of the Reform

Increasing Illegal Cigarette Enforcement Operations

One component of the Custom and Excise Strengthening Reform Program of the Ministry of Finance is the High-Risk Excise Control Program. The aim of this program is to combat illegal commerce and unfair competition in excised goods, especially to secure the lost government revenue. Several activities related to illicit cigarettes in this program are the STOP Illegal Cigarette Campaign, research based on recommendations of regional cigarette control offices, and sustainable enforcement and post-enforcement activities. The program has more than tripled the number of enforcement operations, from 996 in 2014 to 3,950 in 2017 (Figure 14.5).

The rising number of enforcement operations has significantly raised the number of illegal cigarettes seized (Figure 14.6). This number increased by a factor of 3.6, from 94.2 million cigarettes in 2013 to 341.9 million in 2016. The monetary value of the seized cigarettes also rose, by a factor of 4.5, from Rp 52 billion (US\$3.6 million) in 2013 to Rp 232.5 billion (US\$16.1 million) in 2016 (Figure 14.7).

¹¹ Undang-undang Republik Indonesia No. 36 year 2000 tentang Kawasan Perdagangan Bebas dan Pelabuhan Bebas (Republic of Indonesia, Law No. 36 year 2000 on Free Trade Zone and Seaport).

¹² In-depth interview with the head of the Section of Illegal Cigarette Enforcement, Directorate of Enforcement and Investigation, DGCE.

Figure 5. Illegal Cigarette Enforcement Operations, Indonesia, 2014–17

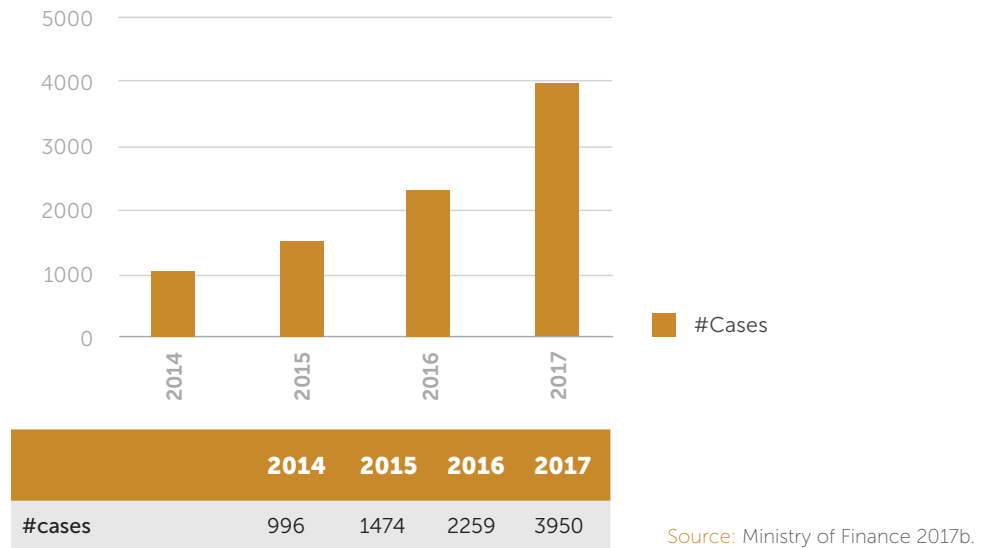


Figure 6. Number of Illegal Cigarettes Seized, Indonesia, 2013–16

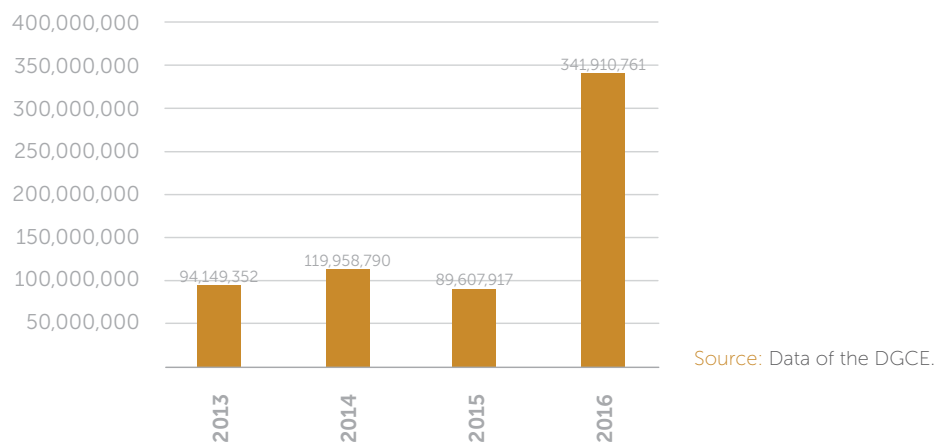
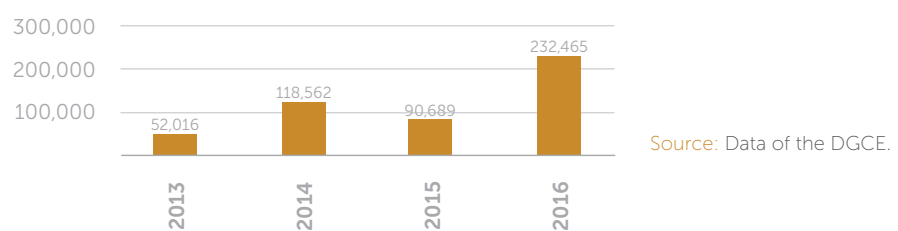


Figure 7. The Value of Seized Illegal Cigarettes, Indonesia, 2013–16 (Rp, Millions)

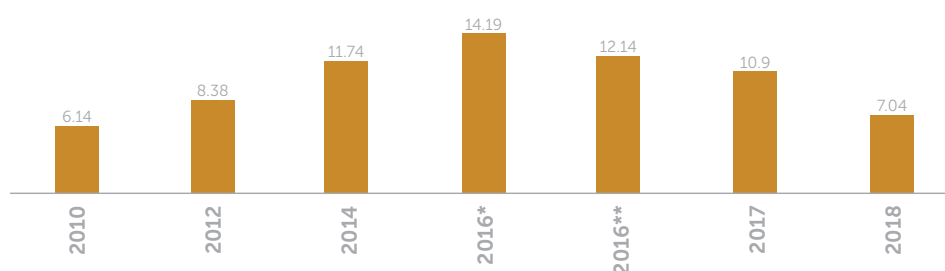


The Decline in the Market Share of Illegal Cigarettes

Several studies have estimated the market share of illicit cigarettes in Indonesia. Relying on a comparison of legal cigarette sales and domestic consumption estimated from surveys, Ahsan et al. (2014) estimate the consumption of illicit cigarettes at 8 percent of the total market in 2013. In their study, Satriawan, Adji, and Jaya (2010) survey 256 villages in 64 municipalities in 16 provinces. They collected 18,200 packs of cigarettes and examined them to estimate the market share of illegal cigarettes in Indonesia. Based on in-depth interviews with DGCE officials and the survey material, the study presents a reduction in illegal cigarettes as a target in Indonesia. The authors project that, by 2018, the market share of illegal cigarettes would reach as little as 6 percent. However, based on estimates of the Universitas Gajah Mada, the market share of illegal cigarettes was slightly more than 7 percent in 2018.

The DGCE deserves a great deal of appreciation. The market share of illegal cigarettes has decreased significantly, although it has not reached the target. The estimated share fell 42 percent, from 12.1 percent in 2016 to 7.0 percent in 2018 (Figure 14.8). This also shows that a rise in the tobacco tax rate is not always followed by the greater use of illegal cigarettes, as the tobacco industry claims. A substantial reform in enforcement has succeeded in decreasing the prevalence of illegal cigarettes in Indonesia. The government should therefore be more confident in raising the tobacco excise tariff and the price of cigarettes because, with effective enforcement, illegal cigarettes can be suppressed.

Figure 8. Estimated Market Share, Illegal Cigarettes, Indonesia, 2010–18

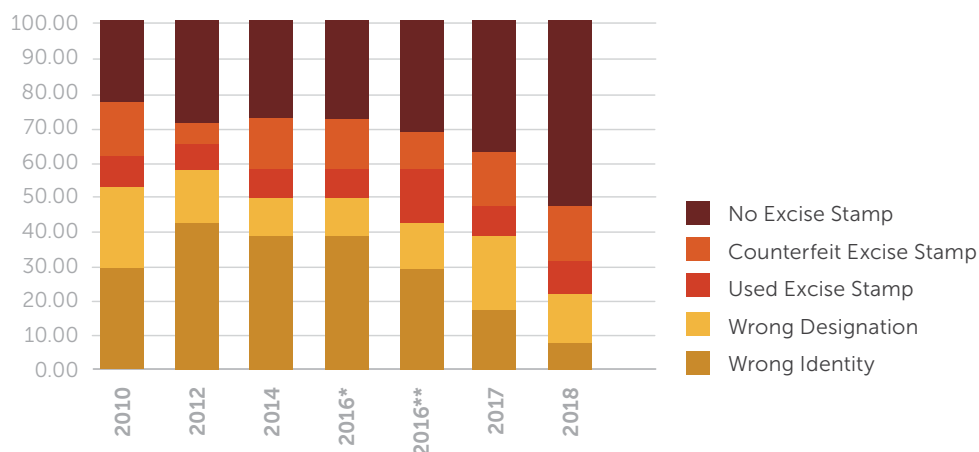


Sources: Data of the DGCE; Ministry of Finance 2017a; Nursalikhah 2018; Satriawan, Adji, and Jaya 2010.

* Projection of the DGCE. ** Estimate of the Universitas Gajah Mada.

According to the DGCE, there are five types of illegal domestic cigarettes: cigarettes in a pack without an excise stamp, cigarettes in a pack with a forged or counterfeit excise stamp, cigarettes in a pack with a used excise stamp in good condition, cigarettes in a pack with an excise stamp with the wrong business excise identification number, and cigarettes in a pack with an excise stamp with the wrong designation (Ahsan et al. 2014). In 2018, the trade in illegal cigarettes was dominated by cigarettes in packs without excise stamps (52.6 percent), while, in 2010–14, the trade was dominated by cigarettes in packs with wrong identity numbers (Figure 14.9).

Figure 9. Composition of the Illegal Cigarette Trade, Indonesia, 2010–18



	2010	2012	2014	2016*	2016**	2017	2018
No Excise Stamp	23.1	29.2	28.1	28.1	32.4	37.5	52.6
Counterfeit Excise Stamp	16.2	5.7	14.4	14.4	9.6	15.5	15.8
Used Excise Stamp	7.6	7.1	8.8	8.8	16.1	8.8	9.1
Wrong Designation	24.6	15.5	10.0	10.0	13.0	21.2	14.9
Wrong Identity	28.6	42.4	38.7	38.7	29.0	16.9	7.7

Sources: Data of the DGCE; Ministry of Finance 2017a; Nursalikh 2018; Satriawan, Adji, and Jaya 2010.
 * Projection of the DGCE. ** Estimate of the Universitas Gajah Mada.

4. Lessons Learned and Policy Recommendations

Lessons Learned

Indonesia has a detailed and comprehensive tobacco excise tax administration. Regulations on tobacco excise taxes are issued by top policy makers. There is a dedicated excise Law No. 39 year 2007 and several ministerial implementation regulations. Many aspects of the tobacco trade are regulated, from production to distribution and marketing. The tobacco industry is thus a highly regulated business. The excise stamp technology is also quite advanced. These factors represent serious hurdles to illicit cigarette activities.

However, these advantages are offset because of the complicated tobacco excise system. The system currently relies on 10 tiers, each with a different excise stamp specification. This favors illicit cigarette activities because of the numerous ways in which excise stamps and cigarette packs may be misappropriated for the illegal trade. Thus, for example, tobacco producers in a lower tier who pay lower excise tariffs can resell used excise stamps or affix their excise stamps to higher-tiered cigarettes at higher prices. The multitiered excise system

means that the process involved in ordering, printing, distributing, and affixing the excise stamps is a long one. The recent 10-tiered excise system where each tier has different excise stamp specification will make a longer process.

The estimated market share of illegal domestic cigarettes shrank from 11.7 percent to 7.0 percent in 2014–18. The market is dominated by cigarette packs with no excise stamp (52.6 percent). This represents a success of the efforts of the DGCE reforms in enforcement. During the same period, the government raised the tobacco excise tariff annually by more than the inflation rate. This is proof that increasing the tobacco excise tariff is not necessarily a significant factor in illegal cigarette activities. Comprehensive and concerted enforcement efforts are key to suppressing these activities.

Policy Recommendations

ADDRESSING THE ILLICIT CIGARETTE TRADE

- » Focus efforts on addressing the illicit trade especially through prosecution of tax evasion in domestic production, where, because of the strong consumer preference for kretek, the risk of smuggling is not yet large
- » Improve the institutional capacity of excise tax administration

The DGCE is responsible for the implementation of customs and excise regulations. It must monitor all border areas to make sure that customs duty procedures are implemented effectively. It must also implement all excise tax regulations, which mostly deal with tobacco products. However, there is an imbalance in resource allocation in terms of human resources, budgets, and institutional support. Excise tax administration is too complicated and faces more challenges than customs administration. This is because the DGCE must supervise a large tobacco industry and manage a tremendous amount of excise revenue. To address these challenges, the government should improve institutional capacity, especially in excise tax administration. This can be accomplished by increasing budgets, human resource capacity, and institutional support for excise tax administration and enforcement.

LINK BETWEEN ILLICIT CIGARETTES AND TOBACCO TAX REFORM

- » The experience of other countries indicates that the main determinant of the illicit tobacco trade is poor tax administration and enforcement, not high prices (Marquez and Moreno-Dodson 2017). This is also the model of the trade in Indonesia: rising tobacco taxes and prices are not the main determinant of the illicit trade.
- » The government should be more confident in improving the tobacco tax system because this system is not the main determinant of the illicit trade.

Improving the tobacco tax system involves two steps:

- » Go big and go fast: increase taxes and prices to reduce cigarette affordability and consumption
- » Simplify the tobacco excise system

The simpler the tobacco excise system, the better the result. Currently, the government plans to simplify the system from one based on 10 tiers in 2018 to one based on five tiers in 2021 (Ministry of Finance Regulation No. 146/PMK.10/2017).¹³ Although it is considered a significant advance, the five-tier system to be implemented over the next four years is still sufficiently complicated to facilitate the illicit cigarette trade. Ideally, there should be only one excise tariff for all cigarettes because they all have a similar negative health impact.

However, for the sake of employment, a two-tiered system would be acceptable. One tariff would be for machine-made cigarettes and large-production hand-rolled kretek; the other, at a slightly lower excise tariff, would be for small-production hand-rolled kretek. This change will reduce the incentive for illicit cigarette activities and will decrease cigarette consumption and, hence, save lives.

¹³ Peraturan Menteri Keuangan Republik Indonesia No. 146/PMK.010/2017 tentang Tarif Cukai Hasil Tembakau (Ministry of Finance Republic Indonesia Regulation No. 146/PMK.010/2017 on Tobacco Product Excise Tariff).

References

- Ahsan, Abdillah. 2018. "Peran Kekuatan-Kekuatan Politik Dalam Perdebatan Penentuan Tarif Cukai Rokok Maksimal Pada Pembahasan Undang-Undang No. 39 Tahun 2007 Tentang Cukai" [Role of political actors in the debate on maximum cigarette excise tariff in law no. 39 year 2007 about excise]. PhD Thesis in Political Science, Universitas Indonesia, Jakarta.
- Ahsan, Abdillah, Nur Hadi Wiyono, Diahadi Setyonaluri, Ryan Denniston, and Anthony D So. 2014. "Illicit Cigarette Consumption and Government Revenue Loss in Indonesia." *Globalization and Health* 10 (1): 75.
- Chandra, Ardan Adhi. 2017. "Sri Mulyani Naikkan PPN Rokok Jadi 9,1%." *detikFinance*, Jakarta, January 10. <https://finance.detik.com/berita-ekonomi-bisnis/d-3392664/sri-mulyani-naikkan-ppn-rokok-jadi-91>.
- Fiscal Policy Board. 2016. "Harga Rokok, Dilema Pembangunan, dan Kualitas Hidup, Badan Kebijakan Fiskal" [Civil society organization workshop: cigarette price, development dilemma, and quality of life]. December 20, Fiscal Policy Board, Ministry of Finance, Jakarta.
- Kosen, Soewarta, Hasbullah Thabrany, Nunik Kusumawardani, and Santi Martini. 2017. *Health and Economic Costs of Tobacco in Indonesia*. Review of Evidence Series. Jakarta: Lembaga Penerbit Badan Penelitian dan Pengembangan Kesehatan.
- Lian, Tan Yen, and Ulysses Dorotheo. 2016. *The Tobacco Control Atlas: ASEAN Region*. 3rd ed. Bangkok: Southeast Asia Tobacco Control Alliance.
- Marquez, Patricio V., and Blanca Moreno-Dodson. 2017. *Tobacco Tax Reform: At the Crossroads of Health and Development; A Multisectorial Perspective*. Washington, DC: World Bank.
- Ministry of Finance, Indonesia. 2016. *Laporan Kinerja Direktorat Jenderal Bea dan Cukai Kementerian Keuangan* (Directorate General Custom and Excise Ministry of Finance Performance Report). Annual publication. Jakarta: Ministry of Finance.
- . 2017a. *Laporan Kinerja Direktorat Jenderal Bea dan Cukai Kementerian Keuangan* (Directorate General Custom and Excise, Ministry of Finance Performance Report). Annual publication. Jakarta: Ministry of Finance.
- . 2017b. *Laporan Kinerja Kementerian Keuangan* (Ministry of Finance Performance Report). Annual publication. Jakarta: Ministry of Finance.
- . 2017c. *Direktorat Penindakan dan Penyidikan, Direktorat Jenderal Bea dan Cukai, Kementerian Keuangan, Pengawasan Barang Kena Cukai Illegal*, 16 Februari 2017 (Directorate Enforcement and Investigation, Directorate General Custom and Excise, Ministry of Finance, "Monitoring of Illegal Excise Goods").
- Nursalikah, Ani. 2018. "Bea Cukai Tanggapi Menurunnya Jumlah Rokok Illegal." *Republika*, Jakarta, May 25. <https://www.republika.co.id/berita/beacukai/berita-beacukai/18/05/25/p99p32366-bea-cukai-tanggapi-menurunnya-jumlah-rokok-illegal>.
- Satriawan, Elan, Arti Adji, and Wihana K. Jaya. 2010. *Survei Cukai Rokok Illegal 2010* [Survey on tax on illegal cigarettes]. Yogyakarta, Indonesia: Center for Economics and Public Policies Studies, Universitas Gajah Mada.

Susanto, Elik. 2017. "Survei Menyebutkan Promosi Harga Rokok Murah Bidik Anak-anak." *O Komentor*, Tempo.co, October 25, Jakarta. <https://nasional.tempo.co/read/1027902/survei-menyebutkan-promosi-harga-rokok-murah-bidik-anak-anak>.

TCSC (Tobacco Control Support Center, Indonesia). 2015.

Zheng, Rong, Patricio V. Marquez, Abdillah Ahsan, Yang Wang, and Xiao Hu. 2018. "Cigarette Affordability in Indonesia: 2002–2017." Global Tobacco Control Program (May), World Bank, Washington, DC.

MALAYSIA

16

MALAYSIA:

Addressing the Illicit Flow of Tobacco Products

Noraryana Hassan, Subromaniam Tholasy, Norliana Ismail, Hasazli Hasan, Norashidah binti Mohamed Nor, and Wency Bui Kher Thinng¹

Chapter Summary

The Government of Malaysia is concerned with illicit tobacco on public-health and fiscal grounds. Action against the illicit tobacco trade is a key component of the country's tobacco-control strategy.

The World Health Organization Framework Convention on Tobacco Control (WHO FCTC) sets standards and provides international legal foundations for anti-tobacco policies. Following Malaysia's ratification of the FCTC in 2005, the Tobacco Control Unit and FCTC Secretariat were established within the Ministry of Health (MOH). The Royal Malaysian Customs Department (RMCD) is the lead agency involved in law enforcement against illicit cigarette smuggling in Malaysia.

Recent key changes in Malaysia's tobacco tax policy include a 2015 increase of 42.8 percent in the tobacco excise duty and the introduction of the Goods and Services Tax (GST), which boosted the overall excise duty on cigarettes from 0.28 cents per stick in 2014 to 0.40 cents in 2015.

¹ FCTC & Tobacco Control Unit, Disease Control Division, Ministry of Health, Malaysia

Tobacco smuggling in Malaysia follows two main pathways. One is direct smuggling, in which perpetrators use illegal entry points to introduce tobacco products from neighboring countries without customs inspection. Indirect smuggling, meanwhile, employs methods such as concealing cigarettes among shipments of other imported goods. The currently most popular modality for smugglers in Malaysia is under-declaring or mis-declaring the value or quantity of transported cigarettes.

The RMCD's enforcement activities include monitoring the movement of goods on Malaysia's duty-free islands, for example physically inspecting goods entering Free Trade Zones. Special operations, road blocks, and regular land and sea patrols are carried out at strategic locations. Special operations target outlets, shops, and restaurants selling illicit cigarettes. The RMCD has also initiated the Collaborated Border Management (CBM) system. Using pre-defined risk rules, Enforcement, Customs, and Technical Services officers work together to target high-risk consignments. The RMCD controls the issuance or renewal of tobacco-product import licenses through vetting by a high-level management panel.

The launch of the National Blue Ocean Strategy (NBOS) has further strengthened co-operation among law-enforcement agencies in tackling illicit tobacco trade. Inter-agency collaborative action can: break illicit cigarette supply chains by identifying trafficking "hotspots"; propose legal amendments to stiffen penalties for smugglers; revise procedures for licensing of private jetties; and accelerate revocation of cigarette import licenses if license holders are caught in smuggling activities.

International cooperation is key to fighting illicit tobacco. International coalitions in which the RMCD is involved include the Regional Intelligence Liaison Office (RILO); United Nations Office on Drugs and Crime (UNDOC); Container Control Program (CCP); Indonesia-Malaysia Coordinated Customs Patrol (PATKOR KASTIMA), and Malaysia-Thai Border Joint Cooperation (MTBCO).

The RMCD is currently working on a system overhaul under Malaysia's Customs Project. This reform is expected to include the creation of a National Targeting Centre. Assistance from the United States, United Kingdom, and the Australian Border Force is reinforcing best practices in targeting and risk analysis.

The measures being taken by the MOH, RMCD, and other agencies are expected to reduce illicit cigarette consumption in Malaysia, ultimately cutting smoking prevalence among the country's adults and adolescents. Authorities aim to reduce smoking prevalence to 15 percent by 2025 and to less than 5 percent in 2045. All countries should cooperate to fight illicit tobacco, as it compromises public health, weakens the rule of law, and costs governments billions annually due to unpaid duties and taxes. Intensified information sharing and collaboration between enforcement agencies in Malaysia, authorities in other countries, and international partners will help curb illicit tobacco while strengthening international ties.

1. Introduction

The Government of Malaysia is concerned with illicit tobacco on public-health and fiscal grounds. Illicit trade increases the availability of affordable cigarettes in the local market. As a result, cigarette consumption and smoking-related diseases threaten to increase in Malaysia, undermining the government's health policy goals. The influx of cheap cigarettes places Malaysia's youth at particular risk of falling prey to addiction. Even as they compromise public health, illicit cigarettes also mean lost tax revenue that the government could have invested in programs that benefit all Malaysians.

While it appears that legal tobacco companies are on the losing end of illicit trade, because they are paying taxes and duties, this picture is at best incomplete. In reality, tobacco companies may profit from rising sales of illicit cigarettes. Legitimate tobacco firms manufacture the majority of cigarettes that end up being sold illegally. Moreover, cheap illegal cigarettes entice the younger generation and induce the habit of smoking. Each individual who becomes addicted to smoking is a market entrée for the tobacco industry, regardless of the person's initial brand preferences (Rejab & Zain 2016). Thus, enforcement to control the illicit flow of tobacco is a crucial component of a robust cigarette tax and public-health policy.

This chapter provides an overview of Malaysia's efforts to combat the illicit tobacco trade. It starts by reviewing the legislative framework that supports Malaysia's action on illicit tobacco. It then outlines the country's strategic plan for tobacco control, with a focus on Malaysia's tobacco taxation regime. The later parts of the chapter discuss the "nuts and bolts" of cigarette smuggling in Malaysia and detail the country's major enforcement actions. Inter-agency collaboration and cooperation with international partners receive special focus. In conclusion, we consider some results achieved and paths to strengthen future outcomes in controlling illicit tobacco.

2. Tobacco Control in Malaysia: Legal and Policy Framework

The International Framework

Malaysia adopted the World Health Organization Framework Convention on Tobacco Control (WHO FCTC) in 2005. The FCTC identifies the elimination of illicit trade in tobacco products as an important component of global tobacco control. To accelerate progress in this area, in 2012, WHO introduced the Protocol to Eliminate Illicit Trade of Tobacco Products, which builds upon FCTC Article 15. The Protocol provides guidance on topics including: anti-smuggling legislation; how to monitor cross-border trade; the marking of tobacco packaging to enable tracking and tracing; and the confiscation of proceeds derived from the illicit tobacco trade. Malaysia has implemented multiple strategies to reduce illicit tobacco trade and is considering ratification of the Protocol.

Tobacco Control Legislation in Malaysia

The gazettement of Malaysia's Control of Tobacco Product Regulation (CTPR) was completed in 1993 (with subsequent revisions up to CTPR 2004). This marked an important milestone for legislation and the enforcement of tobacco control in Malaysia. The CTPR provided the MOH with legal powers for enforcement activities, not only to discourage people from smoking, but also to prevent smoking initiation among young people and to protect the general public from the dangers of second-hand smoke. The MOH regularly amends the CTPR to keep pace with tobacco industry strategies, which capitalize on loopholes in laws and regulations to reinforce tobacco-product marketing.

The WHO FCTC sets the standards for tobacco control worldwide and provides legal foundations at the international level. Following Malaysia's ratification of the Convention, the Tobacco Control Unit & FCTC Secretariat was established within the MOH in 2006, under the Non-Communicable Disease Section of the Disease Control Division.

The National Strategic Plan for Tobacco Control

WHO's MPOWER strategy has been integrated into the Malaysian National Strategic Plan for Tobacco Control. Activities pertaining to the MPOWER strategy can be outlined as follows:

(M) Monitor tobacco use: Continuous surveillance of the smoking population in Malaysia is carried out by the MOH through instruments and institutions such as the National Health Morbidity Survey (NHMS), Global Adult Tobacco Survey (GATS), Global Youth Tobacco Survey (GYTS), Global School Health Survey (GSHS), The E-Cigarette Survey among Malaysian Adolescents (TECMA), National E-Cigarette Study (NECS), and Tobacco Tax Study. These government initiatives are in addition to local studies conducted by universities throughout the country.

(P) Protect people from tobacco use: This is done by creating a smoke-free environment for the betterment of the people. Relevant statutes include Articles 11 and 22 of the CTPR 2004, which enumerate places where smoking is prohibited and specify that the Minister has the power to prohibit smoking in buildings, premises, or public areas. A program known as "*Rumah Bebas Asap Rokok*" (RBAR), or "Smoke-Free Homes," has been introduced by the government under the Community Empowerment Programs (KOSPEN) to encourage a smoke-free environment within the community, while the Blue Ribbon Certification program aims to create smoke-free corporate buildings.

(O) Offer help to quit tobacco use: Existing smokers are not left out of the national effort to reduce the number of smokers in Malaysia. As part of the government's effort, Quit-Smoking Clinics are established in public clinics and government hospitals. The Malaysian Quit-Smoking Services (mQuit) have enabled the unification of various smoking cessation services offered by public and private entities. These services are available from certified

mQuit providers, including retail pharmacies, private general practitioners, private hospitals, and in-house quit-smoking programs in workplaces.

(W) Warn people about the danger of tobacco: The MOH has collaborated with other government agencies to spread the word about the dangers of smoking. The “Refuse Smoking” (*Tak Nak*) campaign was introduced nationwide in 2004 and has been one of the most prominent campaigns directed against the use of tobacco. Television, radio, and social media have been used extensively to spread the message, and younger audiences have been especially targeted. School curricula have incorporated anti-tobacco messages, for example via the IMFree program and annual school dental checkups with the theme “*Kesihatan Oral Tanpa Asap Rokok*” (KOTAK) (Quit Smoking for Oral Health). The KOTAK program also helps students who are caught smoking in schools with behavioral interventions to help them quit smoking.

(E) Enforce bans on tobacco advertisement, promotion, and sponsorship: Malaysia’s banning of tobacco advertisements began in 1982. The CTPR 2004 Part II (Articles 4 through 6) has clarified the legal framework. Indirect promotion through free samples, gift products / prizes, retail price, and packaging of cigarettes are also controlled by the CTPR 2004. To enforce the legislation, the Tobacco Control Unit and the MOH’s FCTC Secretariat act as coordinators, while the MOH enforcement team is responsible for implementation. Tobacco enforcement in Malaysia is generally initiated either at the MOH level (for coordinated nationwide enforcement); at state level by state health departments; or at district level by the District Health Office. Enforcement activities are carried out regularly, and any offense against the CTPR 2004 spurs a legal notice (with fine), or the perpetrator is brought to court.

(R) Raise the price of tobacco: Taxation is a cost-effective measure to prevent or reduce tobacco usage, especially among youth. Tobacco tax hikes, leading to higher retail cigarette prices, reduce the demand for cigarettes. CTPR 2004 Regulation 8A deals with the pricing of cigarettes and aims to prevent the tobacco industry from manipulating prices to increase tobacco product sales (for example, by price reductions or price comparison against competitors).

Cigarette Taxation Policy in Malaysia

In Malaysia, all types of tobacco and tobacco products are subject to excise and import duties, as well as the Goods and Services Tax (GST). Previously, tax on tobacco / tobacco products was imposed according to weight. However, from 2004 forward, all duties and taxes for cigarettes were calculated based on number of sticks.

2015 saw important changes in Malaysia’s tobacco tax policy, including an increase of 42.8 percent in the tobacco excise duty and the introduction of the GST. The GST was initially set at 6 percent, boosting the overall excise duty on cigarettes from 0.28 cents per stick in 2014

to 0.40 cents in 2015. Table 1 summarizes the taxes imposed on tobacco / tobacco products in Malaysia from 1990 to 2015.

Table 1. Tobacco Taxation in Malaysia (1990–2015)

YEAR	SPECIFIC EXCISE DUTY (RM/KG OR RM/STICK)	SALES TAX %	AD VALOREM %
1990	13.0 /kg	15	-
1991	14.0 /kg	15	-
1992 – 1998	28.6 /kg	15	-
1999 – 2000	40.0 /kg	15	-
2001	40.0 /kg	25	-
2002	48.0 /kg	25	-
2003	58.0 /kg	25	-
2004	0.081 /stick	25	-
2005	0.22 /stick	5	20
2006	0.12 /stick	5	20
2007	0.15 /stick	5	20
2008	0.17 /stick	5	20
2009	0.18 /stick	5	20
2010 – 2012	0.21 /stick	5	20
2013	0.26 /stick	5	20
2014	0.28 /stick	5	20
2015 - current	0.40 /stick	6	0

3. The Evolution of Malaysia’s Tobacco Epidemic

Smoking Prevalence and Trends in Malaysia

Malaysia’s MOH conducted its first morbidity survey in 1986 to determine the prevalence of cigarette smoking and related behaviors. In 2015, the National Health and Morbidity Survey (NHMS) estimated that five million Malaysians smoked. In that year, current smokers represented 24.0 percent of the population aged 15 years and older (NHMS, 2015). Figure 1 tracks the prevalence of smoking among Malaysian adults aged 18+ from 1996 to 2015, based on NHMS data. Overall prevalence did not fall substantially during this period. Smoking prevalence among males dropped modestly from 49.1 percent in 1996 to 45.1 percent in 2015.

Figure 1. Smoking Prevalence Among Malaysian Adults Aged 18 Years and Above

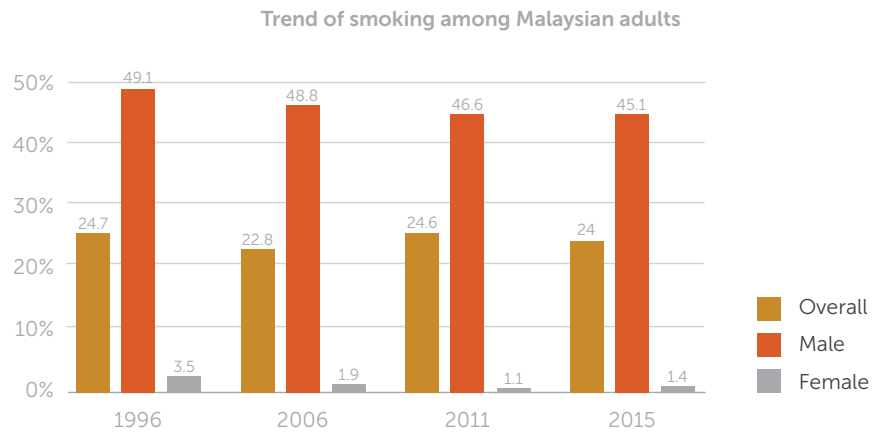


Figure 2 shows the pattern of smoking among Malaysian youth aged 13 to 15 years, from 2003 to 2016. The results show a significant decrease in youth smoking prevalence, from 20.2 percent in 2003 to 14.8 percent in 2016. Data are based on the Global Youth Tobacco Survey (2003 and 2009), the Global School Health Survey (2012), and the Tobacco and E-Cigarette Survey Among Malaysian Adolescents (TECMA) (2016). Notable changes were recorded among boys, whose smoking prevalence fell from 36.3 percent in 1996 to 26.1 percent in 2016. Prevalence of smoking among girls was initially low at 4.2 percent in 1996 and fell further to 2.4 percent in 2016.

Figure 2. Prevalence of Smoking Among Malaysian Youth Aged 13 – 15 Years

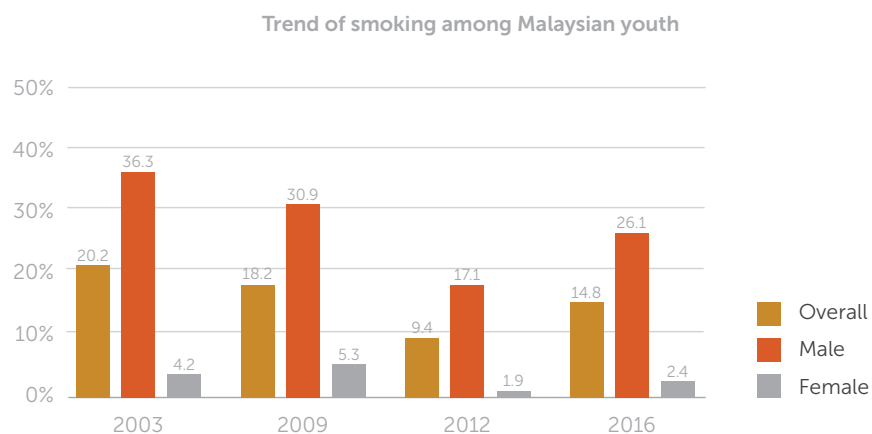
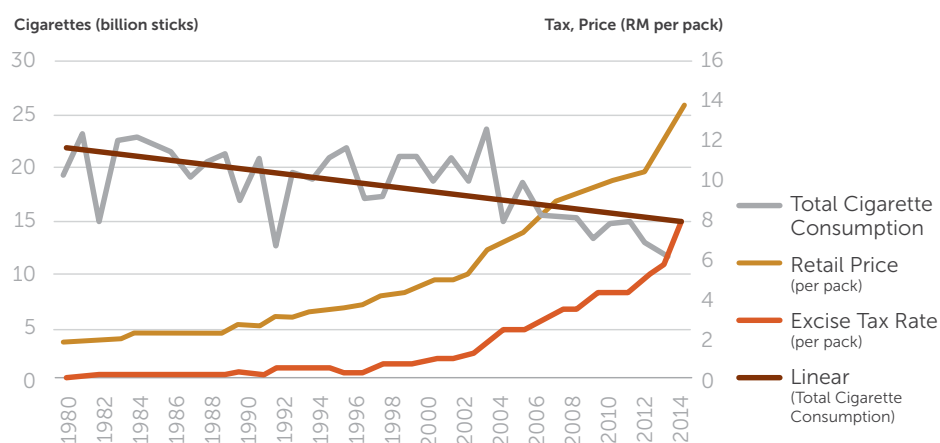


Figure 3. Relationship Between Excise Duty Rate Per Pack, Retail Price, and Total Consumption of Cigarettes from 1980 to 2014 (Real Prices)



Cigarette Consumption

Figure 3 illustrates the relationship between cigarette prices, excise duties, and cigarettes consumption in Malaysia. Total cigarette consumption is reflected by the blue line (and the black trend line). They show a decreasing trend in cigarette consumption, while the red line denotes the rising excise duty. The reduction of total cigarette consumption observed since 1980 is small, due to the inelastic demand for cigarettes in Malaysia, as discussed by Ross and Al-Sadat (2007). The inelastic demand for cigarettes implies that to obtain a significant reduction in cigarette consumption requires a relatively large increase in taxation and retail price.

4. Tackling Illicit Tobacco in Malaysia: Enforcement Challenges and Solutions

Types of Illicit Cigarettes

As defined by the FCTC, illicit trade is “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase, including any practice or conduct intended to facilitate such activity” (Calderoni et al. 2016; WHO FCTC 2015). This definition covers:

- » Smuggling – The unlawful movement or transportation of tobacco products (including counterfeit products) from one tax jurisdiction to another without the payment of taxes or in breach of laws prohibiting their import or export (Joossens et al. 1998).
- » Counterfeiting – Cigarettes manufactured and packaged to imitate an established brand without the brand owner’s consent.

- » Cheap or illicit whites – Cigarettes produced legally in one country but intended for smuggling into other countries where there is no prior legal market for them. Taxes in the country of production are typically paid but avoided in the destination countries.
- » Unbranded tobacco – Manufactured, semi-manufactured, and loose leaves of tobacco carrying neither labelling nor health warnings.
- » Bootlegging – Tobacco legally bought in a low-tax country by individuals or small groups and then smuggled into a country with higher tax rates and illegally resold.
- » Illegal manufacturing – Cigarettes manufactured for consumption which are not declared to the tax authorities. These cigarettes are sold without tax and may be manufactured in approved factories or illegal covert operations.

In Malaysia, cigarettes are considered illicit if any of the following conditions exist: no duties or taxes have been paid; the cigarettes are sold below MYR10.00 per pack (under Regulation 8C, Control of Tobacco Product Regulation 2004); cigarettes are not imported under a valid permit; tax stamps are absent; importers or manufacturers of the cigarettes are unlisted; the brands are unregistered; the pack size includes fewer than 20 cigarettes; or packaging lacks the six rotational graphic health warnings mandated by the MOH.

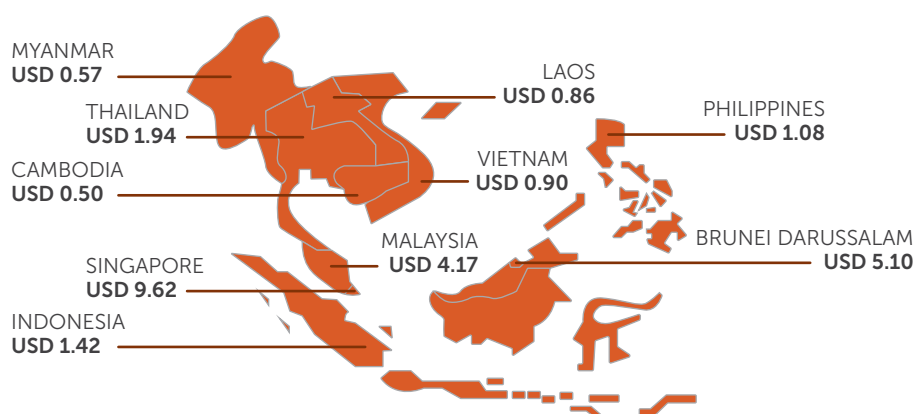
Cigarette Smuggling in Malaysia: The Nuts and Bolts

Tobacco smuggling in Malaysia follows two main pathways. One is direct smuggling, in which illegal entry points are used by perpetrators to directly introduce tobacco products via sea or land from neighboring countries without customs inspection. Indirect smuggling, meanwhile, employs additional deceptive methods, such as concealing cigarettes in secret compartments aboard ships or other vehicles, or among other imported goods. The currently most popular modality for smugglers in Malaysia is under-declaring or mis-declaring the value or quantity of transported cigarettes, rather than trying to conceal the cigarettes' existence altogether.

Cigarette smuggling can adopt a land mode (through entry points on Malaysia's borders with Thailand, Singapore, and Indonesia); sea mode (involving ports, jetties, and coastal areas throughout the country); or air mode (via air cargo or by passengers, air crews, or employees working within the airport area). Most illicit cigarettes are smuggled through the country's main ports of entry, such as Port Klang and Johor Port, located in West Malaysia.

Malaysia has a coastline of approximately 4,600 km and land borders of about 3,100 km shared with countries including Thailand, Brunei, and Indonesia. Malaysia also shares maritime borders with Singapore, Indonesia, Thailand, Brunei, Vietnam, Philippines, and to a certain extent with China. Malaysia's geography, with extensive coastline and porous jungles, poses significant challenges for anti-smuggling enforcement. Smuggling of illicit cigarettes – mainly by sea and land – is a lucrative business for organized crime and is expanding.

Figure 4. Regional Cigarette Price Disparities, 2016 (Price per pack, most popular brand)



Source: The Tobacco Control Atlas ASEAN Region, Third Edition (November 2016) SEATCA

Drivers of this expansion include: cigarette price disparities among countries in the region, with the market price for cigarettes in Malaysia being the second highest in Southeast Asia (Figure 4); correspondingly high profits from cigarette smuggling versus low risks taken by smugglers; the abuse of facilities at duty-free islands; and the rapid influx of foreign workers into Malaysia, who may be more inclined to purchase and consume smuggled cigarettes.

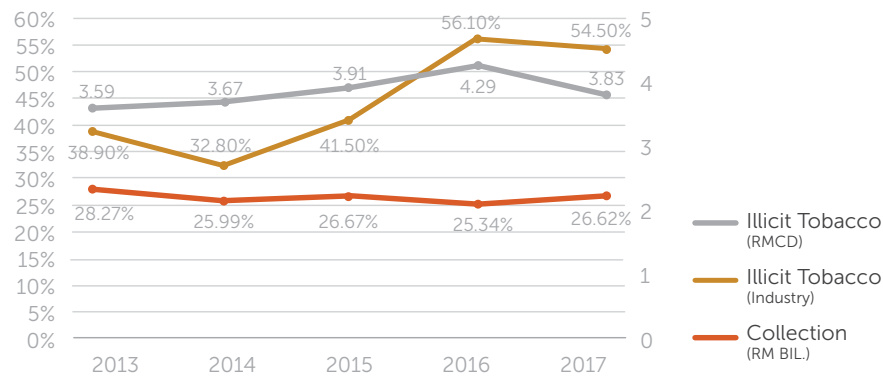
Do Higher Tobacco Taxes Boost Illicit Trade?

The tobacco industry offers systematic resistance to higher tobacco taxes and other control measures. Documented industry tactics include: claiming that higher taxes will increase smuggling and other forms of illicit trade; threatening governments that raise tobacco taxes with lawsuits; labeling tobacco taxes as anti-poor; and asserting that higher tobacco taxes will reduce government revenue and weaken employment.

Research evidence in the Malaysian context does not support the industry claim that higher taxes prompt substantially greater tobacco smuggling. Indeed, figures on illicit tobacco derived by the Royal Malaysia Custom Department (RMCD) contradict the main arguments advanced by the industry (Figure 5). The true incidence of tobacco smuggling in Malaysia is likely to be about half what the industry claims. Meanwhile, impartial research shows that raising tobacco taxes is likely to reduce the number of smokers in Malaysia and to increase tax revenue.

The RMCD analysis emphasizes the impact on tobacco smuggling of non-tax factors such as the presence of a large population of foreign workers who prefer to smoke their own brands of cigarettes, along with the geographical particularities discussed above. It is worth noting, moreover, that the large tobacco companies themselves are sometimes engaged in illicit cigarette trade. Ultimately, the key strategies to fight smuggling and illicit trade are stringent enforcement and cracking down on corruption. It is to such enforcement issues that our discussion now turns.

Figure 5. Illicit Tobacco Incidence in Malaysia as Estimated by the Tobacco Industry and the RMCD, and Tobacco Taxes Collected, 2013-2017



Enforcement Practices Against Illicit Cigarettes in Malaysia

In Malaysia, the RMCD is the leading agency involved in law enforcement against illicit cigarette smuggling, alongside the Royal Malaysian Police Force (RMP), the Malaysian Maritime Enforcement Agency (MMEA), the Ministry of Domestic Trade, Co-operatives and Consumerism (MDTCC), and the Ministry of Health. Besides cooperation with other government ministries and agencies, the RMCD also works closely with Interpol to address the illicit cigarette trade.

The current legislation under the purview of the RMCD regarding illicit cigarettes is summarized in Table 2.

Control of Tobacco Product Regulations 2004 (CTPR 2004) provided legal powers to the MOH to enforce the law pertaining to illicit cigarettes. Among the legal instruments that can be directed against perpetrators of illicit tobacco trade are CTPR 2004 Regulations 8A, 15, and 16. Regulation 8A requires every manufacturer or importer of tobacco products to submit an application for retail price of new tobacco products to the MOH. In addition, Regulation 8A (5A) requires individuals to sell tobacco products only with an approved retail price, and Regulation 8A (5B) prohibits any individual from selling tobacco products without a price label or an approved retail price. The practice in Malaysia is that manufacturers or importers must inform retailers of the approved price of a tobacco product. Illicit cigarettes brought in from other countries do not carry approved retail prices and are deemed illegal. Persons who sell cigarettes without approved prices in Malaysia are subject to a fine of up to MYR 10,000.00 or imprisonment for up to two years or both.

Regulation 15 of the CTPR 2004 requires specific health warnings on cigarette packaging, as depicted in Schedules 5 and 6. Regulation 15A also instructs the placement of labeling on cigarette packs as specified in Schedules 7 and 8 of the CTPR 2004. Illicit cigarettes

Table 2. Legal Framework for Import and Export of Tobacco Products

REGULATION	DETAILS
1. Regulation 18, Customs Regulations 1977	<i>Import license is compulsory for importation of cigarettes and liquor.</i> No person shall import intoxicating liquor, tobacco or denatured spirit except under and in accordance with a license issued by or under the direction of the Director General; provided that intoxicating liquor or tobacco which a senior officer of customs is satisfied is intended for the private consumption of the importer and not for sale or intoxicating liquor or tobacco exempted from the payment of customs duty under the provisions of section 14 of the Act may be imported without such license.
2. Regulation 19 (2), Customs Regulations 1977	<i>Import license is subject to yearly period.</i> Such license shall be for any period not exceeding one year but shall expire not later than 31st December next following of the date of issue.
3. Third Schedule, Part II, Customs Order 2017 (Prohibition of Imports)	Refer to item no 1. Cigarettes 2402.20.20 and 2402.20.90 (All importers shall apply; health warning & tax stamp on each cigarette packaging; tax stamp for every bottle, can, keg or other container of liquor.)
4. Financial Standing Order 2017	<i>Management procedures on tax stamp and security ink.</i> This order is to describe the accounting and procurement, management, and account management processes: "Treasury Collection Management Trust Fund (Banderol) for intoxicating Cigarettes and Liquor" at the headquarters level, states, and all responsibilities centre (PTJ) of the Royal Malaysian Customs Department.
5. Customs Standing ORder 2014	Importation of cigarettes / tobacco and liquor requires a license issued by the Director General of Customs under regulation 18. The Customs Regulations 1977 include importation by foreign diplomats and organizations. For effective control purposes, the Customs Director General has set out from 1 January 2009 that the authority to approve the application for cigarette import licenses is under the jurisdiction of cigarette / liquor headquarters licensing panel.
6. Food Act Part 5 Miscellaneous Provisions No. 36	The provisions of this Act so far as they are applicable shall apply, with such modifications as may be provided in regulations made under this Act, to tobacco, cigars, cigarettes, snuff, and other like substance in the same manner as the 9 provisions apply to food.

generally carry health warnings, texts, and labels different from those required by the law. CTPR 2004 Regulation 16 also mandates only 20 sticks of cigarettes per pack. Anyone who contravenes this regulation faces a fine of up to MYR 10,000 or maximum imprisonment of up to two years or both.

Improvements in Importation Procedures for Tobacco and Tobacco Products

The RMCD has recently introduced several improvements in the import procedures for tobacco and tobacco products. Importers of tobacco and tobacco products for commercial purposes are required to obtain import licenses and to submit a valid bank guarantee for the consignments to the RMCD. In addition, imported and locally manufactured cigarette packets are required to bear RMCD tax stamps. Tax stamps protect customers from purchasing counterfeit cigarettes, while enabling the RMCD to better curb the smuggling and sale

of illicit cigarettes. The RMCD has also taken the initiative to conduct physical inspection of every shipment that contains cigarettes or tobacco.

Taking Enforcement to the Next Level

As part of its ongoing effort to strengthen anti-smuggling enforcement mechanisms, the RMCD closely monitors the facilities established on Malaysia's duty-free islands so that traders do not abuse them. Customs control at duty-free islands has been restructured such that only certain areas within the islands have been gazetted as duty-free. All other areas of the islands are considered Principal Customs Areas (PCAs) where normal customs control is observed. Goods which are moving from a PCA to a Free Trade Zone (FTZ) are physically inspected. The Customs No. 8 Form (K8) has to be declared to the RMCD in order for goods to be moved. Once the goods reach the FTZ, a copy of the K8 form must be returned to the original station at the PCA. Failure to comply with this regulation leads to the forfeiture of the bank guarantee submitted by the importer to the RMCD. An additional RMCD control mechanism on the issuance or renewal of tobacco-product import licenses is vetting by a high-level management panel. Special operations, road blocks, and regular land and sea patrols are carried out periodically at strategic locations. These special operations target outlets, shops, and restaurants selling illicit cigarettes.

The RMCD has also initiated the Collaborated Border Management (CBM) system. Using pre-defined risk rules, Enforcement, Customs, and Technical Services officers work together to target high-risk consignments. RMCD officers stationed at border entry and exit points are often exposed to threats from organized crime syndicates. To enhance security, they are armed and work closely with the police.

Many illegal activities carried out by smugglers lead to money laundering. Therefore, a special task force called the National Revenue Recovery Enforcement Team (NRRET) has been formed. The task force comprises the RMCD, Police Force, Malaysian Central Bank, Malaysian Anti-Corruption Commission (MACC), and the Attorney-General Chambers. The task force takes action against offenders under Malaysia's Anti-Money Laundering, Terrorist Financing, and Proceeds of Unlawful Activities Act.

The RMCD has also introduced a demerit system on forwarding agents engaged in the import of tobacco products. Those found to have misused the facilities given by the RMCD are penalized. To date, the licenses of 31 agents have been suspended for various offenses. In the near future, the RMCD will also impose a similar demerit system on public and private warehouse operators. Operators who fail to comply with customs regulations will face immediate cancellation of their licenses.

Co-operation with Other Agencies

The launch of the National Blue Ocean Strategy (NBOS) further strengthens co-operation among law-enforcement agencies. Inter-agency collaborative action can: break illicit

cigarette supply chains by identifying trafficking “hotspots”; propose legal amendments to stiffen penalties for smugglers; revise procedures for licensing of private jetties; and accelerate revocation of cigarette import licenses if license holders are caught in smuggling activities. Under the NBOS, the RMCD cooperates with the RMP in information-exchange and capacity-building programs. Periodic joint operations are also carried out with the MOH, MACC, and MDTCC, as well as local authorities and town councils. The RMCD works in close partnership with the Malaysian Border Security Agency, which is a special agency responsible for curbing smuggling and other illegal activities along the country’s land borders. In addition to regional collaboration, the RMCD also links with international agencies to further strengthen the control of cigarette smuggling.

International coalitions in which the RMCD is involved include the Regional Intelligence Liaison Office (RILO); United Nations Office on Drugs and Crime (UNDOC); Container Control Program (CCP); and the Indonesia-Malaysia Coordinated Customs Patrol (PATKOR KASTIMA), as well as Malaysia-Thai Border Joint Cooperation (MTBCO). The RMCD is also an active member of the World Customs Organization (WCO) and is strongly connected with the United States Customs and Border Protection Agency, the Australian Border Force, and HM Revenue and Customs of the United Kingdom, among others. Special joint operations among partners are conducted on a regular basis to combat the illicit movement of cigarettes and tobacco.

The RMCD is currently working on a system overhaul under the Customs Project. This reform is expected to include the creation of a National Targeting Centre. Assistance from the United States, United Kingdom, and the Australian Border Force fosters the sharing of best practices on targeting and risk analysis. Close collaboration with Local Councils assists in cancelling the licenses of outlet operators who are found guilty of selling illicit cigarettes.

Expected Effect of Reforms to Address the Illicit Tobacco Trade

The measures and initiatives being taken by the MOH, RMCD, and other agencies are expected to reduce illicit cigarette consumption in Malaysia, ultimately cutting smoking prevalence among the country’s adults and adolescents. Authorities’ long-term target is to reduce smoking prevalence to 15 percent by 2025 and less than 5 percent in 2045. This will cut government health expenditures on smoking-related diseases, an especially important consideration, since almost 70 percent of such treatment costs in Malaysia are currently government funded. With all the steps taken to combat illicit cigarettes, together with the MPOWER strategies, Malaysia hopes to achieve a Smoke Free Generation and Tobacco Endgame by the year 2045.

5. Conclusions

Intensified information sharing and collaboration between enforcement agencies in Malaysia, authorities in other countries, and international partners will help curb illicit tobacco while strengthening international ties. Through such partnerships, Malaysia is committed to control the flow of illicit cigarettes into and within the country.

References

- Aljunid S. M. 2007. Health care cost of smoking in Malaysia, SEATCA Report.
- Calderoni F, Savona EU, Solmi S. Crime-proofing the policy options for the revision of the Tobacco Products Directive: Proofing the policy options under consideration for revision of EU Directive 2001/37/EC against the risks of unintended criminal opportunities. Transcrime - Universita degli Studi di Trento, 2012 http://transcrime.cs.unitn.it/tc/fso/pubblicazioni/AP/Transcrime-CP_of_the_EU_TPD.pdf.
- Institute for Public Health (IPH). 2012. Report of the Global Adults Tobacco Survey (GATS) Malaysia, 2011. Kuala Lumpur: Ministry of Health Malaysia.
- Institute for Public Health (IPH). 2015. National Health and Morbidity Survey 2015 (NHMS 2015). Vol. II: Non-Communicable Diseases, Risk Factors & Other Health Problems.
- Joossens L, Raw M. 1998. Cigarette smuggling in Europe: who really benefits? *Tob Control* 7:66–71.
- Ministry of Health Malaysia. 2015. National Strategic Plan for Tobacco Control 2015-2020.
- Ministry of Health Malaysia. 2016. The Relationships between Tobacco Taxation and Demand Determinants to Reduce Cigarettes Consumption and Smoking Prevalence in Malaysia.
- Rejab, Ismail & Zariah Zain. 2006. The Modus Operandi Of Cigarette Smuggling In Malaysia. The Collaborative Funding Program for Southeast Asia Tobacco Control Research.
- Ross H, Al-Sadat NA. 2007. Demand analysis of tobacco consumption in Malaysia. *Nicotine Tob Res.* 2007 Nov;9(11):1163-9.
- WHO (World Health Organization). 2003. WHO Framework Convention on Tobacco Control. Geneva: WHO.

PHILIPPINES

17

PHILIPPINES:

Addressing the Illicit Flow of Tobacco Products

Kim Henares and Malou B. Recente¹

Chapter Summary

The Philippines has recently made progress in addressing illicit tobacco trade, within an ambitious overall reconfiguration of the country's tobacco control efforts. The Philippines' widely discussed 2012 excise tax reform eliminated previous weaknesses in the excise tax structure on tobacco products. Earlier design flaws had limited the tax system's capacity to curb tobacco consumption and raise government revenues. These weaknesses had also complicated efforts to check illicit trade flows. The 2012 reform introduced broad changes, notably abolishing the previous multi-tiered classification of cigarettes based on net retail price. A single-tier cigarette excise tax structure is operational in the Philippines as of 2018. Philippine leaders have continued to raise tobacco tax rates and are weighing further increases to reach World Health Organization (WHO) recommended levels. These reforms set the context for the Philippines' action to control illicit tobacco flows.

The Bureau of Internal Revenue and the Bureau of Customs, the two major revenue-generating agencies of the Philippine government, are at the forefront of the fight against illicit tobacco. Both bureaus employ a wide range of enforcement tools, including the affixture of

¹ K. Henares (Former Commissioner, Bureau of Internal Revenue, Philippines) and M. Recente (Former Undersecretary, Department of Finance, Philippines)

revenue stamps, profiling, licensing, monitoring and surveillance of taxpayers and importers, use of x-ray machines and other technology, audit programs, and the imposition of stiff penalties for violators. The mechanisms deployed are aligned with the principles of the WHO Framework Convention on Tobacco Control and the Protocol to Eliminate Illicit Trade of Tobacco Products. Opportunities now exist to implement a tighter track-and-trace system involving reinforced collaboration between the two bureaus, other government agencies, and legitimate industry players.

Tax policy and enforcement mechanisms to combat illicit tobacco flows in the Philippines can be enhanced by (a) strengthening capacity, technology, and the use of data; (b) expanding partnerships with legitimate business; and (c) stronger coordination among enforcement agencies. Our findings support the following specific recommendations:

1. There should be stronger coordination between the Bureau of Internal Revenue and the Bureau of Customs, along with other law enforcement agencies and legitimate industry players, to better enforce the law regarding excise tax on cigarettes. Monitoring illicit tobacco products in the market and aggressively prosecuting violators are key parts of the agenda. Policy makers can boost results by creating a system wherein all regulatory agencies share a common database to monitor tobacco product flows.
2. International collaboration to curtail the illicit tobacco trade should be actively pursued within the ASEAN integration initiative and other forums. A priority aim for international collaboration would be ensuring that, in future, no cigarettes leave an exporting country without bearing the legal tax stamps of the importing country. To this end, customs authorities in exporting countries can and should share export documents with the importing countries. Region-wide collaboration in the use of revenue stamps and sharing of trade documents among governments of exporting and importing countries would go far in reducing illicit tobacco flows.
3. Government should resolve illicit tobacco cases quickly and ensure the enforcement of heavier penalties for violations.
4. The security features of tax stamps should be guarded and continuously updated to prevent counterfeiting.
5. Open data on tobacco trade and tax statistics are necessary to improve estimates of illicit trade and better evaluate tax and administrative measures used to control illicit tobacco.
6. Stronger capability-building programs for the Bureau of Internal Revenue and the Bureau of Customs should be prioritized. These should include training to sharpen analytical, profiling, and audit skills, and the use of technology.

1. Introduction

This chapter presents a case study on the Philippine experience in curtailing illicit tobacco flows. It discusses recent structural changes that corrected weaknesses in the country's tobacco tax structure. Administrative and enforcement measures are reviewed, including operational issues. The chapter details actual frontline interventions against illegal tobacco trading and analyzes how these came about through the joint efforts of the two agencies mainly responsible for controlling illicit tobacco in the Philippines: the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC). The concluding portions of the study formulate recommendations and identify areas for further progress for the BIR and BOC.

Methods and sources

In preparing the study, literature on tobacco taxation, curtailing illicit tobacco flows, and related topics were reviewed, as well as laws, rules, and regulations governing the implementation of excise taxes on tobacco products in the Philippines. Interviews were conducted with tax and customs administrators to determine specific processes in the implementation of tobacco excise taxes, including how controls and safeguards have been aligned to monitor the flow of tobacco products from manufacturers to final consumers. Data cited in this chapter, e.g., import data, volume of removals of tobacco products, and information on excise tax and total tax collections, are official data from the BIR and BOC. Other data such as smoking prevalence figures were drawn from the Global Adult Tobacco Surveys conducted in 2009 and 2015.

2. The Context of Action on Illicit Tobacco

2.1 The Philippines 2012 Excise Tax Reform

On December 19, 2012, the Philippine Congress enacted an ambitious reform law which restructured the excise tax system for cigarettes as well as alcohol products. This was Republic Act No. 10351,² which became effective in 2013. The reforms addressed many of the policy and implementation weaknesses found in the previous tax structure. The measures: (1) made the excise tax system more robust in generating revenues for government; (2) reduced cigarette consumption, fulfilling health objectives; and (3) helped reduce the illicit movement of tobacco that escapes taxation and other forms of government regulation.

RA 10351 abolished the multi-tiered classification of cigarettes based on net retail price, which had imposed different excise taxes on low-priced, medium-priced, and high-priced cigarettes. The new law reduced the previous four-tiered arrangement to a two-tiered structure from 2013 to 2017, then a unitary structure starting in 2018 (Table 1).

² "An Act Restructuring the Excise Tax on Alcohol and Tobacco Products by Amending Sections 141, 142, 143, 144, 145, 8, 131 and 288 of Republic Act No. 8424, otherwise known as the National Internal Revenue Code of 1997, as Amended by Republic Act No. 9334, and For Other Purposes."

Table 1. Comparative Tobacco Excise Tax Structure Before and After RA 10351

BEFORE RA 10351		TAX RATES IN 2012					
Cigarettes packed by hand (in 30s)		Php 2.72/ pack					
Cigarettes packed by machine (in 20s)							
Net retail price (NRP):							
Below Php 5.00		Php 2.72/pack					
Php 5.00 but not over Php 6.50		Php 7.56/pack					
Over Php 6.50 but not over Php 10.00		Php 12.00/pack					
Over Php 10.00		Php 28.30/pack					

AFTER RA 10351	TAX RATES PER RA 10351						2018 AND THEREAFTER
	2013	2014	2015	2016	2017		
Cigarettes packed by hand	Php 12.00	Php 15.00	Php 18.00	Php 21.00	Php 30.00		The specific tax rate shall be increased by 4%
Cigarettes packed by machine, where the NRP is:							The specific tax rate shall be increased by 4%
P11.50 and below	Php 12.00	Php 17.00	Php 21.00	Php 25.00	Php 30.00		
More than P11.50	Php 25.00	Php 27.00	Php 28.00	Php 29.00	Php 30.00		

What some had perceived as an “equity” feature of the previous system, subjecting low-priced cigarettes to low excise tax, had in reality become an invitation for manufacturers to misclassify higher-end cigarette brands as low-priced, low-tax brands as a means to evade taxes. This had made the work of tax administrators especially challenging. The Philippines Department of Finance (DOF) referred to the misclassification as a form of technical smuggling. The removal of the multi-tiered system and the imposition of a unitary tax of Php 30.00 under RA 10351 shut down these opportunities to cheat the system.

Along with the multi-tiered classification system, the previous excise tax structure had included other features that kept cigarette prices low, and which were addressed to an extent by RA 10351. A price classification freeze on numerous brands of cigarettes (indeed, 90 percent of all brands) meant that these products were taxed based on their prices prior to October 1996. On the other hand, all new brands introduced after October 1996 were taxed based on their current prices. This “legislative protection” spelled unfair competition and at the same time made cigarettes, on the whole, a relatively cheaper commodity than food, utilities, and education. This approach constrained the capacity of the new excise model to curtail consumption of a “sin product” (Sta. Ana and Latuja 2010).

2.2 Smoking Trends and Tobacco Tax Revenues in the Philippines

Smoking Trends. Various published studies have shown that smokers of any form of tobacco products have declined as a proportion of the Philippine population from 1989 up to the latest survey results in 2015. In 2009, 28.2 percent of the country's adult population (aged 15 and above) were reported to be tobacco smokers. This figure dropped to 22.7 percent in 2015. Some 22.7 percent of adults in urban areas are reported to be current tobacco smokers. The proportion is 25.3 percent in rural areas.

Daily smokers of any tobacco product represented 22.5 percent of the adult population in 2009, but this figure had shrunk to 18.7 percent in 2015. On the other hand, the GATS 2015 survey reported that daily smokers consumed 16.5 cigarettes per day on average in 2015, compared to 15.7 cigarettes per day in 2009. Considering all smokers (i.e., both daily and less frequent smokers), men (11.2 cigarettes per day) consume more cigarettes than women (8.6 cigarettes per day).

The government's anti-smoking campaign has had a striking effect on the attitudes and perceptions of the adult population regarding the effects of smoking. In the most recent surveys, about 95 percent considered smoking as a cause of serious illness, 93.5 percent believed that inhaling other people's smoke causes serious illness to non-smokers, and 97.2 percent of adults favored complete prohibition of smoking in indoor workplaces and public places.

The GATS 2015 results conveyed that more and more smokers made quit attempts (47.9 percent in 2009, rising to 52.2 percent in 2015), although the proportion of smokers who successfully quit remained almost unchanged from 2009 (4.5 percent) to 2015 (4.0 percent).

Table 2. Proportion of Tobacco Smokers Among Adult Population in the Philippines, Various Studies

YEAR	PREVALENCE	SOURCE
1989	58.6	Lung Center of the Philippines, DOH
1995	33.0	Social Weather Station Survey
1996	32.0	
1998	31.6	National Nutrition & Health Survey
2001	23.5	DOH - UPM Survey
2003	23.6	World Health Survey
2007	27.0	Social Weather Station Survey
2009	28.2	GATS, 2009
2015	22.7	GATS, 2015

Results of the Global Youth Tobacco Surveys in 2007 and 2015 indicate that 17.5 percent of Filipino youth surveyed in 2007 were cigarette smokers, but that by 2015 the proportion had dropped to 12 percent.

Table 2 indicates that the Philippines saw a remarkable decline in smoking prevalence from 1989 to 1995, then a more gradual decline until 2001, followed by rising prevalence in 2007-2009. A new, strong downtrend then emerged that, by 2015, had almost returned the country to its 2001 prevalence level. This pattern shows that the Philippines has the ability to cut smoking prevalence. That capacity, coupled with the robust public support for tobacco control described above, shows the country’s potential to take the anti-tobacco fight much further.

Cigarette Consumption and Excise Tax Revenues. The 2012 excise tax reform altered cigarette consumption patterns but at the same time boosted government tax collections. Legal domestic sales of cigarettes in the Philippines dropped from 4.3 billion packs in 2013 to 3.1 billion packs in 2016, a 28.3 percent decline in four years. Annual domestic cigarette sales declined by 24 percent from 2013 to 2014 and by 18.4 percent from 2015 to 2016 (Table 3).

Table 3. Domestic Consumption of Cigarettes, Philippines, 2013 – 2016, in millions

YEAR	DOMESTIC CONSUMPTION, LOCALLY MANUFACTURED & IMPORTS		ANNUAL GROWTH RATE	INCREASE FROM 2013 – 2016
	PACKS	PIECES		
2013	4,339.4	86,787.95		
2014	3,295.9	65,918.4	-24.0%	
2015	3,812.8	76,256.8	15.7%	
2016	3,111.5	62,229.9	-18.4%	-28.3%

Source: Bureau of Internal Revenue

Despite this steep decline in sales, the Philippines’ tobacco excise tax collection in 2016 had risen by approximately 289.6 percent over its 2009 level. Clearly, the drop in the volume of cigarettes sold during this period was not enough to negatively impact cigarette tax collection.

Excise Tax State of Play as of 2018. Republic Act (RA) No. 10963, otherwise known as the “Tax Reform for Acceleration and Inclusion (TRAIN)” Law, enacted on December 27, 2017, increased the unitary tax rates mandated by RA 10351. Effective on January 1, 2018, RA 10963 is set to increase tax rates by Php 2.50 four times from 2018 through the end of 2023, and then to apply an annual adjustment of 4 percent starting in 2024. While this is intended to make the excise taxes more revenue productive, the increments of tax increase still remain far below optimal levels that would sharply curb tobacco consumption.

Table 4. Excise Tax Rates under the TRAIN Law

BEFORE THE TRAIN LAW	UNDER THE TRAIN LAW
Effective January 1, 2017, unitary rate of Php 30.00 per pack (on cigarettes packed by hand and cigarettes packed by machine)	January 1, 2018 to June 30, 2018 – Php 32.50 per pack
January 1 to December 31, 2018 – Php 31.20	July 1, 2018 to December 31, 2019 – Php 35.00 per pack
January 1 to December 31, 2019 – Php 32.45	January 1, 2020 to December 31, 2021 – Php 37.50 per pack
January 1 to December 31, 2020 – Php 33.75	January 1, 2022 to December 31, 2023 – Php 40.00 per pack
January 1 to December 31, 2021 – Php 35.10	
January 1 to December 31, 2022 – Php 36.50	
January 1 to December 31, 2023 – Php 37.96	
Tax shall continue increasing by 4% annually	Tax shall increase by 4% annually starting January 2024

According to the World Bank, citing studies from the World Health Organization, the tax per pack of cigarettes must be around 75 percent of the price in order to make a sharp dent in consumption (World Bank 2017). As of December 2017, the Php 30 excise tax represents some 40 percent of the retail price of a Php 75 pack of Marlboro cigarettes. At the new tax rate of Php 32.50/pack, clearly, the rate still does not approach the WHO-recommended level.

Will Tax Hikes Mean More Illicit Trade? Would higher excise taxes, resulting in higher-priced cigarettes, induce illicit tobacco flows? One of the risks of imposing higher taxes is that it provides a high economic return for evading taxes. Thus, there is a need to provide additional administrative and enforcement measures, strict implementation thereof, and aggressive criminal prosecution as a deterrent to the illicit tobacco trade, as tobacco tax hikes take effect.

3. Administrative Mechanisms to Control Illicit Tobacco Flows

3.1 At the Point of Taxation

The provisions of the Philippines’ National Internal Revenue Code (NIRC) are sufficiently broad to encompass taxable events under the excise tax regime. Importation of tobacco products by duty-free shops, a huge loophole in the past, is no longer exempt from excise taxes. If exemption is requested, such as for direct export, an export bond and a transfer bond must be posted.

The Tax Code has been further clarified under several Revenue Regulations (RR) issued by the Bureau of Internal Revenue, in particular RR 3-2006, RR 3-2008, and RR 17-2012. These regulations stipulate that the excise tax on locally manufactured cigarettes shall be paid by the manufacturer or producer before removal of the cigarette product from the place of production. If the tobacco product is consumed within the premises of the tobacco producer, the tobacco producer becomes liable for the excise tax on said consumed tobacco. If the manufacturer removes the tobacco products from the place of production for purposes of exportation or sale to a tax-exempt entity (for example, foreign embassies) or international carriers, the manufacturer may pay the excise tax upon removal and claim excise tax credit or a refund later. Or the manufacturer may use the so-called product replenishment scheme provided under RR 3-2008, by applying previous excess excise tax payments to the current removals to cover current excise tax dues. Both schemes provide tightened controls. They require presentation of proofs, instead of simply granting outright exemption of a tobacco product once the taxpayer declares it to be for export or sale to a tax-exempt entity, a model prone to abuse and leakage.

Imported tobacco products are subject to excise taxes unless there is a qualification provided by law. A bond is also to be posted by the importer to guarantee payment of excise taxes. For imported manufactured cigarettes, the importer is liable for the excise tax. The importer prepays the tax upon acquiring revenue stamps from the BIR for affixture by the foreign supplier on the cigarettes being imported. If the specific tobacco product is imported on a smaller scale, for example semi-prepared tobacco to be used as raw material in producing twisted cigarettes, the excise tax is paid by the importer prior to release of the imported product.

If the imported semi-prepared tobacco product or imported stemmed tobacco leaves are to be directly exported or are to be used as an input in producing tobacco products for export, the importation is not excisable, but the importer posts an additional amount as bond equivalent to the excise tax that was not imposed. In addition to the export bond, a transfer bond is required if the exporter intends to transfer the good from the place of production to a bonded facility.

Importation of tobacco products by Duty-Free Philippines, Inc., and by duty-free shops in the country's special economic zones, along with other imports into these special economic zones or free ports, are no longer exempt but have become subject to excise taxes. They may be exempt from customs duties but are subject to the excise tax and the value-added tax (VAT).

Tobacco products imported into the Philippines for transshipment to a foreign country shall be subject to a bond equivalent to the amount of excise tax, VAT, and duties had the product been imported and sold on the domestic market. This is clarified under RR 17-2012. The bond serves as guarantee to the government that the imported products are to be directly exported to a foreign country and are not intended for sale in the local market.

3.2 Key Agencies and Regulatory Requirements in the Production or Importation of Tobacco Products

Several Philippines government agencies play roles in regulating the production or importation of tobacco products.

The **National Tobacco Administration (NTA)** issues an annual permit to import, export, or transship unmanufactured tobacco or manufactured tobacco, and an annual permit to manufacture tobacco products. The Import Commodity Clearance issued by NTA is a pre-requisite for the release of all importations of tobacco products, as well as tobacco-related equipment, supplies, raw materials, and ingredients.³ It is listed among the documents to be submitted to the Bureau of Customs (BOC).

The legal basis of NTA is Executive Order No. 245, issued on July 24, 1987, which gave the NTA the power to regulate the tobacco industry. The agency has the primary mandate to set tobacco prices so as to guarantee tobacco farmers a minimum return of 25 percent on their investments. Floor prices have an indirect effect of dampening any plan to flood the market with cheap cigarettes. According to the NTA, the floor price considers prevailing market conditions such as production cost and a reasonable return to the farmer. Tobacco is the only product that is regulated in this manner.

The **Bureau of Internal Revenue** requires that producers, importers, and exporters of tobacco products register annually as taxpayers. An Authority to Release Imported Goods (or "ATRIG") is issued by the BIR prior to release of all imported excisable goods, including all tobacco products. This is a requirement every time an importation is made. Revenue Memorandum Order No. 35-2002 and Revenue Memorandum Order No. 35-2014 are the pertinent issuances, with the latter implementing the electronic ATRIG system, using the Philippine National Single Window (NSW) system at the Bureau of Customs. The importer files the eATRIG through the NSW system but still submits a hard copy and duly notarized application form to the Excise Large Taxpayers Regulatory Division of the BIR, which is the designated approving officer. Electronic filing has eliminated the falsified ATRIGs that were observed when these documents were manually filed and processed. The eATRIG system has allowed the "least manual intervention and personal representation of the importer or his representative."

One requirement for the approval of the eATRIG application is that the applicant must have a Permit to Operate as Importer of Excisable Articles. Likewise, applicants must be able to present their latest Annual Income Tax Return and Audited Financial Statements. If documentation is complete, an application can be approved on the next working day.

³ Provided under NTA Memorandum Circular 3-2004 issued on July 28, 2004.

The **Bureau of Customs** lists tobacco products as regulated imports. As such, the BOC requires the tobacco importer to submit the following clearances issued by other government regulatory agencies prior to release of any imported tobacco product:

1. ATRIG from the BIR
2. Authority to Import Leaf Tobacco and Tobacco Products or Import Commodity Clearance from the NTA
3. Sanitary and Phytosanitary Import Clearance from the Bureau of Plant Industry for importation of tobacco dust, stems, leaves, and other related materials.

Customs Memorandum Order (CMO) No. 9-2015, issued on April 10, 2015, lays down the strict enforcement of rules on regulated imports. Rules require that the importer or broker must be accredited with the BOC. In the process of accreditation, the importer or broker submits several documents including registrations or clearances secured from other government agencies, which the BOC uses for profiling. These include:

- a. Latest General Information Sheet (if a corporation) or Registration with the Department of Trade and Industry (if a sole proprietor) or Articles of Partnership or Articles of Cooperation (if a cooperative)
- b. Corporate Secretary Certificate (if a corporation) or Affidavit (if sole proprietor) or Partnership Resolution for designated signatories in the import entries
- c. Original copy of the National Bureau of Investigation (NBI) Clearance of Applicant (issued within three months prior to the date of application)
- d. Company Profile with pictures of office and warehouse premises with proper signage
- e. Previous Certificate of Accreditation, if applicable
- f. License / Permit / Accreditation from the concerned agency, when applicable, i.e., from NTA or BPI.

As part of data transparency, the customs website has a window on “tobacco importation” that shows the lists of tobacco importers and data on importation by port.

3.3 Submission of Manufacturer’s or Importer’s Sworn Statement

Under Revenue Regulations 17-2012, every manufacturer or producer or importer of an excisable product like cigarettes is required to submit a sworn statement as a supporting document to the application for initial registration of his product. An updated sworn statement is thereafter required to be submitted on or before the end of the months of June and December of every year. The following information must be contained in the manufacturer’s or importer’s sworn statement, as enumerated in the regulations:

- » Name, address, Taxpayer Identification Number (TIN), and assessment number or control number of the manufacturer or importer assigned to him by the Excise Taxpayer Regulatory Division of the BIR
- » Complete root name of the brand as well as the complete brand name with modifiers
- » Complete specifications of the brand detailing the specific measurements, weights, manner of packaging, etc.
- » Names of the regions where the brand is to be marketed
- » Wholesale price per case, gross and net of VAT and excise tax
- » Suggested retail price, gross and net of VAT and excise tax, per pack or per bottle
- » Detailed production or importation costs and all other expenses incurred or to be incurred until the product is finally sold
- » Applicable excise tax rate
- » Corresponding excise and VAT.

If there is a change in the cost to manufacture, or a change in the actual selling price of the brand, the BIR requires that the sworn statement shall be updated and submitted five days before the removal of the product from the place of production or before release of the product from customs' custody.

The sworn statement is then verified by the BIR for accuracy and completeness. For instance, the BIR uses the reference books kept by the Bureau of Customs in determining the proper valuation of imports. If these are found to be erroneous or inaccurate, a revised sworn statement is required to be filed, and the taxpayer can be subject to corresponding penalties.

Section 13 of Revenue Regulations 17-2012 provides for the following penalties:

- a. "Any manufacturer or importer who misdeclares or misrepresents in his or its sworn statement herein required any pertinent data or information shall, upon discovery, be penalized by a summary cancellation or withdrawal of his or its permit to engage in business as a manufacturer or importer of alcohol or tobacco products;
- b. "Any corporation, association or partnership liable for any of the acts or omissions in violation of the Act and implemented by these Regulations shall be fined treble the aggregate amount of deficiency taxes, surcharges and interest which may be assessed pursuant to the provisions of the Act;
- c. "Any person liable for any of the acts or omissions prohibited under the Act and implemented by these Regulations shall be criminally liable and penalized under Section 254 of the NIRC of 1997; and
- d. "If the offender is not a citizen of the Philippines, he shall be deported immediately after serving the sentence, without further proceedings for deportation."

If the BIR finds out that there is an understatement of the suggested net retail price by as much as 15 percent, the manufacturer or importer shall be liable for additional excise tax equivalent to the tax due and difference between the understated net retail price and the actual net retail price, as provided for under Section 144 of the National Internal Revenue Code of 1997 as amended by Republic Act No. 10351.

From experience, the manufacturer's or importer's sworn statement is not misdeclared, because it is a sworn statement. If changes occur during the production process, for example regarding prices, these may be corrected through an amended statement submitted prior to release of the product from the warehouse.

The submission of the manufacturer's or importer's sworn statement is important for the following reasons:

1. To ensure that the government has a complete list of cigarette brands that are duly registered. Any brand that is not in the list provided by the manufacturer or importer is presumed to have been manufactured or imported illicitly, and it is presumed that no excise tax thereon has been paid;
2. To ensure that the brand is properly classified and the proper excise tax due thereon is collected under the multi-tier excise tax system;
3. As third-party information aiding in the collection of other taxes.

3.4 Affixture of Revenue Stamps on Cigarette Packs

Although the requirement to affix internal revenue stamps in the form of a bar code or fusion stamps has been mandated since 1997, this was actually implemented only in 2014. The BIR developed the Internal Revenue Stamp Integrated System (or "IRSIS") to implement the affixture of new internal revenue stamps on both imported and locally manufactured cigarettes, whether sold domestically or for export. Through the IRSIS, revenue stamps can be ordered, distributed, and monitored in real-time. The stamps have specific dimensions and different color designs. There are multi-layered security features, an IRSIS-assigned "Quick Reference Code," which is a two-dimensional bar code holding information about the revenue stamp, and a "Unique Identifier Code" which is a code or serial number referring to the revenue stamp.

The manufacturer or importer must enroll in the IRSIS. To order revenue stamps through the system, the taxpayer must have made his excise tax payment through the electronic Filing and Payment System (or "eFPS"). Under RR 7-2014, the price of a revenue stamp had been computed at Php 0.13 per piece. This has been adjusted to Php 0.15 per piece under RR 6-2017. Changes in the cost of raw materials and equipment incurred by APO Inc., the government agency mandated to print the revenue stamps and implement the IRSIS, caused an adjustment in the price by the BIR.

In 2016, BIR issued Revenue Memorandum Circular 51-2016 introducing the use of a Stamp Verifier app in verifying the authenticity of revenue stamps. The Stamp Verifier app is innovative and smart, as it uses modern technology as well as involving the cigarette user or smoker in identifying illegal cigarettes. This technology encourages consumers to download the mobile application and use it to check the validity of the revenue stamp affixed to the cigarette pack (either domestically manufactured or imported) that they are purchasing. The app will read the QR code, a two-dimensional code which is a security feature of the revenue stamp that contains information about the product. If the app shows a non-valid QR code, this would mean that the Unique Identifier Code (or UIC) for the cigarette pack is not in the database of UICs in the BIR, and one can conclude that the cigarette is counterfeit. BIR personnel received training in the use of the new technology.

Effective monitoring using mobile verification devices is, however, dependent on internet connection which could be weak in many areas. The BIR thus continues to conduct on-the-spot surveillance of production facilities as well as markets. Outstanding excise taxes are collected, in addition to penalties and sanctions, if discrepancies are detected during these surveillance activities.

RR 6-2017 mandates the affixture of new revenue stamps on all locally manufactured cigarettes starting on January 1, 2018, and on imported cigarettes starting on June 1, 2018. This is in line with the policy that security features of the revenue stamps should not be compromised and thus should be replaced every three years or sooner, if there is evidence of counterfeiting of stamps.

With the affixture of tax stamps, it has become easy for the BIR to determine whether the excise tax due on the cigarette pack has been properly paid or not. The BIR can easily confiscate cigarettes for which taxes were unpaid or erroneously paid, and assess the proper taxes due thereon. The tax stamps have greatly helped the government in conducting raids and bringing airtight cases against tax evaders.

The presence of revenue stamps on cigarette packs, to gauge implementation, was measured in a World Bank project in partnership with PREMISE. Simply described, the project identified sites nationwide and asked surveyors to collect evidence of revenue-stamp usage, such as pictures of stamps on cigarette packs bought by individuals from stores. The surveyors used mobile technology to send this data for analysis by PREMISE. Results of surveys conducted in the week of September 25, 2016, showed a high revenue stamp presence in several places, notably, Quezon and Pampanga with a 100 percent stamp usage rate, Bulacan with 98.7 percent, Laguna with 88.6 percent, and Metro Manila with 83 percent.⁴ In addition to tax stamps presence, the project also tracked tobacco prices. However, this project has lapsed and the decision to continue the project has not been made by the BIR and the DOF.

⁴ World Bank Philippines Sin Tax Dashboard, April 5, 2015 – September 25, 2016.

Notable in the BIR experience with the use of tax stamps is the success in engaging the public, especially young people who are comfortable with new technology, in the drive to detect illicit tobacco in the market. Another possible innovation is developing a website that could receive reports of illicit cigarettes from the public or consumers themselves.

The presence of a tax stamp on a pack of cigarettes is, in the first instance, a visual “proof” that tax must have been paid. The BIR has advised the BOC that cigarettes being imported without properly affixed stamps (for example, inside the clear plastic covering of the cigarette case and not outside the plastic cover) should immediately be confiscated. Determining whether the brand is fake, or the stamp is counterfeit, or the importer is unregistered all involve additional steps for the BIR and the BOC. Thus, both agencies should strengthen their track-and-trace capabilities, tighten their coordination, including linking up with relevant agencies and legitimate industry players, and continuously equip themselves with training and technology to go after illicit activities.

3.5 Other Administrative Monitoring Measures

All manufacturers and/or importers of cigarettes must be registered with the Bureau of Internal Revenue and are required to obtain permits from the Bureau for every sale, export, and import of their products. This rule also applies to suppliers of the following raw materials: tobacco leaves, tipping paper, filter rod, and cigarette papers. Cigarette manufacturers/importers are required to register themselves and obtain appropriate permits before they can operate. Necessary documents may include the Permit to Operate as Manufacturer of Cigarettes, Permit for a Storage Warehouse of Leaf Tobacco Within Factory Premises, Permit to Operate as a Dealer of Leaf Tobacco, and Permit for a Storage Warehouse of Cigarette Paper and Non-Tobacco Materials. Factories and warehouses relating to the manufacture and importation of cigarettes require the prior approval of the BIR. The taxpayer is required to provide a plot and plan of the premises which are in compliance with security measures that will ensure that the entry and exit points are limited in number and location and are specifically identified so that no raw materials and cigarettes can enter or exit without being observed by the Revenue Officer on Premises (ROOPs) assigned by the BIR.⁵

The BIR posts a number of ROOPs on the premises of each cigarette manufacturer/importer to ensure that the movement of cigarettes is not impeded, as a Withdrawal Certificate signed by the ROOPs is required for raw materials to enter and for cigarettes to be withdrawn from the facility. A cigarette manufacturer cannot transport cigarettes from its premises without the ROOPs issuing a Withdrawal Certificate, and this certificate can only be issued when the ROOPs is satisfied that the proper excise tax has been paid, and the tax stamp has been properly affixed. In theory, the facilities of each cigarette manufacturer need to be monitored 24 hours a day, seven days a week, since no cigarettes may be released without a withdrawal certificate. In practice, however, the surveillance is not strictly continuous, as the

⁵ Revenue Memorandum Order 38-2003.

BIR personnel assigned as ROOPs are limited in number, and they follow standard working hours. The BIR relies on voluntary declarations by the taxpayer for withdrawals made outside working hours and without the ROOPs' presence. Declaration is subsequently verified during audit. Because ROOPs cannot be present 24/7, the BIR had planned to install close circuit television (CCTV) monitoring systems on all production and withdrawal points on the premises of the manufacturers, but this has yet to be implemented.⁶ One issue that remains to be settled is responsibility for the maintenance and upkeep of the CCTVs.

The whole process of cigarette manufacturing is intended to be highly controlled. The design of packaging materials from the individual pack to the master cases requires BIR prior approval before it can be used. A graphic warning design on a cigarette pack that is not BIR-approved and is found in the market is already proof of illegal tobacco trade. Disposal of any raw materials or finished cigarettes requires prior approval from the BIR and may only be carried out when a BIR officer is present to witness the destruction.

As an additional monitoring measure, the tobacco industry is required to maintain an Official Registry Book, wherein daily transactions of receipts and removals of regulated raw materials, goods-in-process, and finished products must be entered and submitted to the BIR. All raw materials have a specific conversion rate to finished products. For a defined input quantity of tobacco leaves, cigarette paper, tipping paper, and filter rod, the conversion rate can be used to determine whether an appropriate quantity of cigarettes have been reported as manufactured and withdrawn. In 2013, the BIR developed the Electronic Official Registry Book (eORB) System, and on July 23, 2013, Revenue Memorandum Order No. 23-2013 mandated that the submission of the ORB be conducted electronically through the eORB mechanism.

Using the data submitted by taxpayers, the BIR can also conduct audits, assess possible reporting deficiencies, and/or order an inventory of raw materials, goods in process, and finished products to verify the accuracy and completeness of taxpayers' reports.

3.6 Profiling of Importers, Developing "Alert Orders," Use of X-Ray Machines, and Stiffer Penalties on Smuggling

The BOC employs several techniques to arm itself against smuggling activities. The information provided when the importer or customs broker applies for accreditation or permit to import goes to the Account Management Office of the BOC. The Account Management Office administers the Client Profile Registration System for importers and customs brokers, as mandated by Customs Memorandum Order No. 4-2014, and provides guidelines for risk profiling of importers and brokers. The BOC also inputs information on past importations, data from the exporting country, industry data, and information from other third-party sources.

⁶ To further enhance the monitoring of the premises and the affixture of tax stamps on cigarettes packs, Section 14 of Revenue Regulation No. 7-2014 provided that the BIR shall study and cause the installation of CCTVs.

The Bureau issues so-called “alert orders” to effect apprehension of suspicious shipments coming into the country. Alert orders are formulated based on information coming from third-party sources and records obtaining from within the BOC itself. Outside sources include foreign customs authorities, Interpol, the business sector, or other government authorities. Again, the BOC relies on past records of importations and experience with the type of product being imported. For instance, if an importation deviates from the normal or average weight, volume, value, measurement, or tariff classification based on industry practice, this raises a red flag among customs operatives, and an alert order for an incoming shipment may be issued to the port collector.

The BOC has procured x-ray machines for key ports like the Port of Manila, Manila International Container Port, Port of Batangas, Subic Port, among others, which are mainly containerized ports. The proposal is to arm all containerized ports with x-ray machines and to consider doing this for non-containerized ports to strengthen border controls against illicit importations.

Under RA 10863, or the “Customs Modernization and Tariff Act (CMTA),” enacted on June 10, 2016, stiffer penalties and surcharges are now imposed for misdeclaration, misclassification, or undervaluation of importation and on unlawful importation or exportation of goods. The cost of committing these illegal acts should be greater than the reward, thus, the stiffer sanctions under the CMTA are long overdue. The surcharge for misdeclared, misclassified, or undervalued importation has risen from 100 percent to 250 percent of the taxes and duties due. If fraudulent intent has been established, the surcharge shall be equivalent to 500 percent. The good is also subject to seizure. Unlawful importation or exportation of goods subjects the person to imprisonment or a fine of up to Php 50 million, depending on the value of unlawful importation or exportation, but up to Php 200 million only. Beyond Php 200 million, the act is already deemed a heinous crime punishable with imprisonment of 20 to 40 years and a fine of not less than Php 50 million.

4. BIR and BOC Initiatives at Work in Recent Cases Against Illicit Tobacco Trade

Illicit tobacco trade activities were curtailed in three recent apprehensions carried out by teams from the BIR and BOC. Both bureaus have successfully harnessed modern technology and equipment, taxpayer profiling, and third-party information in their operations. A proposal has now been advanced to create a composite team and formalize coordination among the BIR, BOC, and DOF in addressing illicit tobacco trade. Other government agencies may also join the initiative, given the diverse and wide-ranging nature of illicit trade.

4.1 The Case of Mighty Corporation

The Mighty Corporation was a very large manufacturer and seller of cigarettes, cigars, and other tobacco products in the Philippines. The firm was also engaged in importing tobacco

leaves, rolling paper, and acetate used in cigarette filters, as well as buying and selling machinery, equipment, and appliances used for making cigarettes and tobacco products.

The joint efforts of the BOC and BIR led to the filing of tax evasion charges against Mighty Corporation in 2017, as part of the revenue agencies' campaign against evasion, smuggling, and all forms of illicit trading.

Several raids of Mighty's warehouses confirmed that the company had stored master cases of cigarettes with false tax stamps in its facilities. The warehouses were allegedly owned by a local chief executive and had no business permit. With the use of the BIR Stamp Verifier, the BIR-BOC team proved that the cigarettes had received forged stamps. The BOC's Bureau Action Team Against Smugglers (BATAS) suspended the firm's import accreditation, which effectively prevented it from importing or sourcing raw materials outside the country for use in its production. A Php 38 billion tax evasion case was filed against the company. In September 2017, Japan Tobacco International (JTI) acquired Mighty Corporation's cigarette business, paving the way for settlement of the tax case. In October 2017, Mighty/JTI settled the case for Php 30.4 billion, of which Php 25 billion was paid to the government in settlement of Mighty's tax obligations, linked to three criminal cases for seized goods, assessment for open years with the BIR, and documentary stamp tax and withholding taxes payable. An additional Php 5.4 billion was paid as VAT on the deal.

4.2 Two Recent Apprehensions of Illicit Tobacco Imports by the BOC

In the first quarter of 2018, an intervention led by the BOC captured misdeclared cigarettes worth Php 8.2 million. The cigarettes came from China and were consigned to the firm Paragon Platinum International Trading Corporation (PPITC). They were hidden in container vans, and the importation was initially declared as brackets. Through the BOC profiling system, an alert order on the shipment was immediately issued by the Port of Manila. The shipment received a warrant of seizure and detention, and the importers face charges under Section 1400 of the Customs Modernization and Tariff Act (CMTA), which establishes sanctions for misdeclaration, misclassification, and undervaluation of goods.

A second interception, in April 2018, seized counterfeit cigarettes worth Php 18.5 million, again allegedly smuggled from China. The shipment was consigned to Marid Industrial Marketing and contained counterfeit cigarettes bearing the brands "Jackpot," "Fortune," "John," "Marvels," and "U2." The BOC reported that the shipment was declared as industrial artificial fur texture, but was intercepted when the container passed the x-ray machine, and the contents were found to be in boxes (as cigarette cartons are) instead of rolls (the typical format for industrial fur textures). Formal investigation is currently ongoing for both of these cases of intercepted illicit cigarettes.

5. Conclusion and Recommendations

The tax policy response and administrative mechanisms to combat illicit tobacco flows in the Philippines may be judged broadly sufficient and successful. They are aligned with the principles espoused under the Framework Convention for Tobacco Control, as well as the World Health Organization Protocol to Eliminate Illicit Trade in Tobacco Products. Nonetheless, these mechanisms can be further reinforced in a number of ways, through capacity, technology, and database build-up, partnerships with legitimate business, and stronger coordination among enforcement agencies. The analysis presented here also highlights the importance of international collaboration through the sharing of information and best practices among trading partners, especially at regional level. Together, these strategies may create a stronger track-and-trace system to combat and ultimately halt the illicit tobacco trade.

The evidence presented in this chapter supports the following recommendations:

1. There should be stronger coordination between the BIR and the BOC, along with other law enforcement agencies and legitimate industry players, to better enforce the law regarding excise tax on cigarettes. Monitoring illicit tobacco products in the market and aggressively prosecuting violators are key parts of the agenda. Policy makers can boost results by creating a system wherein all regulatory agencies share a common database to monitor tobacco product flows.
2. International collaboration to curtail the illicit tobacco trade should be actively pursued within the ASEAN integration initiative and other forums. A priority aim for international collaboration would be ensuring that, in future, no cigarettes leave an exporting country without bearing the legal tax stamps of the importing country. To this end, customs authorities in exporting countries can and should share export documents with the importing countries.
3. Government should resolve illicit tobacco cases quickly and ensure the enforcement of heavier penalties on violations.
4. The security features of tax stamps should be guarded and continuously updated to prevent counterfeiting.
5. Open data on tobacco trade and tax statistics are necessary to improve estimates of the extent of illicit trade and better evaluate the impact of tax and administrative mechanisms in controlling illicit tobacco.
6. Stronger capability-building programs for the BIR and BOC should be prioritized. These should include training to sharpen analytical, profiling, and audit skills, and the use of technology.

References:

- Abola, V., Sy, D., Denniston, R., and Sy A. 2014. "Empirical Measurement of Illicit Tobacco Trade in the Philippines." <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4737979/>
- Chaloupka, F.J., Yurekli, A., Fong, G.T. 2012. "Tobacco Taxes as a Tobacco Control Strategy." <http://tobaccocontrol.bmj.com/content/tobaccocontrol/21/2/172.full.pdf>
- Depasupil, W. "Mighty Corp. Import Accreditation Suspended," *Manila Times*. March 15, 2017.
- GATS (Global Adult Tobacco Survey). 2015. Philippines country report. http://www.doh.gov.ph/sites/default/files/publications/GATS-PHL2015-Executive_Summary.pdf
- GYTS (Global Youth Tobacco Survey). 2015. Philippines country report. http://www.doh.gov.ph/sites/default/files/publications/FinalGYTS_CountryReport.pdf
- "Price increase will worsen the crisis of illegal cigarette trade," *The Sun Daily*. March 31, 2017.
- Raj, A. "Government seen getting less tobacco revenue despite hefty duty hikes," *The Edge Malaysia*. July 20, 2016.
- Santos, T. "BOC Seizes P8.98M Worth of Smuggled Cigarettes, Fireworks," *Philippine Daily Inquirer*. March 6, 2018.
- Sta. Ana, F., and Latuja, J. 2010. Cigarette Affordability and the Impact of Tobacco Taxation on Health and Revenue. Action for Economic Reforms. <http://www.aer.ph/tobaccotax/wp-content/pdf/Cigarettes.pdf>
- Surendran, S. "Malaysia's Taxation on Cigarettes Excessive," *The Edge Financial Daily*. May 11, 2017.
- Tamayo, M.A. "Changes Under the Customs Modernization and Tariff Act: An Overview," *Business World*. June 20, 2016.
- Unite, B. "Customs Creates Anti-Smuggling Task Force," *Manila Bulletin*. January 26, 2018.
- WHO (World Health Organization). 2005. WHO Framework Convention on Tobacco Control. Geneva: WHO. http://www.who.int/tobacco/framework/WHO_FCTC_english.pdf
- WHO (World Health Organization). 2013. Protocol to Eliminate Illicit Trade in Tobacco Products. Geneva: WHO. http://apps.who.int/iris/bitstream/10665/80873/1/9789241505246_eng.pdf?ua=1&ua=1
- WHO (World Health Organization). 2015. WHO Report on the Global Tobacco Epidemic, 2015. Raising Taxes on Tobacco. Geneva: WHO. http://apps.who.int/iris/bitstream/handle/10665/178574/9789240694606_eng.pdf?sequence=1
- World Bank Group. 2017. Tobacco Tax Reform at the Crossroads of Health and Development: A Multisectoral Perspective. Prepared by a team led by Patricio Marquez and Blanco Moreno-Dodson. <https://openknowledge.worldbank.org/bitstream/handle/10986/28494/119792-REVISED-v2-FINAL-WBG-TobaccoTaxReform-FullReport-web.pdf?sequence=1&isAllowed=y>
- World Bank Philippines Sin Tax Dashboard, April 5, 2015 – September 25, 2016.

**SUB-
SAHARAN
AFRICA**

18

SOUTHERN AFRICA CUSTOMS UNION (BOTSWANA, LESOTHO,
NAMIBIA, SOUTH AFRICA, AND ESWATINI) AND ZAMBIA

19

BOTSWANA-LESOTHO AND SOUTH AFRICA

20

KENYA

21

SENEGAL

**SOUTHERN AFRICA
CUSTOMS UNION
(BOTSWANA,
LESOTHO, NAMIBIA,
SOUTH AFRICA, AND
ESWATINI)
AND ZAMBIA**

18

SOUTHERN AFRICA CUSTOMS UNION (BOTSWANA, LESOTHO, NAMIBIA, SOUTH AFRICA, AND ESWATINI) AND ZAMBIA:

Addressing the Illicit Flow of Tobacco Products

Michael Eads, Telita Snyckers, and Ziyaad Butler¹

Chapter Summary

Background and Methods

This chapter examines efforts to combat illicit tobacco trade flows in the countries of the Southern African Customs Union (SACU): Botswana, Lesotho, Namibia, South Africa, and Swaziland (renamed eSwatini in April 2018), along with Zambia. The approach is based primarily on desk research relying on information available in the public domain or experience with initiatives conducted in some SACU countries. An electronic survey was sent to each of the countries, however Swaziland/eSwatini, Lesotho, and Zambia were the only countries that responded.

Report preparation highlighted the challenges in assessing the volume and share of illicit trade as a percentage of total tobacco consumption in the relevant countries. South Africa was the only country for which academic estimates were available. Nevertheless, the chapter presents sufficient data to provide an overview of relevant issues and offer recommendations. Additionally, this chapter can serve as a gap analysis to guide future studies towards areas that require further investigation.

¹ Sovereign Border Solutions, Cape Town, South Africa

Key Findings on Policy and Enforcement

In SACU and Zambia, relatively poor maturity is noted across key indicators, resulting in a weak capacity to combat illicit tobacco trade in the region. The contributing factors and key issues facing governments include:

- » Weak demand-reduction policy implementation;
- » The lack of reliable data regarding the share of illicit trade as a percentage of total consumption, fueled by a lack of independent research in the field, and inconsistencies between industry and academic estimates;
- » Limited control over tobacco supply chains – from growers to manufacturers through to retail;
- » Under-capacitated and inadequately skilled government agencies;
- » Legal frameworks which do not necessarily reflect contemporary good practices;
- » Limited focus on excise modernization and controls, resulting in mainly manual and paper-intensive processes and control measures;
- » Lack of robust risk management approaches; and
- » An aggressive tobacco industry that leverages its power to influence political, economic, and enforcement activities.

In their survey feedback, country officials also noted the following constraints:

ZAMBIA	LESOTHO	SWAZILAND
<ul style="list-style-type: none"> › Limited staff › Ineffective risk management systems › Corruption › Obtaining data from other agencies › Lack of industry liability for diversion once cigarettes have been sold 	<ul style="list-style-type: none"> › Limited staff › Inability to distinguish licit from illicit on market › Inability to identify where in the supply chain packs are being diverted › Lack of industry liability for diversion once cigarettes have been sold › Industry failure to respond to information requests › Tampering with Customs seals, locks, labels, gauges 	<ul style="list-style-type: none"> › Limited staff › Limited investigations capacity › Inabilities to distinguish licit from illicit on market › Obtaining data from other agencies

Despite these obstacles, SACU and Zambia have made some progress in addressing illicit tobacco trade, but countries require a concerted and coordinated approach to meet the rising challenge of illicit trade in the region.

Recommendations

Detailed recommendations for policy makers have been set out in the body of the chapter and include the following. Governments may:

SACU AND ZAMBIA TOBACCO CONTROL RELATIVE MATURITY

INDICATOR	RELATIVE MATURITY				COMMENTS
Demand reduction measures					<ul style="list-style-type: none"> › Limited demand reduction measures: poor progress with advertising bans; very low tax rates; weak cessation support; weak health warnings
Licensing					<ul style="list-style-type: none"> › Licensing obligations only apply to manufacturers of tobacco products › No know-your-customer or commensurate demand obligations on manufacturers or exporters › No obligations re manufacturing equipment › Limited instances of licenses being withdrawn
Production input controls					<ul style="list-style-type: none"> › No specific controls over inputs into production, e.g. acetate tow, tobacco leaf production etc.
Product markings/ stamps					<ul style="list-style-type: none"> › No secure tax stamps except for Zambia which has a rudimentary tax stamp
Track-and-trace					<ul style="list-style-type: none"> › No traceability of packs across the supply chain
Enforcement					<ul style="list-style-type: none"> › Limited enforcement – worsened by removal of specialist units in South Africa › Poor data quality; limited insights from data; data not seen to be driving activities › Seized cigarettes destroyed but by industry › No region-wide enforcement strategy
Agency Coordination					<ul style="list-style-type: none"> › Limited local coordination › Some regional coordination in general, but not targeting illicit cigarettes › Exclusion of key players like SARS in South Africa
Penalties					<ul style="list-style-type: none"> › Generally strong legislative frameworks but which do not translate into prosecutions › No penalties for downstream supply chain actors
Public awareness					<ul style="list-style-type: none"> › Some illicit cigarette media campaigns, but mostly driven by industry
<i>Meeting FCTC supply chain-related measures</i>					<i>None of the countries currently have legislative or operational frameworks that meet the minimum requirements relating to supply chain security under the WHO's FCTC Protocol.</i>

KEY TO RATINGS

				
Absent	Policy in place poorly implemented	Implemented; notable opportunities for improvement	Implemented; some opportunities for improvement	Fully meets international good practice

- » Better understand the character, market share, and evolution of the illicit tobacco trade by supporting high-quality, independent research. This research should include critically reviewing enforcement agencies' capabilities and challenges in responding to illicit trade

- » Initiate remediation efforts including, inter alia, excise modernization programs; implementation of fiscal marking and track-and-trace programs; non-intrusive inspection; audit management solutions; due diligence regarding know-your-customer requirements; more focus on risk-management policies, procedures, and tools; stronger data analysis; and capacity building
- » Establish formal inter-governmental structures to share information and collaborate on anti-illicit tobacco enforcement within the region
- » Complement enforcement by strengthening demand-reduction measures.

1. Overview of Illicit Trade and Efforts to Address It

1.1 Overview of Tobacco Trade in SACU Region and Zambia

This chapter uses the definition of illicit trade set out in Article 1.6 of the World Health Organization's (WHO) Framework Convention on Tobacco Control (FCTC)²: *"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."*

General estimates put the illicit trade in tobacco in Africa at around 43 billion sticks a year – with a trade share in some countries as high as 41 percent (Cameroon) and 38 percent (Ethiopia,) and in several others hovering around an estimated 25 percent (e.g., Algeria, Nigeria, South Africa, Zambia³), resulting in annual tax losses of around \$10 billion a year across Sub-Saharan Africa alone.⁴

SACU IN THE CONTEXT OF A UNIQUE AFRICAN PARADIGM

Academic estimates of illicit trade are not readily available (except for South Africa, where the work is some years old). A South African Revenue Service (SARS) estimate put the loss to illicit cigarettes at between R2 and R4.5 billion in 2012.⁵ Industry estimates⁶ range from a

² Framework Convention on Tobacco Control, World Health Organization 2003, updated reprint 2004, 2005, available at http://www.who.int/fctc/text_download/en/

³ http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Training/Emerging_Researcher_Programme_2015/Illicit-Trade-Africa.pdf

⁴ http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Training/Emerging_Researcher_Programme_2015/Illicit-Trade-Africa.pdf

⁵ <http://www.sars.gov.za/AllDocs/SARSEntDoelib/Ent/SARS-Strat-07%20-%20SARS%20Strategic%20Plan%202012%202013%20to%202016%202017.pdf>

⁶ The data for the illicit cigarette market share used in the map comes from a range of sources, including: http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Training/Emerging_Researcher_Programme_2015/Illicit-Trade-Africa.pdf; <http://www.pagemarkafrika.com/products/tax-stamps/>; <https://www.standardmedia.co.ke/business/article/2001235698/how-african-countries-lose-sh1tr-to-illicit-tobacco-trade>

low 2 percent for Lesotho, to 23 percent in South Africa⁷, but should be treated with caution, as the methodologies used to develop the estimates are opaque. Being industry-funded, such estimates are likely to reflect arguments that support industry positions, and they lack the objectivity one would associate with an independent academic study. (The most recent academic study for South Africa – conducted in 2010 – estimated the share of illicit trade in the country at that time at around 10 percent.⁸)

Numerous reports note the tobacco industry's turning to increasingly aggressive tactics across Africa, both in marketing its products and in pressuring governments to block anti-smoking regulations. Reported industry tactics include threatening and bullying governments and filing lawsuits to delay or stop further regulation.⁹ Much of the industry's argument turns on vaunting its position as a key revenue contributor. Governments are warned that further regulation or tax increases will result in plant closures and job losses.¹⁰ Tobacco industry revenues far exceed the gross national income of many African countries, making the playing field unequal, and giving tobacco firms extensive lobbying power in the region.

As tobacco firms face increasingly strong regulation elsewhere in the world, dramatically reduced smoking rates in Europe, and increasingly hostile regulatory environments, Africa holds a number of strategic advantages for the industry.¹¹ Africa, with its growing wealth, booming youth market, generally low excise taxes (and cigarette prices), patchwork regulations, and relatively weak government structures, is a strategic growth market for the tobacco industry – and consequently also for the illicit tobacco trade.

KEY RISKS FACED BY REVENUE AGENCIES IN RELATION TO EXCISABLE PRODUCTS

The risks posed by the illicit trade in cigarettes across the region are largely similar to those found around the world, centering on import fraud, production fraud, export fraud, and transit fraud (Figure 1).

In contrast to other jurisdictions (where regulations and enforcement controls may be stronger), media reports note some instances of bootlegging in South Africa, though this is not as prevalent as in Europe, arguably in part because the tax differentials between neighboring African countries are not as high as between, for example, the UK and its neighbors. However, bootlegging in Africa is also limited by the fact that commercial-scale smuggling

⁷ See e.g. www.tobaccosa.co.za; <http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150424tisa.pdf>; <http://www.tobaccosa.co.za/tobacco-farming/>; <https://www.whoownswhom.co.za/store/info/3200?segment=Manufacturing>; <https://citizen.co.za/news/south-africa/1263756/the-day-pravin-took-on-big-illegal-tobacco/>

⁸ http://www.fctc.org/images/stories/INB-3/INB3_report_illicit_trade_in_South_Africa.pdf

⁹ <https://www.theguardian.com/world/2017/jul/12/big-tobacco-dirty-war-africa-market> and <https://www.theguardian.com/world/2017/aug/18/british-american-tobacco-cigarettes-africa-middle-east>

¹⁰ See for instance <https://www.theguardian.com/world/2017/jul/12/big-tobacco-dirty-war-africa-market> and <https://www.theguardian.com/world/2017/aug/18/british-american-tobacco-cigarettes-africa-middle-east>

¹¹ <http://articles.latimes.com/2012/dec/12/world/la-fg-south-africa-smoking-20121213>; <https://www.theguardian.com/world/2017/jul/12/big-tobacco-dirty-war-africa-market> and <https://www.theguardian.com/world/2017/aug/18/british-american-tobacco-cigarettes-africa-middle-east>

Figure 1. Fraud Archetypes



of full containers is far more lucrative and far easier to perpetrate than in more regulated markets, making the relatively smaller profits per bootlegging trip less attractive.

Considering the ratio of production and movement across the region, South Africa and Zambia present the largest production and export fraud risks, making production and supply-chain controls critical in those countries, whilst the remaining SACU countries display the highest transit and import fraud risks, emphasizing the need for border, entry, and movement controls.

Figure 2 provides an overview of the tobacco context of the countries studied. South Africa has by far the largest population and GDP amongst the countries, although its GDP per capita ranks second-highest behind Botswana. Smoking prevalence across the region is statistically highest in Lesotho at 21 percent and lowest in Swaziland/eSwatini at 9 percent.

In 2015, the price of the most-sold cigarette brand across SACU countries was low relative to the rest of the world,¹² and there have been no significant price increases in SACU countries in the past two years. None of the SACU countries meet the minimum WHO-prescribed cigarette tax level (75 percent of retail price). Zambia’s tax incidence is the lowest across the countries under review. WHO tobacco control country profiles¹³ suggest that, in 2016, the estimated average cost of a pack of 20 cigarettes of the most-sold local brand across the reviewed countries (excluding Lesotho) was \$2.55. Botswana had the highest cost at \$3.12 and Zambia the lowest at \$1.66.

¹² <http://chartsbin.com/view/38424>

¹³ http://www.who.int/tobacco/surveillance/policy/country_profile/en/

Table 1. SACU and Zambia Tobacco Trade Profile

BOTSWANA		NAMIBIA		SOUTH AFRICA	
Population	2.3M	Population	2.5M	Population	54M
Border Length	4347 Km	Border Length	4220 Km	Border Length	5244 Km
GDPperCapita (thousand)	\$ 7,67	GDPperCapita (thousand)	\$5,36	GDPperCapita (thousand)	\$6,09
Smoking Prevalence	19%	Smoking Prevalence	21%	Smoking Prevalence	20%
Smoked per person, per yr	433	Smoked per person, per yr	298	Smoked per person, per yr	510
Total taxes on retail price	49,7%	Total taxes on retail price	43%	Total taxes on retail price	52,4%
Price of most sold brand	\$3,12	Price of most sold brand	\$3,11	Price of most sold brand	\$2,33
Illicit trade	8%	Illicit trade	12%	Illicit trade	23%

ZAMBIA		SWAZILAND		LESOTHO	
Population	16.7M	Population	3.7M	Population	2.3M
Border Length	6043 Km	Border Length	546 Km	Border Length	1106 Km
GDPperCapita (thousand)	\$1,48	GDPperCapita (thousand)	\$3,51	GDPperCapita (thousand)	\$1,41
Smoking Prevalence	21%	Smoking Prevalence	9%	Smoking Prevalence	26%
Smoked per person, per yr	145	Smoked per person, per yr	92	Smoked per person, per yr	448
Total taxes on retail price	37,3%	Total taxes on retail price	49,1%	Total taxes on retail price	No data
Price of most sold brand	\$1,66	Price of most sold brand	\$2,54	Price of most sold brand	n/a
Illicit trade	20%	Illicit trade	20%	Illicit trade	2%

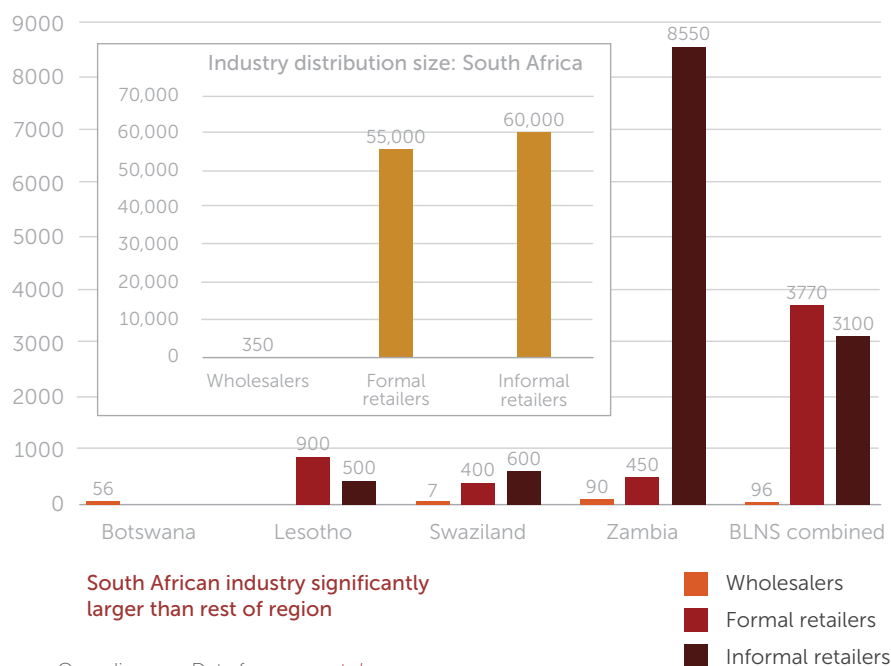
Figure 2. SACU and Zambia Tobacco Metrics¹⁴

	SMOKING PREVALENCE				CIGARETTES SMOKED PP/ PA				TAXES ON RETAIL PRICE				ILLICIT TRADE (INDUSTRY ESTIMATES)				EFFICIENCY OF VAT SYSTEM (AS PROXY INDICATOR OF AGENCY EFFICIENCY)			
Botswana	19%				443				38%				8%				56%			
Lesotho	26%				448				n.a.				2%				48%			
Namibia	21%				298				30%				12%				56%			
South Africa	20%				510				40%				23%				67%			
Swaziland	9%				92				36.7%				20%				n.a.			
Zambia	21%				145				23.5%				20%				34%			

Source: *IMF rating: How effective is VAT administration out of 100?

¹⁴ <https://tobaccoatlas.org/topic/consumption/> <http://chartsbin.com/view/38424> http://www.who.int/tobacco/surveillance/policy/country_profile/en/

Figure 3. Estimated Number of Entities Involved in the Tobacco Supply Chain in SACU and Zambia (Tobacco Industry Estimates)



Source: Own diagram; Data from www.tobaccosa.co.za

LICIT/LEGAL TRADE OVERVIEW

Relatively little has been published on the tobacco trade in SACU and Zambia from a government perspective, although the tobacco industry itself commissioned studies some years ago that provide at least basic insights into the relative size of the industry (Figure 3).¹⁵

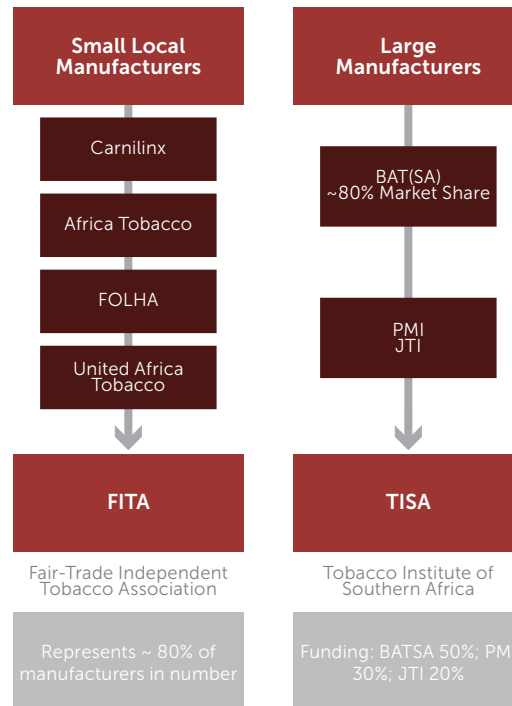
DOMINANT PLAYERS

British American Tobacco (BAT) is the dominant cigarette producer and distributor in South Africa (Figure 4). Because of its dominance, BAT had significant pricing power to increase the net-of-tax price of cigarettes. Around 2010, the South African cigarette market changed substantially. High profit margins began to attract many smaller cigarette manufacturers and distributors, who were primarily competing in the low-price segment.¹⁶ The larger manufacturers are represented by the Tobacco Institute of Southern Africa (TISA). TISA is active across the region and is funded by the three largest companies: BAT, Philip Morris International (PMI), and Japan Tobacco International (JTI). Smaller firms – accounting for around 80 percent of manufacturers – are represented by the Fair-Trade Independent Tobacco Association (FITA). FITA firms routinely argue that bigger companies like BAT(SA) are abusing their market

¹⁵ Tobacco Institute of Southern Africa funded study, 2012, http://www.tobaccosa.co.za/wp-content/uploads/NKC-Tobacco_Value_Chain_Report-October_2012.pdf

¹⁶ <http://tobaccocontrol.bmj.com/content/early/2017/03/24/tobaccocontrol-2016-053340>

Figure 4. Key Tobacco Industry Players, South Africa



dominance to the detriment of smaller manufacturers, a situation reportedly exacerbated by TISA's close relationship with government agencies.

GOVERNMENTS' ENGAGEMENT WITH THE LEGAL TOBACCO INDUSTRY

TISA has signed memorandums of understanding (or is in the process of negotiating them) with a number of customs agencies in the region, including those in Mozambique, Lesotho, Botswana, Swaziland/eSwatini, Zimbabwe, and Zambia.¹⁷ By all accounts, Lesotho, Swaziland/eSwatini, and Namibia have a relatively low focus on the industry, as there is limited or no production occurring locally, while South Africa and Botswana have a far stronger focus on engagement. The South African Revenue Service (SARS) has traditionally maintained a good relationship with the industry body representing big tobacco (TISA), which meets regularly with SARS, conducts training for customs officers, and destroys seized tobacco products on behalf of SARS (a similar situation is seen in Botswana). FITA and its members argue that they have not enjoyed similar opportunities for access and engagement.

The Botswana Unified Revenue Service (BURS) is generally highly facilitative to industry. However, in the absence of an adequate system of controls and checks and balances, this facilitative approach has left Botswana unnecessarily exposed. Government was forced to

¹⁷ <http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150424tisa.pdf>

cancel an MOU with TISA after it was heavily criticized by the Ministry of Health and the Anti-Tobacco Network for violating the FCTC Protocol on Illicit Trade in Tobacco Products (hereafter "FCTC Protocol"¹⁸). The Botswana Police Service was similarly criticized for violating the Protocol by accepting a vehicle from BAT. Concerns have also been raised that the lack of progress in updating excise controls is possibly attributable to the industry's putting pressure on government, ostensibly arguing that industry could not absorb the cost of such measures, and that the program would result in job losses and plant closures.

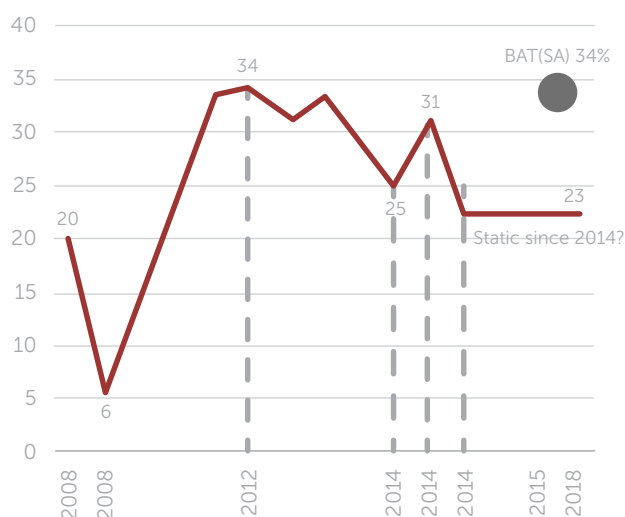
A substantial percentage of all vehicle hijackings in the region relate to trucks transporting cigarettes. In the Gauteng province in South Africa, for example, 20 percent of vehicle hijackings involve trucks carrying BAT cigarettes.¹⁹ As a result, BAT(SA) has negotiated for police escorts for its trucks – a concession that has raised the ire of smaller manufacturers who are not afforded similar protection.²⁰

ILLICIT TRADE OVERVIEW

Magnitude of Illicit Trade

Customs-agency estimates on the size of the illicit trade in cigarettes are not readily available. The most widely-quoted industry estimates put the penetration rate in South Africa as high as 23 percent, though curiously situating the rate as low as 2 percent in Lesotho. An analysis of industry estimates quoted in the media seems to suggest a recent decline in

Figure 5. TISA Estimates of Illicit Trade Over Time

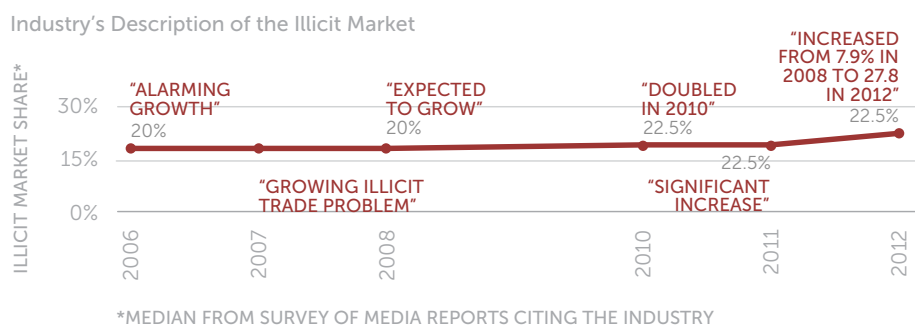


¹⁸ <http://f-ita.co.za/govt-tricked-into-promoting-tobacco/>

¹⁹ <https://www.timeslive.co.za/news/south-africa/2015-07-28-police-foil-cigarette-truck-hijacking/>

²⁰ <https://city-press.news24.com/News/Tobacco-giant-gets-free-police-protection-20150719>

Figure 6. Tobacco Industry Descriptions of Illicit Trade, 2006-2012



illicit trade in South Africa, from a high of 34 percent in 2012 to a 23 percent rate since 2014 (Figure 5). It should be noted, however, that the methods underlying the industry analysis are not clear. Academic studies have challenged industry claims, concluding that industry analysts inflate illicit trade numbers to support their case against further tobacco tax increases. Figure 6 tracks the vocabulary used by the industry to describe the illicit tobacco trade in South Africa over a recent six-year period. Academic researchers have observed: "The tobacco industry appears to rewrite history, apparently to emphasize the rapidity with which the illicit market has ostensibly increased. [Industry] claims that illicit trade in South Africa has consistently increased over the past 15 years, and has continued its sharp increase since 2010, are proven to be inaccurate."²¹

As in many jurisdictions around the world, industry estimates differ significantly from those of government and academics. However, with industry conducting its own assessments more regularly, its estimates get more prominence in the media, and are more widely quoted.

» **South Africa:** In 2012, SARS noted that it estimated its losses from the illicit trade in cigarettes at R2 to R4.5 billion per annum (it is not clear on what basis this estimate was produced). Research commissioned by the industry body TISA estimated the illicit cigarette market in South Africa at approximately 5.3 billion sticks for 2014 (between 20 and 25 percent of total sales). An earlier 2010 academic study estimated that the share of illicit trade as a percentage of total consumption sat at around 10 percent; new academic research is now in process. Since 2010, the South African Government is reported to have lost well over R21 billion in unpaid taxes (excise duty and VAT on excise) due to illicit cigarettes.²² If treated as a single collective tobacco company, illicit trade would be the second-biggest tobacco company in South Africa. South Africa faces a number of challenges from an enforcement perspective – one of them being the country's 1,840 km

²¹ "Are the tobacco industry's claims about the size of the illicit cigarette market credible? The case of South Africa," <https://www.ncbi.nlm.nih.gov/pubmed/24920576>

²² <http://tobaccosa.co.za>

border. This border includes some 96 illegal points of entry,²³ 50 of them with Zimbabwe, and many of them used by cigarette smugglers.²⁴ While some smuggling happens corruptly at legal border crossings (for around \$350-750 per container²⁵), much smuggling is believed to take place at illegal crossings away from border posts. Meanwhile, most of the illicit packs in South Africa are believed to originate from domestic illicit manufacturing. (Industry estimates that around 60 percent of illicit packs are manufactured locally.) However, the country is also the main destination point of illicit cigarettes that are smuggled from source countries like Zimbabwe.

- » **Botswana:** Industry estimates put the illicit trade in cigarettes in Botswana at around 10 percent, but given the research findings on how the industry inflated illicit trade numbers in South Africa, these estimates should be viewed with caution. No independent academic studies are readily available.
- » **Namibia** has been noted as a transit country, with illicit cigarettes being routed from China and the United Arab Emirates (UAE) through Namibia's Walvis Bay port mostly to South Africa, but also other neighboring countries in SACU.
- » **Swaziland/eSwatini:** Industry estimates put illicit market penetration in Swaziland/eSwatini at around 10 million sticks (20 percent of the market), accounting for estimated tax losses of \$0.8 million a year. No independent academic studies are available.
- » **Zambia:** Industry estimates put illicit trade in Zambia at around 20 percent. No independent academic studies are available. Zambia is largely positioned as a transit country for illicit cigarettes, with indications that illicit cigarettes are largely smuggled from Zimbabwe, Botswana, Tanzania, Malawi, and the Democratic Republic of Congo (DRC).²⁶

SOURCE OF ILLICIT CIGARETTES

Aside from locally manufactured illicit sticks, a significant source of illicit cigarettes imported into all of the SACU countries is widely believed to be Zimbabwe, where it is estimated that six factories are manufacturing more than 20 brands of cigarettes.²⁷ While no academic or official study could be found detailing the smuggling routes that feed the illicit trade across SACU, it is possible to piece together a view based on customs agency experience and limited-scope information in the public domain²⁸.

²³ <https://audioboom.com/posts/2419944-50-illegal-crossing-points-from-zimbabwe-to-south-africa-pose-a-major-health-terrorism-threat-to-the-population>

²⁴ <https://www.idsa-india.org/an-may-8.html>

²⁵ Major General Meetsi, South African Police Service, https://www.saps.gov.za/resource_centre/publications/maj_gen_kr_meetsi_presentation.pdf

²⁶ <http://zambianformer.blogspot.co.id/2014/08/cigarette-smuggling-to-cost-zambia.html>

²⁷ "The Illicit Trade in Tobacco Products and How to Tackle It". International Tax and Investment Center <http://www.iticnet.org/images/AIT/English-FirstEd-TheIllicitTradeinTobaccoProductsandHowtoTackleIt.pdf>

²⁸ Based on agency experience. See also e.g. <http://www.thepatriot.co.bw/news/item/1794-tobacco-smuggling-scourge.html>; www.icij.org/investigations/tobacco-underground/; www.theguardian.com/world/2013/jan/27/cigarette-smuggling-mokhtar-belmokhtar-terrorism

- » According to TISA, an estimated 60 percent of South Africa's illicit cigarettes are produced domestically, while 38 percent are smuggled from Zimbabwe (making that country pivotal for any illicit trade strategy) and the remainder from other countries;
- » Additional volumes – notably in respect of counterfeits – are attributed to manufacturing plants in countries like China, which either smuggle the consignments to South Africa directly, or through free trade zones in places such as Singapore or Dubai, or through transit countries like Namibia;
- » Because customs and excise controls are perceived to be relatively weak in Lesotho, experience shows that the country has been used as a destination market for round tripping or diversion of other commodities. Goods are exported tax-free from South Africa to Lesotho but subsequently smuggled back into South Africa, or are declared for export to Lesotho but are diverted to the local South African market before physically leaving the country. These goods can then be sold on the local market with no duties having been paid. It is likely that this weakness is exploited for cigarettes, as well as other commodities.

REGION-SPECIFIC ILLICIT TRADE ISSUES

Enforcement sources have noted a number of relatively unique manifestations around illicit cigarettes and the concomitant tax losses, including:

- » **Single stick sales:** It is commonplace to find vendors breaking up cigarette packs and selling single cigarette sticks (often to children).²⁹ Of course, the sale of single sticks severely limits the traceability of packs;³⁰
- » **Wastage allowances:** Agency sources suggest that manufacturers have managed to negotiate for a 5 to 20 percent wastage allowance from their production – which does not appear to be mandated by legislation. Internationally, other agencies do not generally grant wastage allowances for tobacco products (or limit wastage allowances to around 1 percent);
- » **Prison sales:** Informal interviews with enforcement experts suggest that a significant volume of illicit cigarettes is being supplied to prisons, where their consumption largely goes undetected, unmeasured, and unchallenged. This may warrant further investigation as a new destination market for illicit cigarettes.

The cigarette supply chain across most of SACU is largely unsecured, significantly contributing to the relatively high regional share of illicit trade as a percentage of total consumption.

²⁹ <https://www.theguardian.com/world/2017/jul/12/big-tobacco-dirty-war-africa-market>; <https://www.pressreader.com/south-africa/pretoria-news-weekend/20161210/281659664671990>

³⁰ Other commodities pose unique challenges too, like beer being sold in plastic bags.

1.2 Legal Frameworks

LEGAL FRAMEWORKS AIMED AT REDUCING DEMAND AND CONSUMPTION

Most of the studied countries have made relatively poor progress in establishing legislative frameworks to reduce demand and consumption of cigarettes (Table 2). Only Namibia and Zambia have declared six or more categories of public places smoke-free; only Lesotho, South Africa, and Swaziland/eSwatini bear some of the costs of cessation treatment; only Namibia has large health warnings³¹; not one of the countries has recently had a national anti-smoking campaign lasting more than three weeks; Botswana is the only country with a complete ban on both direct and indirect advertising; only Namibia and Swaziland/eSwatini have adopted all seven of the advertising bans recommended by the WHO; and the recommended indirect advertising bans have been very poorly adopted.

REDUCING DEMAND THROUGH TAXATION

SACU countries tax imports from outside the customs union upon entry at an ad valorem rate of 45 percent, in proportion to the estimated value of the goods or transaction concerned. Products originating from SACU, SADC, EU, and EFTA countries are imported duty-free.³²

South Africa, Botswana, Lesotho, and Zambia (the only countries with cigarette manufacturing) apply specific excise duties at source (that is, as close as possible to the point of manufacture). This is administered via periodic (post-sale and distribution) self-declared excise declarations. South Africa offers deferred payment of duties, whilst the other countries require payment at the time of declaration. Over-reliance on tobacco company self-declaration, coupled with insufficient audit resources, poses a considerable risk in the region.

The cigarette tax burden across SACU and Zambia is well below the WHO-recommended 75 percent of retail sales price, and Botswana continues to use ad valorem excise taxes.

- » **Botswana:** Excise 39 percent; and ad valorem duty 9.4 percent.
- » **Lesotho:** Excise 33 percent.³³ Lesotho is somewhat different from neighboring countries, in that 68 percent of its tax revenue comes from customs/excise, making efficient customs and excise administration a core strategic priority for the country. While limited information is available, indications are that government is in the process of approving a levy on tobacco following World Bank recommendations. Combined with a levy on alcohol, the IMF estimates that this will result in an additional 200 million Maloti (\$16 million) in government revenues.³⁴
- » **Namibia:** Excise 30 percent.

³¹ The Tobacco atlas: <https://tobaccoatlas.org>

³² <http://www.sars.gov.za/AllDocs/LegalDoctlib/SCEA1964/LAPD-LPrim-Tariff-2012-04%20-%20Schedule%20No%201%20Part%201%20Chapters%201%20to%2099.pdf>

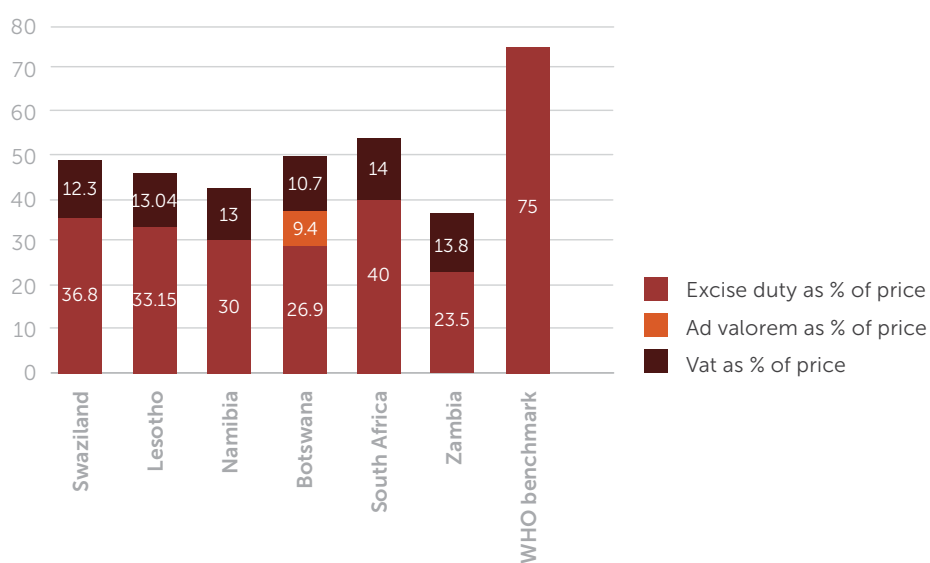
³³ http://www.who.int/tobacco/global_report/2015/appendix2.pdf

³⁴ IMF Staff Country Report, Lesotho

Table 2. Legislative Frameworks for Demand Reduction, SACU Countries and Zambia

LEGISLATIVE FRAMEWORK: DEMAND REDUCTION						
	BOTSWANA	LESOTHO	NAMIBIA	SWAZILAND	SOUTH AFRICA	ZAMBIA
Demand reduction measures: General	Poor adoption of demand-reduction measures					
Health warnings	Small or none	Small or none	Large	Medium	Small or none	Small or none
Direct advertising bans (out of a recommended 7 types)	5/7	5/7	5/7	5/7	5/7	5/7
Indirect advertising bans (out of a recommended 10 types)	1/10	0/10	3/10	6/10	6/10	1/10
Tax rates (Excise; Total)	39%	--	30%	37%	40%	24%
	50%	--	43%	41%	52%	37%
Exemptions for travelers	200 cigarettes	200 cigarettes	400 cigarettes	200 cigarettes	200 cigarettes	400 cigarettes
	20 cigars	20 cigars	50 cigars	20 cigars	20 cigars	500g cigars
	250g pipe tob	250g pipe tob	250g pipe tob	250g pipe tob	250g pipe tob	500g pipe tob

Figure 7. SACU Tax Rates as Percentage of Retail Price



» **South Africa** has the highest tax rates among the SACU member countries: 52 percent of cigarette retail prices is accounted for by taxes. South Africa's tax ratios are close to the world average, but still far below the recommended norm.³⁵ After steadily increasing over a number of years, real excise collections from tobacco products have more recently been declining. For the tax year 2017/18, specific excise duties were R900m (-9.2 percent) lower than the published estimate, mainly because of collections on cigarettes and tobacco being lower by R1.2bn (-30.2 percent).³⁶ The reasons for this shortfall are not clear and contradict other data points which show smoking prevalence rising. From a tobacco control perspective, although there was a decline in adult consumption from the 1960s to the late 2000s, attributed to an array of government actions, developments in South Africa since 2010 have been disappointing. In 1994, government announced that it would aim to impose a total tax burden on cigarettes of 50 percent. This level was reached in 2005. In 2006, the total tax target was increased to 52 percent. Since 2006, the tax regime and the targeted tax percentage have remained unchanged.³⁷

Although SACU legislation seeks to harmonize tax rates across the different countries, there is a fairly inconsistent approach to taxation of cigarettes, with some countries adopting a mixed model that levies both specific excise and ad valorem duties, others just levying excise duties, and still others adopting an additional levy on tobacco products. Inconsistencies in tax rates create opportunities for arbitrage – and contribute to incentives for smuggling.

MANAGING DEMAND BY LIMITING EXEMPTIONS: DUTY-FREE ALLOWANCES

Zambia has an exceptionally high duty-free allowance for travelers: 400 cigarettes, 500g of cigars, and 500g of pipe tobacco. Tax- and duty-free sales generally erode the effects of tax and price measures aimed at reducing the demand for tobacco products. In line with WHO recommendations, a growing number of countries are prohibiting or restricting tax- or duty-free sales, for example by limiting the number of tobacco products that can be bought duty free (number of packs per purchase, or number of purchases within a particular period of time), or by imposing excise duties on tobacco products sold in duty-free shops.^{38 39}

³⁵ WHO *Technical Manual on Tobacco Tax Administration* 2010, p. 103; World Bank, 1999, *Curbing the Epidemic* (Washington: World Bank), 1999, p. 83.

³⁶ <https://www.businesslive.co.za/bd/national/2017-09-12-sars-has-a-r13bn-shortfall-and-these-are-th>

³⁷ <http://tobaccocontrol.bmj.com/content/early/2017/03/24/tobaccocontrol-2016-053340>
e-culpits/

³⁸ <http://www.sars.gov.za/ClientSegments/Customs-Excise/Travellers/Pages/Arrival-in-SA.aspx> <http://www.lra.org.ls/sites/default/files/2017-03/Guidelines%20for%20Extra%20SACU%20importation%20and%20exportation%202010.pdf> <https://www.booknamibia.com/travel-information/duty-free-allowances> <http://www.burs.org.bw/index.php/customsexcisemain/travelers-guide/duty-free-allowance> <http://www.sra.org.sz/customs/general-import-and-export-rules.php> <https://www.worldtravelguide.net/guides/africa/zambia/money-duty-free/>

³⁹ WHO Guidelines on Implementing FCTC Article 6, http://www.who.int/fctc/guidelines/adopted/Guidelines_article_6.pdf

Table 3. Duty-Free Allowances for Tobacco

DUTY-FREE ALLOWANCES FOR TOBACCO	
Botswana, Lesotho, South Africa, Swaziland	200 cigarettes, 20 cigars, 250 g pipe tobacco
Namibia	400 cigarettes, 50 cigars, 250 g pipe tobacco
Zambia	400 cigarettes, 500g cigars, 500 g pipe tobacco

Table 4. Legislative Frameworks for Supply Management

LEGISLATIVE FRAMEWORK: SUPPLY MANAGEMENT						
	BOTSWANA	LESOTHO	NAMIBIA	SWAZILAND	SOUTH AFRICA	ZAMBIA
General supply chain management	Very weak tobacco supply chain management					
Secure serialized tax stamp	None					Basic tax stamp but poorly enforced – 20% of packs on market are not marked
Traceability	Draft traceability legislation but long delayed	None			Draft traceability legislation but long delayed	
Institutional capacity	Weak				Some strategic strengths	
Administrative mechanisms to control supply chain	Weak production controls, audit controls, inspections capacity					

LEGAL FRAMEWORKS AIMED AT MANAGING SUPPLY

Most of the customs and excise-related legislation in the region had its genesis in the South African Customs and Excise Act of 1964 (along with the Act's subsequent revisions). Member countries' respective laws – although not identical - mirror each other to a large degree in terms of general principles and policy positions. The legislative underpinning for measures to combat illicit trade is not as robust as it should be. Indeed, in some cases the legislation actually imposes archaic measures (for example, the use of a physical imprint diamond stamp) or limits governments' ability to address the dynamic illicit trade problem. South Africa's tobacco-control legislation was thought to be one of the most comprehensive in the world at the time of its adoption, but it is now falling behind newer laws in many other countries. Out of a total of 24 tobacco-control measures identified by the WHO, South Africa currently complies with only 11.⁴⁰

⁴⁰ Shisana, et al., SANHANES-1 Team, 2013, *South African National Health and Nutrition Examination Survey (SANHANES-1)*, (Cape Town: HSRC Press), 2013, p. 38

Table 5. Key Requirements of the FCTC Protocol on Illicit Tobacco

FCTC PROTOCOL ON TOBACCO – KEY REQUIREMENTS		RATING			COMMENT
Licensing	Licensing for any person involved in the manufacture/import/export of tobacco products and tobacco manufacturing equipment	■	■	■	Don't mandate licensing across the supply chain. No licensing requirements in respect of manufacturing equipment.
Due diligence	Due diligence checks of all customers/their agents, to ensure that sales are commensurate with legitimate demand	■	■	■	No due diligence or know-your-customer obligations on tobacco companies; No commensurate demand obligations or calculations done; No substantive controls after ex factory sales
Tracking and tracing	Unique identification markings to assist in determining the origin and the point of diversion; enable the monitoring of the movement of tobacco products	■	■	■	Zambia: Rudimentary tax stamp implemented but not appropriately enforced. SACU: No tracking and tracing of tobacco packs
Record keeping	All persons engaged in the supply chain of tobacco, tobacco products and manufacturing equipment maintain complete records	■	■	■	Record-keeping obligations for manufacturers and importers, but not other economic entities across the supply chain
Destruction of goods	Destruction of confiscated manufacturing equipment, tobacco, non-tobacco materials and illicit tobacco products	■	■	■	Tobacco is destroyed, but in most countries by an industry representative body. Only one known case of manufacturing equipment that was seized – not destroyed.
Preventing diversion	Obligations on all licenses to prevent the diversion of tobacco products into illicit trade channels	■	■	■	No traceability requirements; No know-your-customer obligations; No commensurate demand calculations; No obligations to prevent diversion
Offenses and enforcement	Prosecutions and sanctions for criminal activity, seizure of evidence, confiscation of assets, destruction of seized products and investigative techniques.	■	■	■	Generally appropriate legislative powers in place Limited investigative capacity and capabilities Limited impact from prosecutions – not targeting kingpins
International cooperation	Sharing a wide range of enforcement information and best practices; cooperation in providing training and technical assistance	■	■	■	Strong general regional coordination but still relatively limited in terms of illicit tobacco in particular, and should be expanded to include more source and destination countries (e.g. Zimbabwe)
Engagement with industry	Competent authorities should interact with the tobacco industry and those representing the interests of the tobacco industry only to the extent strictly necessary	■	■	■	MOU's with industry representative body. Industry body sits on enforcement structures; destroys seized goods on behalf of agency; trains customs officers. Contravenes FCTC Protocol.

KEY TO RATINGS

■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■	■ ■ ■ ■ ■
Absent	Policy in place poorly implemented	Implemented; notable opportunities for improvement	Implemented; some opportunities for improvement	Fully meets international good practice

LIMITED AWARENESS OF AND COMPLIANCE WITH WHO FCTC OBLIGATIONS

The FCTC Protocol contains a series of good practices aimed at better securing tobacco supply chains and empowering law enforcement with tools to detect and investigate illicit trade. Even for countries that are not signatories to the Protocol, tracking progress against its provisions provides a useful means to measure an agency's relative maturity, and to assess opportunities for further strengthening tobacco supply chain control.

Interactions with agencies throughout SACU and a review of the agencies' strategic documents both suggest a very limited awareness of the obligations customs and excise agencies would face under the FCTC Protocol, once the Protocol is ratified and comes into operation. Table 5 highlights the extent to which the reviewed countries meet obligations under the FCTC Protocol as one proxy for effective tobacco control.

Effective implementation of the FCTC Protocol requires that government agencies that are not traditional network partners (e.g., agencies dealing with health and revenue) work together. Considerable effort is required to secure a sustainable platform for mutual cooperation across the departments of health, police, border security, tax, customs, and excise.

To date, none of the countries studied has adopted minimum good practice measures in its legislation. FCTC compliance does not yet directly drive either strategy development or operational initiatives, and all of the countries reviewed would need to secure a more strategic focus on meeting their potential future obligations under the FCTC Protocol.

The various legislative frameworks fall short in respect of a number of good practices that would significantly assist in curbing the illicit tobacco trade:

- » **Licensing** obligations only apply to manufacturers and importers of tobacco products, and do not extend to other economic operators across the tobacco supply chain. Such obligations currently fail to include regular audits of tobacco manufacturing equipment;
- » **There are no due diligence obligations on any licensees**, or other obligations that would require them to conduct "know-your-customer" checks, or to assess whether the orders they receive are commensurate with the demands in the intended destination markets;
- » **There are no obligations on manufacturers or importers to introduce measures to prevent the diversion of their products.** Ex-factory sales are the norm, with no obligations on tobacco manufacturers or importers to ensure that their products are not subsequently diverted into illicit channels;
- » **Fiscal marks used are obsolete or are non-existent** (aside from Zambia, which has introduced a very rudimentary tax stamp). The diamond stamp employed by South Africa and Botswana is a simple die impression placed on packs (as opposed to an affixed paper tax stamp). The number of die stamps issued to industry is unaccounted for, and the mark itself is easily counterfeited. The "stamp" provides absolutely no assurance that duty has been paid or that the product is genuine. Nor does it confirm where a pack originated from;

- » **No track-and-trace systems have been implemented:** Currently, only Zambian legislation provides for the use of a true tax stamp. Both South Africa and Botswana had previously made progress with the preparation of draft legislation, and officials have intimated that these countries may introduce a more secure fiscal marking regime, but recent years have seen no progress in implementing solutions. The efforts now appear to be tabled in South Africa and on hold in Botswana;
- » **Most of the legislative frameworks have sufficiently strong punitive options, but these are not translating into prosecutions** or concrete punitive actions against the tobacco industry.

A significant first step should include the introduction of legislation that implements, at a minimum, the good practices noted in the FCTC Protocol.

1.3 Institutional Frameworks

OPERATIONAL OVERVIEW

The capacity of the various administrations differs greatly across the region. There are relatively broad disparities between countries on a range of fronts, including their GDP, the estimated scope of illicit cigarette trade,⁴¹ the size of the shadow economy, and tax administration efficiency.⁴² The disparity makes the development of a region-wide strategy and alignment of response plans more complex – but also more important.

SARS is arguably the most advanced, and its tax administration meets that of many developed countries in terms of efficiency and automation of taxes. SARS has a strong tradition of rigorous strategy development, and its in-principle strategy aimed at targeting illicit trade was relatively well-defined and comprehensive as far back as 2013. Components included: modernizing warehousing management and acquittal systems; changing import and export risk processes; targeting the entire supply chain; improving control of warehouses; automating the excise system and processes; increasing collaboration with key stakeholders; and strengthening detection capabilities.⁴³ There are no indications to what extent the strategy has been effective, or that the strategy has subsequently been reviewed.

A similarly strong strategic focus was not immediately evident from this high-level overview in respect of the other five countries, although Botswana is undergoing a modernization program which includes a new information technology platform for customs and a review of excise policies and processes, as well as the potential introduction of a fiscal marking and track-and-trace solution for excisable goods. (BURS had made considerable progress in conducting a thorough analysis and even published a tender to introduce a solution across excise goods, but the tender was not awarded and ultimately expired.)

⁴¹ Using industry estimates, in the absence of more objective academic estimates

⁴² Using VAT-C efficiency as a proxy

⁴³ SARS, 2014a, Strategic Plan 2014/15-2018/19.

LIMITED STRATEGIC FOCUS ON EXCISE ADMINISTRATION

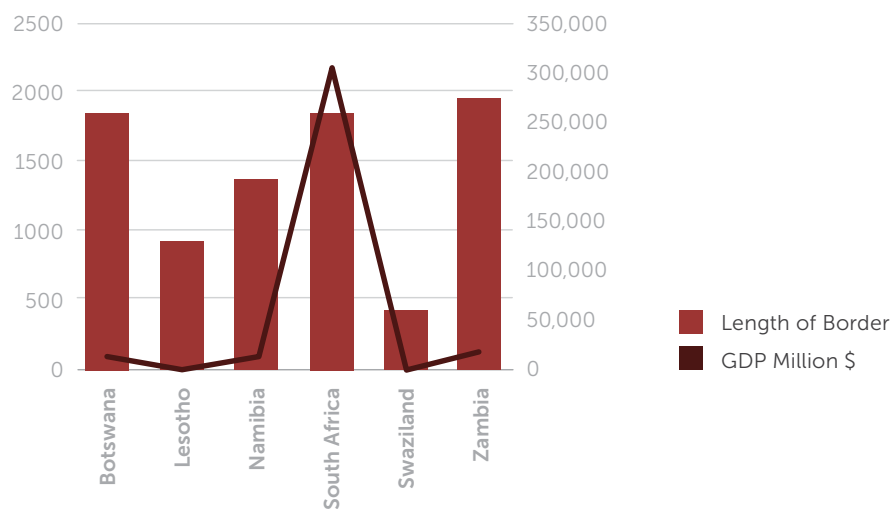
Excise taxes contribute relatively little by way of revenues, compared to other taxes. Their administration is typically underfunded and understaffed, and they are generally not prioritized from a modernization perspective.

The current approach is short-sighted: excise administration is critically important, not only from a revenue or health-risk perspective, but because excisable products like cigarettes offer an easy way for criminality to slip into the legitimate supply chain. Indeed, in South Africa, there are a number of indications of links between the illicit trade in cigarettes and other criminal activities.⁴⁴

All the countries studied here have long borders to secure, but also a relatively low GDP from which to fund such operations, requiring more innovative methods to secure borders (Figure 8).

Over-reliance on industry self-declaration as the basis for taxation; the lack of an effective risk management approach; and non-existent fiscal marking and track-and-trace regimes place the region at high risk for the increased proliferation of illicit trade.

Figure 8. SACU Border Lengths (km) vs. GDP (\$M)



⁴⁴ See e.g. <https://blackopinion.co.za/2016/04/19/mazzotti-alleged-italian-criminal-gave-julius-malemas-eff-r200-000/>; <https://www.news24.com/SouthAfrica/News/R388m-tax-bill-for-Cape-gangster-20150412>; <https://www.enca.com/south-africa/has-a-cigarette-smuggler-and-fraudster-been-helping-dlamini-zumas-campaign>; <https://www.maritime-executive.com/editorials/north-korean-diplomats-smuggle-ivory-cigarettes-and-gold>; <http://defsec.csir.co.za/wp-content/uploads/2016/05/1.-Dr-Louise-Shelley-Convergence-of-Illicit-Actors-and-Flows.pdf>; <https://khulumaafrika.com/2018/02/07/fuel-tankers-center-drug-smuggling-operations-zim-sa/>; <https://www.biznews.com/undictated/2016/03/03/ejected-sars-bosses-start-fighting-back-illicit-cigarette-industry-tagged/>

INTERNAL CAPACITY AND CAPABILITY

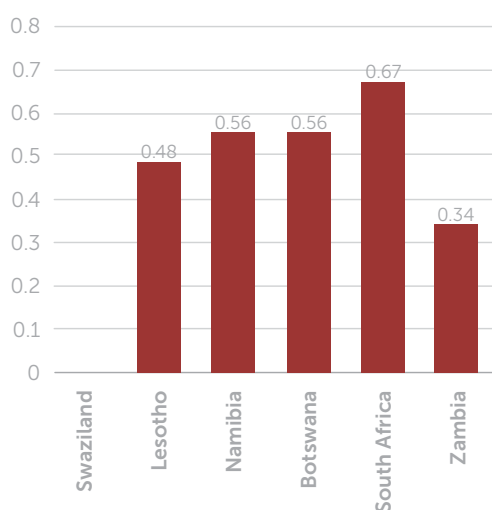
This limited-scope study did not provide for a formal review of agency capacity and capabilities. It relies on experience in the region. While not directly addressing agencies' excise capabilities, in the absence of other specific assessments, the IMF's assessment of the respective countries' VAT C-efficiencies could be used as a rough proxy for agency efficiency. (VAT C-efficiency is defined as actual VAT collections as a share of the potential VAT base and is frequently used by organizations like the IMF as one measure of an agency's effectiveness.) Given that excise taxes are generally afforded less strategic priority than VAT in most agencies, efficiency in respect of excise administration can be assumed to be below that of VAT.

While South Africa and Zambia have relatively more advanced capabilities, all of the countries surveyed have relatively low maturity across the capabilities required to deliver on an agency's excise administration mandate. People, policy, processes and procedures, forms, business rules, payment terms, and information technology systems all require varying degrees of transformation. Audit and risk-management capabilities are generally weak across the excise value chain within the region.

Despite this, some of the countries have made positive strides towards improving their capacity and capability to manage and control excise processes, although these improvements have not been targeted specifically at tobacco control.

- » **South Africa** generally has a more mature framework in terms of its ability to counter illicit trade in cigarettes, being particularly strong in respect of strategy development, business intelligence, and the use of technologies like scanners. SARS notes its commitment to

Figure 9. VAT C-Efficiency Ratings for Countries, as Proxy for Relative Agency Efficiency



contributing to building capacity in the region,⁴⁵ for example by improving its focus on training excise officers;⁴⁶ hosting a regional risk-accreditation event in 2017; conducting direct technical assistance missions on data warehouse capabilities for the Swaziland/eSwatini Revenue Authority; supporting risk management capacity building missions to Zimbabwe, Kenya, and Zambia; and training eight dogs and their handlers as part of detector-dog technical assistance missions to Botswana.

- » **Botswana:** Audit and risk management capabilities are relatively weak across the excise value chain. A number of tax administration reforms are underway (including the establishment of a risk management unit), but progress has stumbled with Botswana's failure to enact the planned Tax Administration Act and with persistent capability gaps, particularly from an audit and risk management perspective.⁴⁷
- » **Lesotho:** The Lesotho Revenue Authority's weak risk management capacity is exacerbated by the country's customs information management system, ASYCUDA, sometimes being down for weeks. Even when the system is operative, some features may not function fully, and information about inspections does not feed back into the risk assessment process. As a result, audit effectiveness and general compliance levels are both low.⁴⁸
- » **Zambia:** An IMF review notes that Zambia's VAT efficiency and corporate income tax productivity are well below those of SADC comparators, with relatively poor tax base management, auditing capacity, and compliance monitoring capabilities. These weaknesses are all likely to extend to the country's excise management capabilities and maturity, contributing to poor revenue collection performance in Zambia.⁴⁹

LIMITED ALIGNMENT ACROSS GOVERNMENT AGENCIES

The countries that achieve the best success in respect of moderating the illicit trade in cigarettes tend to be those that adopt a whole-of-government approach, leveraging the powers and capabilities of various enforcement bodies beyond just those of the customs/excise administration. However, across SACU and Zambia there is generally limited evidence of any significant amount of coordination and cooperation between relevant government agencies.

SARS historically had a good working relationship with a number of law enforcement agencies, using intelligence gathered by the relevant agencies to drive its investigations, and conducting many of its enforcement interventions in conjunction with the police. A national illicit tobacco task team was established but excluded SARS. The creation of duplicate structures leave space for duplication of effort, arbitrage, misalignment, and missed opportunities.

⁴⁵ <http://www.sars.gov.za/AllDocs/SARSEntDoclib/AnnualReports/SARS-AR-22%20-%20Annual%20Report%202016-2017.pdf>

⁴⁶ <http://www.sars.gov.za/AllDocs/SARSEntDoclib/AnnualReports/SARS-AR-22%20-%20Annual%20Report%202016-2017.pdf>

⁴⁷ IMF Staff Country Report, Botswana

⁴⁸ IMF Staff Country Report, Lesotho

⁴⁹ IMF Staff Country Report, Zambia

Moreover, the industry is known to have built allies across a number of government institutions outside of SARS, who were used to either thwart SARS' efforts, or to put pressure on SARS to be more sympathetic towards the tobacco industry. SARS noted: "Certain companies and individuals in the tobacco industry have penetrated a fragmented government system and have been using some elements and access to political parties and persons to further their personal interest."⁵⁰ The agency voiced concern about state agencies not being sufficiently aligned in respect of the challenges posed by the industry.

REGIONAL ALIGNMENT STRUCTURES

A SACU Regional Risk Management Working Group – with a regional risk register – has been established. Its mandate focuses on identifying significant customs risks that are common across the region and that require a collective mitigation approach. The group seeks to maintain a central record of the results of countries' interventions.⁵¹ Given the importance that other neighboring countries such as Zimbabwe play in the illicit cigarette trade, it would be prudent to consider expanding the regional group beyond just SACU members, to include prominent illicit tobacco source or destination countries.

Recent regional joint operations focusing on the textile, alcohol, and tobacco industries are reported to have yielded positive results,⁵² strengthening the case for more expansive regional campaigns focused on illicit tobacco. Highlights of recent operations included 14 arrests for the smuggling of cigarettes and the seizure of 9,485,637 cigarettes, representing a potential revenue loss of R72 million. Intensified action of this type could inform a regional approach to stop contraband upstream, at the point of manufacture, long before goods cross countries' borders illegally.

SARS has made progress in establishing one-stop-border posts with Mozambique and Zimbabwe. It has also piloted the WCO – SACU IT Connectivity Initiative with Swaziland/eSwatini and Mozambique to enable interface capabilities for information and data exchange. If further developed and fully implemented, these initiatives could better position the agencies to target illicit trade.

INDUSTRY DRIVES MOST OF THE PUBLIC DISCOURSE ABOUT ILLICIT TRADE

Across SADC – but perhaps most markedly in South Africa – most of the discourse around illicit trade in cigarettes is driven by the tobacco industry. This discourse presents illicit trade primarily as a function of high tax rates; vaunts the importance of industry as a revenue generator and employer; portrays industry as both victim and savior in the fight against illicit trade; and pressures governments to reduce the regulations imposed on the tobacco industry.

⁵⁰ <https://www.dailymaverick.co.za/article/2017-01-23-state-capture-all-roads-lead-to-tobacco-some-to-marius-fransman/#.Woo9N2aQ1E4>

⁵¹ <http://www.sacu.int/docs/reports/2017/SACU-Customs-Operation-External-Publication.pdf>

⁵² <http://www.sacu.int/docs/reports/2015/topliq.pdf>

South Africa is widely cited in the local media as being “in the top five” countries with the highest market share of illicit trade in cigarettes – a statement that is simply not true, but that has become part of the lexicon in the local market, unchallenged by media or officials. The statement can be traced back to the industry body TISA, which continues to frequently cite this groundless assertion as fact. In reality, there are many countries around the world with a far higher incidence of illicit trade, including Albania, Bolivia, Bosnia, Brazil, Ethiopia, Georgia, Hong Kong, Iraq, Laos, Macedonia, and Uzbekistan (to name but a few).⁵³ This highlights the importance of applying a critical lens to industry claims.

POLITICAL INTERFERENCE

Some observers express concern about criminal enterprises’ close ties to leading political figures, at least in South Africa. Recently, a notorious cigarette smuggler’s lavish birthday party is reported to have been attended by high-profile policemen and politicians.⁵⁴ Similarly, multiple reports allege that a leading cigarette smuggler met with South Africa’s ex-President to secure a votes-for-protection agreement.⁵⁵ A number of sources have noted how industry players sought to use senior political connections to halt SARS investigations into the tobacco industry.^{56 57} All future policy and enforcement measures must reckon with the reality that, in this region, the tobacco industry is disproportionately powerful.

⁵³ See e.g. http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Training_Emerging_Researcher_Programme_2015/Illicit-Trade-Africa.pdf; https://smokefreepartnership.eu/position-papers-briefings-reports/download/196_d73fa3d27ef551c49b0d362932a698f8

⁵⁴ <https://select.timeslive.co.za/news/2018-02-13-the-tobacco-tycoons-birthday-bash-and-his-policemen-guests-at-table-9/>

⁵⁵ <http://ewn.co.za/2015/11/20/ANC-refutes-claims-on-Zuma-gang-bosses>

⁵⁶ See e.g. <https://www.economist.com/news/briefing/21732086-ruling-african-national-congress-ponders-choice-between-dynasty-and-reform-how-jacob-zuma>; <https://www.nation.co.ke/news/africa/Book-links-Jacob-Zuma--his-family-to-illicit-money/1066-4177106-8ijq6u/index.html>; https://www.huffingtonpost.co.za/2017/10/29/zuma-worked-for-somebody-else-while-he-was-president_a_23259551/; <https://www.timeslive.co.za/sunday-times/news/2017-10-29-gangster-republic-dirty-cigarette-money-is-funding-ndzs-bid-for-president/>; <https://www.thesouthafrican.com/the-presidents-keepers-most-shocking-claims-jacques-pauw/>; <https://www.news24.com/SouthAfrica/Politics/Cape-gangster-gets-VIP-invite-to-Zumas-party-20140427>; <https://www.biznews.com/sa-investing/2016/11/24/zuma-lifman-sars/>; <https://www.biznews.com/undictated/2016/03/03/ejected-sars-bosses-start-fighting-back-illicit-cigarette-industry-tagged/>

⁵⁷ Rogue: The Inside Story, Johann van Loggerenberg, <https://www.amazon.com/Rogue-Inside-Story-Sarss-Crime-Busting/dp/1868427404>; The President’s Keepers, Jacques Pauw, https://www.amazon.com/Presidents-Keepers-Those-keeping-prison-ebook/dp/B076YBL1WS/ref=sr_1_1?s=books&ie=UTF8&qid=1524214766&sr=1-1&keywords=presidents+keepers; <https://www.biznews.com/undictated/2016/03/03/ejected-sars-bosses-start-fighting-back-illicit-cigarette-industry-tagged/>

1.4 Administrative Mechanisms

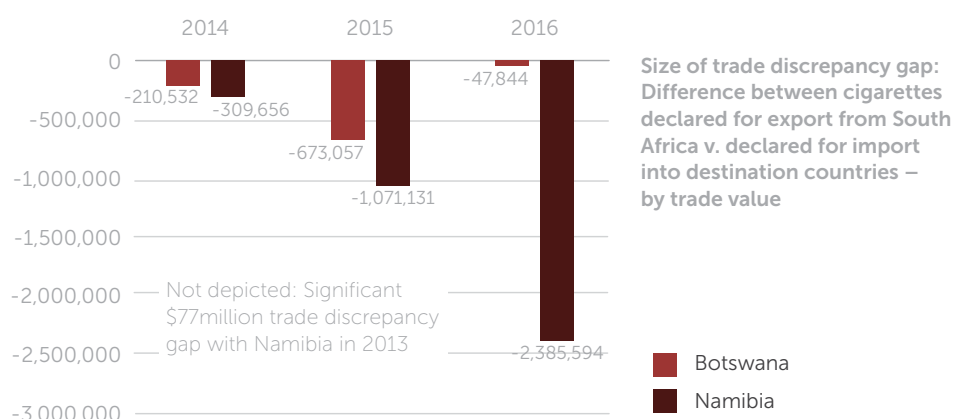
DATA QUALITY AND ACCURACY

The compilation of this report was significantly hampered by the lack of credible, publicly available information. A key example relates to countries' readiness to implement the traceability obligations under the FCTC Protocol. In the WHO country profiles, most of these countries indicate that they mandate the use of secure tax stamps, when in fact this is patently not correct. Although this possibly speaks to a definitional misunderstanding, it does result in a skewed perspective on the readiness of countries to fulfil their obligations under the Protocol.

DATA-CENTRIC DECISION-MAKING

It is not immediately evident to what extent the respective countries rely on data analytics and business intelligence to drive policy development and enforcement targeting. However, even superficial research highlights suggestive disparities in trade statistics between the different countries. The volume of cigarettes declared for export from one country should in theory match the volume of cigarettes declared for import in the destination country – they do not.⁵⁸ (See Figure 10.)

Figure 10. Tracking Trade Discrepancies: Value of Cigarettes Declared for Export from South Africa, vs. Cigarettes Declared for Import in Destination Countries



Source: Own diagram; Data: www.comtrade.un.org

In 2016, there were no reported imports of cigarettes into Lesotho or Swaziland/eSwatini. Yet South African records for the same year show 3,452,659 cigarette packs having been exported from South Africa to Lesotho. These goods are not reflected in any official

⁵⁸ See data at <https://comtrade.un.org/db/dqBasicQueryResults.aspx?px=HS&cc=240220&r=710&p=894&rg=2&y=2016,2015,2014,2013,2012&so=8>

accounts in Lesotho; 3,452,659 cigarette packs remain unaccounted for in the Swaziland/eSwatini system. Conversely, Namibia, reports 2,385,594 more cigarettes having been imported from South Africa than are recorded as exports on the South African side.

This makes Lesotho and Swaziland/eSwatini something of a black hole from a data perspective, which weakens insights into how the tobacco supply chain operates and limits the effectiveness of enforcement activities. These findings suggest significant issues with data capture and data quality – making it difficult for any agency to assess the extent to which cigarettes are unaccounted for.

Additional work is required to raise awareness of the importance of trade statistics as something that goes far beyond a purely administrative task. Done properly, it affords valuable insights into the nature and scope of illicit trade, allowing agencies to focus their efforts where risks are greatest.

1.5 Enforcement Activities and Practices

RISK MANAGEMENT

An excise-specific risk engine was deployed by SARS in 2016/17 to improve the quality and impact of excise audits. Audits based on the new risk rules yielded a relatively low 56 percent hit rate / strike rate (in other words, the percentage of audits that result in a finding and additional assessment being issued)⁵⁹. However, from a very quick review, it is unclear to what extent this is attributable to issues with the risk rules themselves, or to a skills issue, or indeed to what extent this presents an improvement over earlier excise audit success rates.

Table 6. Innovative and Technological Enforcement Solutions in SACU Countries and Zambia

INNOVATIVE AND TECHNOLOGICAL ENFORCEMENT SOLUTIONS ADOPTED		
	Botswana, Lesotho, Namibia, Swaziland, South Africa	Zambia
Tax stamps		Basic tax stamp only
Methods for applying tax stamps		
Digital numbering and coding technologies for unique item identification	No secure, serialised tax stamps used	No innovations or advancements
Readers as authentication tools		
Track and trace of supply chain	Weak tobacco supply chain management	
Enforcement and surveillance techniques		
Monitoring, business intelligence, dashboards		

⁵⁹ <http://www.sars.gov.za/AllDocs/SARSEntDoelib/AnnualReports/SARS-AR-22%20-%20Annual%20Report%202016-2017.pdf>

There is no evidence of similar risk management initiatives from the other SACU countries (Table 6). Controls are typically paper-based or heavily reliant on self-declared documents related to production volumes. Audit controls are typically weak, and teams are under-staffed. Given the labor-intensive nature of these controls (e.g., officers having to frequently enter excise facilities), far too much interaction is forced with industry stakeholders - in the customs/excise world, this too often results in integrity issues. Automated controls are far more targeted and do not pose the same risks.

Table 7. Enforcement Approaches, Activities, and Gaps in SACU and Zambia to Date

ENFORCEMENT APPROACH	RELATED ACTIVITIES
Licensing	All authorities require registration of excise producers and importers, but with no specific control over tobacco producers and importers. Additionally, each country processes licenses differently with varying degrees of entity-based risk management.
Product markings/ stamps	South African and Botswana have adopted the 'diamond stamp' – an impression die-stamp as their solution for marking cigarette packs. This is not an effective solution due to the lack of control of stamps in circulation, the ease of duplicating the stamp itself, and its efficacy as an enforcement tool due to the lack of ability to authenticate the mark as genuine. There is no evidence of any marking solutions for the other SACU countries. Zambia has implemented a rudimentary tobacco tax stamp, but reports note that around 22% of cigarettes on the market remain unmarked.
Track-and-trace	None of the reviewed countries currently have track and trace solutions, although Botswana made progress in developing a modernisation initiative and even published a tender for a track and trace solution for all excisable goods. However, this tender expired without being awarded. South Africa has made some overtures and has published a tender for transaction advisor, to advise on the feasibility of establishing a Public Private Partnership for a fiscal marking solution.
Enforcement	There is evidence of some co-ordinated enforcement effort at the SACU level, where joint Customs/Excise enforcement projects occur targeting tobacco and liquor (see "TopLiq" reference above). At the individual country level, SARS seems quite active in targeting illicit cigarettes being imported into the country, often seizing shipments of smuggled goods coming in from Zimbabwe.
Coordination among Agencies	There is limited evidence of co-ordination of relevant government agencies in targeting and enforcing cigarette control policies or anti-smuggling programmes. South Africa had a tobacco task team, but this seems to have been driven by the "Big" tobacco companies for their own gain and notably excluded SARS as a key government agency. The other countries displayed little or no co-ordination or risk-based approach to combating the production or importing of illicit cigarettes.
Penalties	Other than the imposition of specific excise duties for tobacco production and higher than normal import duties for cigarettes in SACU, there seems to be no other targeted penalties for tobacco products.
Public awareness	Public awareness about illicit trade is generally low across SACU, except for South Africa, where the Tobacco Institute of South Africa (TISA) – an industry body-regularly flights ad campagins and targeted media campaigns that highlight the impacts of illicit cigarette production. Although this has a positive effect on public awareness, it inflates the size of the illicit trade in the country; and creates the false impression that illicit trade is attributable only to smaller low-cost manufacturers.

REGIONAL ENFORCEMENT INITIATIVES

The SACU secretariat has been responsible for driving initiatives to control illicit trade in the region (Table 7). One such effort was Operation TopLiq,⁶⁰ cited earlier, in which regional member authorities embarked on a joint customs enforcement operation targeting tobacco and liquor products, in 2014-15. The collaboration yielded 14 arrests and the seizure of nearly 10 million illicit cigarettes, avoiding a potential revenue loss of R72 million.

LACK OF PRODUCTION CONTROLS, TAX STAMPS, OR SUPPLY CHAIN SECURITY

As noted, apart from Zambia, none of the SACU countries surveyed have implemented secure tax stamps or any other modern and secure fiscal marking regimes. None of the countries effectively controls the cigarette supply chain, beyond the licensing of tobacco manufacturers and periodic audits. All countries rely on the self-declaration of excise production and imports. The information technology solutions utilized in all countries lack robust controls for excisable goods. Lesotho's ASYCUDA customs information system, for example, is notoriously weak when it comes to excise declarations. Zambia does have a tax stamp program, but it is generally viewed as a basic system lacking robust features and controls. Reports suggest it has not been effective in combatting illicit trade.

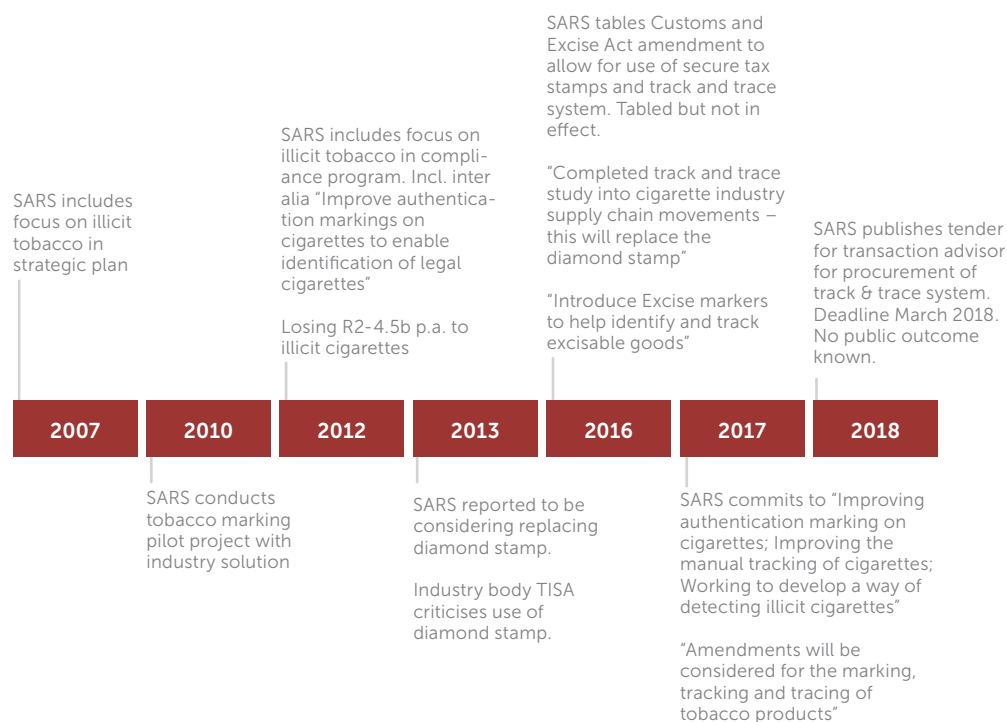
As noted previously, South Africa and Botswana use a very rudimentary "diamond stamp" – a physical die impression stamp that is meant to be impressed on each pack of cigarettes produced. These stamps offer no modicum of control and provide no substantive insights into either the tax status or legitimacy of packs found on the market. The issuing of these stamps is largely manual and uncontrolled; there is no follow-up after the initial issuing to check the status of the stamps or how often have been used; the stamps themselves are easily reproducible; there is no production control or oversight of the stamps in the production environment; and there is no compliance control or monitoring of products that have been stamped. The use of the diamond stamp has thus led to a false sense of control of tobacco production.

SARS has affirmed its intention to address illicit tobacco trade through increased controls for many years,⁶¹ but implementation has lagged (Figure 11). Despite the agency's announcing in 2012 that it would "improve authentication markings on cigarettes to enable identification of legal cigarettes," there have been no changes to the diamond stamp – which cannot be authenticated, as it contains no security features. (In contrast to its slow action on tobacco controls, SARS previously transformed its entire tax and customs systems platforms over a period of seven years, introducing a new operating model and new IT systems across all major tax and customs operations.) Considering that the vast majority of cigarettes consumed in the region are either manufactured in South Africa or are transited through South Africa, the lack of a means of determining the duty-paid status

⁶⁰ <http://www.sacu.int/docs/reports/2015/topliq.pdf>

⁶¹ <https://www.biznews.com/budget/budget-2018/2018/02/21/full-malusi-gigaba-budget-speech/>

Figure 11. Timeline of SARS Efforts to Replace Obsolete Diamond Stamp



of tobacco products in South Africa has the potential to negatively impact the entire region. Draft legislation to enhance existing controls was tabled in Parliament in 2016 but is not yet in effect.⁶² It is critical to introduce a secure fiscal marking and traceability solution in full compliance with the FCTC Protocol in the region's largest illicit tobacco market. This agenda should receive priority attention.

Zambia has tax stamps on cigarettes, but industry complaints have been noted alleging that packs not bearing tax stamps are openly sold in retail outlets, with no enforcement action being taken. A survey conducted by the International Tobacco Control Policy Evaluation Project supports this view. Survey respondents were asked to display their cigarette packets; of the 75 cigarette packs shown, 22 percent did not have tax stamps.⁶³

OTHER TECHNOLOGIES/ENFORCEMENT TOOLS

SARS continues to invest in other technologies, including non-intrusive detection solutions like cargo scanners. Nine additional scanners were deployed by the agency in 2016/17, and

⁶² [http://www.sars.gov.za/Procurement/Pages/TenderDetails.aspx?tendernumber=30&year=2017&type=Request%20for%20Proposal%20\(RFP\)](http://www.sars.gov.za/Procurement/Pages/TenderDetails.aspx?tendernumber=30&year=2017&type=Request%20for%20Proposal%20(RFP))

⁶³ http://www.itcproject.org/files/ITC_Zambia_Wave_2_National_Report-Dec7-FINAL.pdf

⁶⁴ <http://www.sars.gov.za/AllDocs/SARSEntDoclib/AnnualReports/SARS-AR-22%20-%20Annual%20Report%202016-2017.pdf>

procurement processes were initiated for the purchase of two additional cargo scanners.⁶⁴ This has increased the agency's cargo scanning capacity to 300 vehicles a day. Given the volume of trade, however, this is still woefully inadequate, as it represents less than 1 percent of the total containers entering South Africa. The international benchmark for minimum scanning is 3-5 percent.⁶⁵ (Moreover, even where illicit goods are found, prosecutions tend to focus on the transporters, and not on the manufacturers.)

Another successful enforcement tool has been the deployment of detector dog units, which were first introduced in South Africa and have shown significant results in detecting cigarettes hidden in shipments of other goods.

1.6 Effect of Enforcement on Illicit Trade

Very little information could readily be found relating to the various agencies' impact on illicit trade through enforcement activities (Table 8).

Table 8. Results of Reforms to Address Illicit Trade, and How Impact Has Been Measured

EFFECT AND RESULTS OF REFORMS TO ADDRESS ILLICIT TRADE IN TOBACCO			
	Botswana; Lesotho Namibia; Swaziland	South Africa	Zambia
Description of results	n.a.	<ul style="list-style-type: none"> › Nr and value of seizures have reduced in recent years; › Prevalence of illicit trade has decreased (industry estimate): › 2012: 34% -> 2018: 23% 	20% of packs on market not marked
How are results measured? (Metrics)	n.a.	<ul style="list-style-type: none"> › Number of seizures › Number of sticks seized › Value of seizures › Number of prosecutions › Prevalence of illicit trade over time 	n.a.

SARS has had some measurable impact on the illicit cigarette trade: in 2016/17, it seized 17.5 million sticks; conducted 36 investigative audits with an 83 percent success rate; conducted 57 cigarette manufacturing audits with a 51 percent success rate; and conducted 2,156 general excise audits (43 percent of which relate to diesel refunds⁶⁶). Manufacturing audits tend to focus simply on production measures and are aimed at establishing a potential tax liability. By contrast, an investigative audit is used where criminality is suspected. Such audits apply a structured investigative approach by criminal investigators who focus on uncovering fraud or other serious offenses. These investigators are experts at preparing cases for prosecution.

⁶⁵ <https://pdfs.semanticscholar.org/868f/4a2166bcba3469712b2f2bc0d17e9fc5424a.pdf>

⁶⁶ <http://www.sars.gov.za/AllDocs/SARSEntDoctlib/AnnualReports/SARS-AR-22%20-%20Annual%20Report%202016-2017.pdf>

A number of factors appear to have reduced the efficiency of SARS enforcement actions, including a loss of experienced personnel and the effective shuttering of specialist investigations units. As a result, in recent years, SARS has seen a decrease in both the number of sticks seized and the value of the seizures.

A secure fiscal mark would give agencies the capability to determine whether a pack is genuine or not; where the product originated; and how it potentially entered the illicit market. (Currently, the agencies are reliant on the industry to assess whether packs found on the market are counterfeit.) Moreover, in the case of South Africa, an industry representative body - and not SARS itself - carries out the destruction of illicit goods. There are no recorded instances of the destruction of manufacturing equipment.

1.7 Specific Policies or Reforms Enacted

Although a number of stand-alone reforms have been enacted, there does not seem to be a concerted whole-of-government approach to an anti-tobacco campaign, or to combatting illicit trade (Table 9).

The reviewed countries have introduced some policies and initiatives that have had an impact on illicit trade (Table 10).

Table 9. Key Policy Reforms and Gaps Across the Study Countries

POLICY REFORMS						
	BOTSWANA	LESOTHO	NAMIBIA	SWAZILAND	SOUTH AFRICA	ZAMBIA
Point of tax collection	Duty at source; payment due at time of declaration				Duty at source; duty deferments granted	Duty at source
Exemption for travelers	200 cigarettes 20 cigars 250g pipe tob	400 cigarettes 50 cigars 250g pipe tob	200 cigarettes 20 cigars 250g pipe tob	200 cigarettes 20 cigars 250g pipe tob	400 cigarettes 500g cigar 500g pipe tob	200 cigarettes 20 cigars 250g pipe tob
Restrictions on out-of-network sales (internet, duty-free sales)	None					
Use of prominent tax stamps, serial numbers	No secure, serialised tax stamps					Basic tax stamp
Other package markings (e.g. health warnings)	Small or no warnings	Small or no warnings	Large warnings	Medium warnings	Small or no warnings	Small or no warnings

Table 10. Major Policy Reforms and Their Impacts on Illicit Trade

WHAT HAS BEEN DONE TO ADDRESS ILLICIT TRADE?				
	LESOTHO, NAMIBIA, SWAZILAND	BOTSWANA	SOUTH AFRICA	ZAMBIA
Major reforms over last 5 years	n.a.	<ul style="list-style-type: none"> › Plans to introduce marking and traceability – no substantive progress; › Exploring use of canine units 	<ul style="list-style-type: none"> › Plans to introduce marking and traceability – no substantive progress; › Use of canine units; › Increase in vehicle scanners; › Comprehensive industry compliance investigation – initial inroads with 61 criminal cases prepared; investigations units disbanded before cases could go to court (attributed to political and industry interference) 	Introduction of basic tax stamp
Impact	n.a.	› n.a.	› n.a.	22% of packs on market not marked

CONTRIBUTORS TO SARS’ SUCCESSES INCLUDED:

- » Establishing strong multi-disciplinary project teams that combined expertise across a range of topics, including excise, VAT, corporate income tax, criminal investigations, auditing, intelligence and legal;
- » Ensuring that the illicit trade in cigarettes was aligned across the organization’s multi-year compliance program, to its business planning and operational measures;
- » Comprehensive qualitative and quantitative research into the industry and players, focusing on understanding the supply chains, the business practices, and the loopholes and gaps that were allowing illicit trade to flourish;
- » A strong business intelligence capacity that allowed SARS to conduct relationship analysis and develop comprehensive profiles of the subjects of their investigations, with access to multiple third-party data sources and inputs from intelligence sources;
- » The use of special investigative techniques, including controlled deliveries, access to undercover agents affiliated with the country’s intelligence structures, and access to the surveillance capabilities of other law enforcement agencies;
- » Multi-tax investigations that included the following approaches: focusing on the subjects from a holistic perspective – thus, covering their excise duty, customs duty, VAT, corporate income tax, and other related obligations; expanding investigations to include, for example, money laundering and fraud perspectives; and relying heavily on cross-tax comparative analyses to highlight anomalies;
- » Robust project planning with clear phasing of appropriate actions, and with responsibilities clearly mapped – both to ensure alignment and reduce opportunities for divergence;

- » The use of a range of tools within the tax administration legislative framework, including for example the use of estimated assessments and agreed assessments (where appropriate);
- » Addressing instances of corruption through the use of income tax-based indirect lifestyle audits – allowing for the identification of unexplained income sources as an indirect way of targeting corruption, and paving the way for the removal of corrupt officials;
- » Not just targeting consignments, but targeting economic operators; and
- » The use of customs-specific tools like container scanners, x-ray scanners, detector dogs, and mobile anti-smuggling teams.

Of note, in recent years SARS has unfortunately seen a dramatic loss of experienced personnel and the effective shuttering of specialist investigations units. This has resulted in the organization's delaying a series of tobacco industry prosecutions and tax assessments that it had been ready to pursue as far back as 2014.

CONTRIBUTORS TO ZAMBIA'S SUCCESS INCLUDED:

A strategic focus on excise management; the introduction of a professionally staffed national excise audit section; investing in the recruitment of professionally qualified auditors to spearhead its national excise audits and inspections; a comprehensive anti-corruption strategy; stronger oversight of excise producers; the development of a comprehensive excise audit guide; and a strategic focus on securing voluntary compliance.

1.8 Tobacco Industry Role in Illicit Trade

The tobacco industry in Southern Africa has been noted to have a history of non-compliance. Initially, this was limited to allegations of smuggling, but more recently some of the bigger industry players are facing serious charges of money laundering, industrial espionage, and abusing access to political structures to influence the outcomes of investigations related to their potential frauds. From a big-tobacco perspective, the experience in Southern Africa offers an interesting case study. The UK's Serious Fraud Office and the EU Anti-Corruption Unit⁶⁷ are both known to be investigating serious allegations of corruption, bribery, corporate espionage, and money laundering against BAT(SA) and BAT Plc.⁶⁸

Extensive media reporting⁶⁹ suggests how BAT set in motion a concerted and formalized effort to disrupt the activities of smaller competitors. This included securing long-term access to metro police cameras facing competitor's premises; paying police officers to detain competitors' consignments just long enough to make them go moldy; paying a tax auditor to audit competitors on a monthly basis, and to pass production and related

⁶⁷ <https://select.timeslive.co.za/news/2018-02-19-exclusive-british-american-tobacco-used-state-agency-to-spy-on-competitors/>

⁶⁸ Confirmed by multiple industry sources. See e.g. also <https://www.pressreader.com/south-africa/sunday-times/20140330/282299613130796/TextView>

⁶⁹ See e.g. the Twitter account @espionageafrica that posted excerpts, copies and details of project plans, payments made, surveillance photos, etc.

information on to BAT; paying an attorney and chair of the smaller local industry body to both spy on her clients and to secure the removal of the SARS executive heading investigations into criminality in the industry. In order to facilitate undetectable payments to their extensive team of agents, BAT resorted to what the European Anti-Fraud Office (OLAF) has termed "Al Qaeda-style" money-laundering tactics.⁷⁰

2. Recommendations

As set out in the preceding sections, for the most part, agencies across the region have had little impact on illicit trade, largely due to the following:

- » Lack of focus, priority, and resources allocated to tobacco regulation and to excise goods in general;
- » Failure to adequately secure tobacco supply chains at key points (e.g., production, shipment, retail environment);
- » Weak or non-existent controls related to production (e.g., tax stamps/fiscal marks)
- » Poor institutional capability in relation to excise controls;
- » Rudimentary risk management systems for targeting suspicious consignments;
- » Insufficient non-intrusive inspection assets (scanners, dog units, etc.); and
- » Considerable human-capacity gaps across the excise compliance and enforcement value chain.

The various countries across the region largely suffer from similar maladies, and a number of recommendations can be applied to the region as a whole. Excise in the region, and by implication the ability to combat illicit trade in tobacco, has been neglected in terms of transformation and modernization. South Africa has made some strides in advancing their excise capability, but these are mostly limited to automation (introducing automated processes for previously manual ones), rather than modernization and transformation (a systematic approach to improving human capacity, processes, and systems).

Experience has shown that in order for real and beneficial change to occur in combating illicit trade, governments should embark on a holistic health, economic, and enforcement program. Customs, revenue, and excise agencies should lead the vanguard of this approach in their oversight role of managing tobacco production, border entry, and movement control.

⁷⁰ See e.g. *Rogue: The Inside Story*, Johann van Loggerenberg, <https://www.amazon.com/Rogue-Inside-Story-Sarss-Crime-Busting/dp/1868427404>; *The President's Keepers*, Jacques Pauw, https://www.amazon.com/Presidents-Keepers-Those-keeping-prison-ebook/dp/B076YBL1WS/ref=sr_1_1?s=books&ie=UTF8&qid=1524214766&sr=1-1&keywords=presidents+keepers; <http://www.timeslive.co.za/local/2014/03/30/bat-s-smoke-and-mirrors-war-on-rivals1>; <http://www.fin24.com/Economy/Sars-smokes-out-big-tobacco-20150516>; <http://www.full-disclosure.co.za/wp-content/uploads/2013/08/bat-sucked-in-alleged-industrial-espionage.pdf>; <http://www.politicsweb.co.za/news-and-analysis/sars-this-is-the-inside-story--adrian-lackay>; <https://www.pressreader.com/south-africa/sunday-times/20140330/282299613130796/TextView>

Figure 12. Roadmap of Recommendations to Combat Illicit Trade



Source: © Sovereign Border Solutions

2.1 Internal Efficiencies and Reform

CONDUCT AN ENVIRONMENTAL SCAN/DIAGNOSTIC

Following an understanding of the size and nature of illicit trade, a critical requirement for agencies to be able to address and combat illicit trade is understanding and appreciating their internal and external operational capacity and capabilities. Agencies need to be able to better understand their own internal strengths and weakness; review their processes, financial resources, skills, capabilities, and systems; and establish a data-centric fact base from which to guide their efforts. Major gaps should be identified, and remediation efforts should be implemented in alignment with the overall findings. A comprehensive environmental scan/diagnostic will provide a basis from which to design a responsive and appropriate program aimed at combating illicit trade.

STRONGER FOCUS ON DATA ANALYSIS

This review highlighted various gaps in terms of both the scope and quality of data, and the limited use of data and analytics to drive policy development and operational responses.

Additional work is required to raise awareness of the importance of sources like trade statistics as something that goes far beyond a purely administrative task. Done properly, it affords valuable insights into the nature and scope of illicit trade, allowing agencies to focus their efforts where risks are greatest. Data sharing and analysis of the disparities between reported import and export volumes among the different countries would be good first steps.

More comparative analysis across different tax types -- e.g., comparing declarations made from an excise, VAT, corporate income tax, and payroll tax perspective, along with stronger analysis of trade disparity gaps with neighboring countries -- would also likely provide valuable insights into potential tax losses and anomalies. This would create a basis for more targeted anti-illicit trade enforcement and policy measures.

CAPACITY BUILDING

Across the reviewed countries there is a dearth of resources with the relevant level of skill and experience to deal with rising illicit trade in the region. This places governments in potentially compromising situations and undermines the requirements of the FCTC Protocol. It is recommended that agencies embark on capacity building exercises, emphasizing a focus on the latest innovative solutions for combating illicit trade in tobacco. This should be coupled with training programs for staff, and could include training on basic data analytics, entity-based risk management, illicit financial flows, audit methodologies, and related topics. Agencies also generally lack the human resources required to effectively control tobacco supply chains. The primary focus should be on increasing the number of auditors and field inspectors, equipped with the right tools, to conduct more interventions. Eliminating the current largely manual, paper-based processes could be a source of additional human capacity without having to necessarily hire additional staff.

FCTC COMPLIANCE

None of the reviewed countries comply with the obligations that would be imposed once the FCTC Protocol comes into force, insofar as securing the tobacco supply chain is concerned. It is recommended that the necessary legislative requirements be enacted, and the relevant operational solutions be implemented to secure compliance with Part III, Supply Chain Control, in particular. The respective agencies would benefit from establishing an FCTC Protocol compliance working group to create a roadmap and track progress related to implementation of relevant Protocol provisions.

Figure 13. Technique for Estimating the Size of a Country's Illicit Cigarette Trade

SIMPLE ESTIMATE OF # ILLICIT STICKS IN A COUNTRY			
1. Calculate total cigarette consumption		2. Calculate number of cigarettes on the market legally	
Population	1,000		
% of population that smokes	20% = 200,000 smokers		
Each smoker smokes # cigarettes per day -> #x365	<10 a day -> 3,000 a year	Legal cigarette market (based on declared volumes from licensed manufacturers & importers – cigarettes exported)	400 million cigarettes manufactured locally + 200 million cigarettes imported legally – 100 million cigarettes exported legally =
Total cigarettes smoked in the country = # of smokers x #of cigarettes smoked per year per person	200,000 smokers x 3,000 cigarettes = 600 million cigarettes smoked in the country a year		
= 600 million cigarettes smoked in the country		= 500 million legal cigarettes in the country	
Illicit cigarettes = 600 million smoked - 500 million in the country legally = 100 million illicit sticks = 17% of the market			

Table 11. Options to Improve Results in Tackling Tobacco Supply and Demand

WHAT CAN BE DONE TO IMPROVE RESULTS – SUPPLY AND DEMAND	
SACU + ZAMBIA	
Demand reduction	<ul style="list-style-type: none"> › Increase tax rates to WHO recommend 75% › Shift from ad valorem to specific excise tax › Eliminate or reduce duty free allowances › Review duty free allowances › Impose direct and indirect advertising bans › Introduce plain packaging regulations › Adopt and enforce bans on smoking in public places
Production sources	<ul style="list-style-type: none"> › Impose use of secure, serialised tax stamps with traceability back to manufacturers › Impose know-your-customer obligations on manufacturer › Impose commensurate demand calculation obligations › Impose licensing obligations for purchase, sale and importation of tobacco manufacturing equipment
Methods of transportation	<ul style="list-style-type: none"> › Impose licensing and reporting obligations on transporters
Points of sale	<ul style="list-style-type: none"> › Impose legal liabilities for sale of illicit cigarettes › Ban sale of single stick cigarettes › Implement direct and indirect advertising bans
Regional coordination and collaboration	<ul style="list-style-type: none"> › Increase regional focus on Zimbabwe as a source country of illicit cigarettes › Regional illicit cigarettes enforcement campaign › Increase data analysis of trade gap data

2.2 Managing Supply and Demand

UNDERSTAND THE PROBLEM - SIZE AND MARKET SHARE OF ILLICIT TRADE

Aside from industry estimates – which have been criticized in a number of studies for inflating the size of illicit trade - very little objective analysis is available in respect of the size and share of illicit trade as a percentage of total consumption across the region. This makes it difficult to develop coherent policy positions, or to effectively track the impact that enforcement and policy initiatives are having on illicit trade over time. Regional agencies would benefit from engaging with academic institutions or qualified non-industry aligned NGOs for assistance both with objectively assessing the extent to which illicit cigarettes are found on the local market, and with developing a framework against which to assess the impact of efforts aimed at curbing illicit trade.

The University of Cape Town's Economics of Tobacco Control Project has developed a guide to understanding and measuring cigarette tax avoidance, which constitutes an important resource for the countries surveyed to better understand the size of illicit trade in their respective jurisdictions.⁷¹ (At its very simplest, this could be a calculation along the lines of figure 13.⁷²)

STEP UP EFFORTS TO REDUCE DEMAND

A number of opportunities are readily available to all of the countries reviewed to significantly reduce the demand for tobacco products, by adopting the various WHO demand-reduction measures around smoke-free policies; cessation support; large health warnings on packs; introducing plain packaging regulations; mass media campaigns on the health risks associated with smoking; direct and indirect advertising bans; review of duty free allowances for travelers; shifting from ad valorem to specific excise taxes; and a dramatic increase in the tax rates on tobacco products to assure that in each year prices rise as fast as per capita income in current prices (proven to be one of the most significant factors in reducing smoking prevalence) (Table 11).

2.3 Enhanced Enforcement Strategies, Tools, and Capability

IMPROVE RISK MANAGEMENT CAPABILITIES AND TOOLS

Risk management lies at the core of any compliance/enforcement program for combatting illicit trade. It provides the capabilities to:

- » Profile risk by understanding how and where illicit trade in tobacco can manifest;

⁷¹ http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

⁷² http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Training/Emerging_Researcher_Programme_2015/Illicit-Trade-Africa.pdf

- » Assess the pertinent data related to supply chain actors and their transactions to understand both the likelihood and consequences of illicit trade risks;
- » Act by implementing countermeasures and controls; and,
- » Adapt to the ever-changing nature of illicit trade.

A concentrated focus by agencies in the region should encompass a holistic review of their risk management capabilities, which should include a review of excise audit strike rates / hit rates, a review of the effectiveness of excise-specific risk rules, development of illicit tobacco profiles based on previous investigations and increased data sharing with other agencies internally and within the region. These measures would enable governments to better manage compliance and more appropriately target their interventions. Considering the limited capacity of most agencies, automating their risk management capability should include direct inputs from internal and third-party data sources, to drive their inspection, audit, and enforcement activities.

Of course, appropriate case selection is only effective insofar as it is supported by specialist criminal investigations units and audit experts who specialize in complex excise audits, and by political support for prosecution of offenders.

INTRODUCE SECURE FISCAL MARKS AND TRACEABILITY

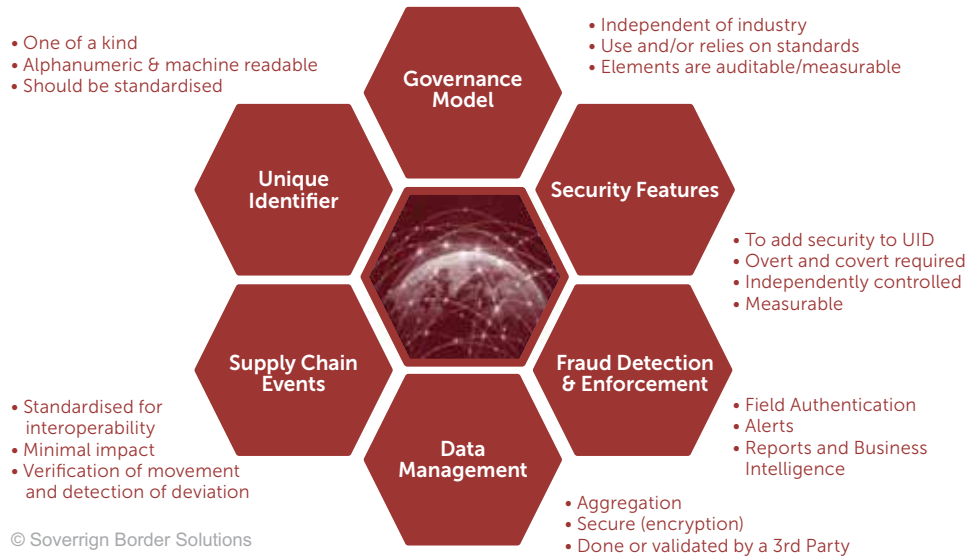
Several of the agencies in the region consider the current diamond stamp as a control mechanism, when in fact it offers little more than a false sense of security. Perhaps the most impactful investment governments in the region can make lies in adopting secure fiscal marks on tobacco products, which would allow administrations to monitor production volumes; track excisable goods through the supply chain; provide the means to authenticate that products are genuine and that all duties and taxes have been paid; and trace goods that are found on the market back to a specific manufacturer. Without these controls, administrations have no means of distinguishing the illicit from the licit.

There are a number of approaches to implementing a secure fiscal marking and track-and-trace program, but there isn't a one-size-fits-all solution – making it all the more important for agencies to conduct an upfront assessment, in order to gauge their real needs and capacities. To this end, the following overview of the solution components required for an effective, FCTC compliant solution is suggested (Figure 14).

A fiscal marking and track-and-trace solution will not solve all issues related to illicit trade in tobacco. It will, however, go a long way to authenticating legitimate trade, thereby enabling identification and enforcement of illicit trade.

This should be augmented with stronger production controls: imposing know-your-customer obligations on manufacturers; imposing commensurate demand calculation obligations on manufacturers; and imposing licensing obligations for the purchase, sale, and importation of tobacco manufacturing equipment. Part III of the Protocol provides specific guidance in these respects.

Figure 14. Tobacco Track-And-Trace Solution Components



IMPROVE AUDIT CONTROLS

Most of the reviewed countries do not appear to have a dedicated, sophisticated tobacco audit capability. Most agencies consider a post-declaration inspection an audit, basically inspecting documentation presented by the declarant, and validating it against self-generated information from the same entity. In most cases, the actual goods are no longer present, as they have moved on in the supply chain, making physical verification impossible. There is normally no independent or third-party validation available for production or movement control, rendering this type of control ineffective in the case of even moderately sophisticated frauds. Further, agencies should have well defined audit procedures, audit manuals, case management reporting systems, and adequate staffing to enable robust audits of producers and importers.

NON-INTRUSIVE ENFORCEMENT CONTROLS

As tobacco products are relatively homogenous in terms of dimensions and weight, cargo and baggage scanners are a viable means of detecting smuggled or mis-declared illicit tobacco products. Detector dog units are also very effective at detecting mis-declared tobacco products at borders and other control points. Coupled with a robust risk management and targeting solution, these assets can serve as an efficient and effective means of targeting illicit tobacco flows. Non-intrusive inspection provides a means of matching paper declarations to the actual goods without having to unpack containers. This is considered a trader friendly means of inspecting goods, as it is less time-consuming and cheaper than traditional inspections that require labor-intensive physical unpacking of containers.

2.4 Regional Coordination and Industry Engagement

RELATIONSHIP WITH INDUSTRY

Agencies in the region should be mindful of the FCTC recommendations relating to engagement with the tobacco industry – engagement is not prohibited but should be limited to what is strictly necessary and with absolute transparency, and with none of the agencies' functions being delegated to the industry.⁷³

REGIONAL COORDINATION

With the porous borders, and the close reliance across SACU on shared revenues, the member countries' respective successes are very much tied to their neighbors' successes, making the development of a regional strategy, and the enhancement of regional capabilities and dramatically improved collaboration, critical components of the response plan to better curb illicit trade. Part of a concerted regional focus should include the development of strategies aimed at clamping down on production and smuggling of illicit cigarettes from Zimbabwe, which is consistently noted as a key source country for illicit cigarettes across the region. The illicit trade in tobacco should be made a focus area for the Regional Risk Management Working Group.

⁷³ "Competent authorities should interact with the tobacco industry and those representing the interests of the tobacco industry only to the extent strictly necessary" - WHO FCTC Article 5.3; FCTC PROTOCOL 8(13)

**BOTSWANA,
LESOTHO,
AND SOUTH
AFRICA**

19

BOTSWANA, LESOTHO, AND SOUTH AFRICA

An Analysis of Alcohol and Cigarette Prices in Maseru, Gaborone, and Neighboring South African Towns

Kirsten van der Zee and Corné van Walbeek¹

Chapter Summary

The government of Lesotho plans to implement a levy on tobacco and alcohol products. The proposed measure is similar to levies that have been implemented in Botswana in recent years. A concern is the possibility that Lesotho's new levy may stimulate a significant increase in bootlegging between Lesotho and South Africa. This chapter investigates the presence and possibility of bootlegging between South Africa and Botswana, and South Africa and Lesotho, by describing the differences in cigarette and alcohol prices between Gaborone, Botswana, and the nearby South African towns of Mafikeng and Zeerust, as well as between Maseru, Lesotho, and nearby Ladybrand, South Africa.

¹ Economics of Tobacco Control Project, University of Cape Town, South Africa.

An analysis of comparative cigarette price data indicated the following:

Gaborone and Mafikeng/Zeerust. Overall, average cigarette prices are significantly higher in Gaborone than in nearby South African towns. The cheapest pack price found in Gaborone was nearly five times the cheapest price identified in South Africa.

Maseru and Ladybrand. Cigarette prices differ between Maseru and Ladybrand, but much less than between Gaborone and Mafikeng/Zeerust. In fact, for a number of pack sizes and outlet types, the price of cigarettes in Maseru is lower than in Ladybrand. Botswana's levy on tobacco products is a plausible reason for the far more acute cigarette price differences observed between Gaborone and neighboring South African towns.

An analysis of comparative alcohol price data indicated the following:

Gaborone and Mafikeng/Zeerust. Alcohol is significantly more expensive on the Botswana side of the border. The cheapest beer price observed in Botswana was more than double that in nearby South Africa. The difference could provide motivation for bootlegging alcohol products from South Africa to Botswana. However, we did not observe very low minimum prices in Gaborone, which might be expected if bootlegging were common.

Maseru and Ladybrand. Alcohol prices were found to be significantly higher in Ladybrand than in Maseru for each product category, so from the outset there is no significant motivation for bootlegging to Lesotho.

An analysis of local perceptions of cross-border trade indicated the following:

Gaborone border area: Informants' general perception is that, although there may have been bootlegging of cigarettes and alcohol into Botswana in the past, stricter border controls have limited this activity in recent years. Where alcohol and cigarettes travel from the Mafikeng area into Botswana, this is believed to be on a small scale, for personal consumption.

Maseru border area: Locals generally perceive that the price of alcohol and cigarettes is similar on either side of the border, thus there is little incentive to transport goods across the border for resale. One retail owner did admit to smuggling products into Lesotho, specifically certain alcohol products that have recently been banned from import, and cigarettes, as these are easy to hide.

The data and analysis show that despite levies of, respectively, 30 and 40 percent on tobacco and alcohol products in Botswana, smuggling is limited and has not even come close to equalizing prices between South Africa and Botswana. This indicates effective measures by customs and border control in Botswana, which limit the illegal movement of these goods. There have also been significant proceeds from the levies, which the government has earmarked to anti-tobacco and anti-alcohol initiatives.

If Lesotho introduces similar levies, it appears likely that the country could also obtain substantial revenues. Since Lesotho scores above the African region in terms of public management, smuggling of tobacco and alcohol from South Africa to Lesotho could probably be limited.

However, is it vital that Lesotho take complementary steps to strengthen customs administration. This is more important in the case of tobacco, where prices in Maseru are already above those in Ladybrand, than in the case of alcohol, where prices in Maseru are lower.

1. Introduction

The government of Lesotho plans to implement a levy on tobacco and alcohol products. A concern is the possibility that this may stimulate a significant increase in bootlegging between Lesotho and South Africa (SA). This possibility is heightened because both Lesotho and South Africa are part of the Southern African Customs Union (SACU) region, which implies free movement of goods and services between the two countries. Geographically, the capital of Lesotho, Maseru, neighbors the South African border, and is only about 15 km away from Ladybrand in South Africa.

The proposed levy is similar to the tobacco and alcohol levies that have been implemented in Botswana in recent years. Botswana is also a SACU member, and its capital, Gaborone, is also close to the South African border and various South African towns, for example Zeerust, which is approximately 50 km from the border.

This chapter investigates the presence and possibility of bootlegging between South Africa and Botswana, and South Africa and Lesotho, by describing the differences in cigarette and alcohol prices between Gaborone and nearby South African towns, as well as between Maseru and nearby Ladybrand. We also summarize the perceptions of locals about cross-border trade of alcohol and cigarettes. To do this, data on the price of cigarettes and alcohol have been collected in Maseru, Ladybrand, Gaborone, Zeerust and other small South African towns and villages close to the Botswana border. Furthermore, retailers, street vendors, consumers, and border post officials were interviewed about purchasing patterns in these areas and across these borders, to provide insight into local perceptions about bootlegging.

This chapter provides an analysis of the price data and the interviews, to inform the debate on the prospective alcohol and tobacco levies in Lesotho. The first section of the report describes the current structure of alcohol and tobacco taxes in Botswana, Lesotho, and South Africa. The second section gives geographical context to the study. The third section provides a summary of the data that have been collected. The fourth section of the chapter compares cigarette prices between Gaborone and South African towns near the Botswana border, as well as between Maseru and Ladybrand. In the fifth section, a similar analysis is done for the price of alcohol products in these regions. The sixth section summarizes the findings of the interviews with locals in these areas. An annex provides a detailed summary of the price data by brand and packaging. Given the similarities between Botswana and Lesotho in terms of the closeness of their capital cities to the South African border, the Botswana analysis can inform the Lesotho situation on the possible cross-border trade effects of the proposed levies.

2. Alcohol and Tobacco Taxes in South Africa, Lesotho, and Botswana

South Africa, Lesotho, and Botswana are all members of the Southern African Customs Union (SACU). Under the 1969 SACU Agreement, South Africa holds sole discretion in setting excise taxes and import tariffs, and thus the agreement extends South Africa's excise tax structure and rates to Botswana and Lesotho (SACU Agreement 1969).

The government of SA follows a formula-based approach to cigarette and alcohol excise taxation. For tobacco, each year the excise tax is increased by either the expected inflation rate or the amount required to maintain a 52 percent total tax burden on the price of the most popular price category (whichever gives the higher tax increase). Similarly, the excise taxes on beer and spirits are targeted at an excise burden of 23 and 36 percent, respectively (this excludes the VAT amount). The SACU countries apply the same specific excise taxes that are determined by South Africa.

For the 2017/18 financial year the tobacco excise tax is R14.30 (USD 1.10) per 20 cigarettes, while the alcohol excise taxes are R86.39 (USD 6.60)/liter (of absolute alcohol) on malt beer and ciders, 7.82c (USD 0.01)/liter and 34.70c (USD 0.03)/kg on traditional African beer and traditional African beer powder, and R175.19 (USD 13.40)/liter (of absolute alcohol) on spirits (National Treasury 2017).²

In recent years the government of Botswana has introduced levies on tobacco and alcohol products. In 2008, the "Control of Goods (Intoxicating Liquor (Levy))(Amendment) Regulations, 2008" imposed a 30 percent levy on the price payable for alcohol beverages (or, in the case of imports, the value for customs duty purposes). This levy has subsequently increased to 40 percent. In 2014, the government passed the "Public Finance Management (Levy on Tobacco and Tobacco Products) Fund Order," in which the government imposed a levy of 30 percent of the value of tobacco products manufactured in or imported into Botswana.

The money raised by the Botswanan tobacco levy is aimed at anti-tobacco initiatives through a variety of community and population-based interventions. The funds raised by the alcohol levy are aimed at programs for youth deterrence from alcohol and social upbringing programs. In the 2015/16 fiscal year, the alcohol levy raised 325 million Pula (34.3 million USD), and the tobacco levy raised 39 million Pula (4.1 million USD) (Botswana Unified Revenue Service 2016).

3. Geography

This section provides geographical context for the study. Table 1 below presents the populations of the major cities/towns in Lesotho and Botswana, including Gaborone and Maseru,

² Exchange rate for conversion is the average exchange rate for the 22nd February 2017, the date the National Treasury Budget Review was published.

which are mentioned throughout this report. The table also gives the distance between each city/town and the nearest border crossing into South Africa.

Table 1. Population and Distance to South African Border for Major Cities, Botswana and Lesotho

CITY/TOWN	POPULATION	DISTANCE TO NEAREST BORDER CONTROL (KM)
Botswana	2 024 904	
Gaborone	231 592	26
Francistown	98 961	271
Molepolole	66 466	80
Maun	60 263	695
Mogoditshane	58 079	28
Lesotho	1 894 194	
Maseru	178 345	11
Teyateyaneng	61 578	27
Maputsoe	48 243	3
Mafeteng	30 602	17
Butha-Buthe	30 115	44

Source: Population and Housing Census of Botswana 2011, and 2011 Lesotho Demographic Survey. The distances are estimated with Google Maps, from the center of the city/town to the border crossing.

Roughly 10 percent of both countries' populations are located in the capital, and the remainder of the population is spread across significantly smaller towns; the second largest towns contain only 5 and 3 percent of the population in Botswana and Lesotho, respectively. The capitals, Gaborone and Maseru, are also very close to the South African borders. More than half of the population of both countries live in small villages or deep rural areas.

4. Data

To estimate the difference in cigarette and alcohol prices across South Africa and Botswana, and South Africa and Maseru, as well as the local perceptions about cross-border shopping in these areas, primary data collection was done.

Fieldworkers were tasked with collecting cigarette and alcohol prices in Maseru, Ladybrand, Gaborone, and the Mafikeng/Zeerust area.³ Fieldworkers also conducted informal interviews

³ Numerous small South African towns near Gaborone were visited, including Mafikeng, Zeerust, Disaneng, Lehurutshe and Ramatlabama. We refer to this general area as "Mafikeng/Zeerust," as these are the largest towns and the majority of data was collected there.

with various locals, including shop owners, managers, employees, customers and border officials. The fieldworkers who collected this data are part of an ongoing project of the Economics of Tobacco Control Project, called the African Cigarette Prices (ACP) project. The ACP project provided an appropriate platform for the collection of the required cigarette, alcohol, and interview data, as fieldworkers were already trained to collect cigarette prices in their hometowns in Africa, and were already in the field. Thus, the collection of the data described below was a dedicated process of the ACP project. In total, seven fieldworkers collected data in the three countries.

The University of Cape Town gave ethics clearance for the interviews to be conducted, while ethics clearance was not required for the price collection element. All prices in the dataset can be verified with a photograph, and both the photographs and raw dataset are available.

For the collection of price data, three types of outlets were identified. A retail outlet refers to a formal shop, usually a grocery store, petrol station, liquor store, etc. Retail outlets are located in a built structure, have electricity and offer a wide range of products. Secondly, a spaza shop refers to outlets that are less formal and smaller than retail outlets. Spaza shops are generally located in a permanent structure, and this may be made of brick, wood, clay, a container, etc. Lastly, street vendors are informal stalls. These are generally operated on the side of the road, often from a table, basket or tray, with no permanent structure.

For analysis purposes, alcohol products are grouped into five categories, namely beer, cider, spirits, spirit coolers, and other. Spirit coolers are ready-to-drink spirits-based products that are mixed by the manufacturer, for example pre-mixed brandy and cola. "Other" includes any collected prices that did not fit into the other broad categories. This includes wine products (wine, port, sherry, brut, and vermouth) and bitters. It is important to note that the spirits category includes a large variety of products, including various aperitifs, liqueurs, gin, whisky, and these can range from affordable to luxury products. For this reason, we foresee a large range of prices in this alcohol category.

The alcohol prices can also be broken down into further categories, for example by brand, can or bottle, pack size (for example, single, 6 pack, 12 pack, etc.), milliliters per item, etc. However, for simplicity in the analysis, we standardize each price to a per-liter price of the beverage. Annex 1 presents more detailed summaries of prices by product brand and packaging. For comparability, all prices were converted into United States dollars using the average of the exchange rate over the period in which the data was collected (4th of December 2017 to 8th of January 2018).

A summary of the price data is presented in Table 2.

Of the four regions, the majority of cigarette prices were collected in Maseru, due to the fact that the majority of the fieldworkers were located in this area. Overall, more cigarette prices were collected than alcohol prices, with the majority of cigarette prices collected from street vendors, followed by retail outlets.

Table 2. Data Summary: Number of Observations

	GABORONE	MAFIKENG/ ZEERUST	MASERU	LADYBRAND	TOTAL
Cigarette Prices	531	381	1932	341	3185
Outlet Type					
Retail Outlet	396	347	53	234	1030
Spaza Shop	19	24	88	48	179
Street Vendor	116	10	1791	59	1976
Alcohol Prices	1153	368	255	141	1917
Outlet Type					
Retail Outlet	1153	320	241	141	1855
Spaza Shop	0	48	14	0	62
Street Vendor	0	0	0	0	0
Product Type					
Beer	122	145	100	45	412
Cider	32	0	17	19	68
Spirit	52	2	67	51	172
Spirit Cooler	923	213	63	26	1225
Other	24	8	8	0	40
Interviews	22	20	30	8	80

Notes: "Other" includes wine products and bitters.

Alcohol prices were primarily collected from retail outlets, and no prices were collected from street vendors, as fieldworkers were instructed to focus on formal retail establishments. The majority of alcohol prices collected were of spirits, and this is driven by the large number of spirit prices collected in Gaborone. After spirits, beer and cider prices were the most common.

Data Limitations

The data has a number of limitations to keep in mind throughout the analysis.

The first is the small sample size and the non-representative nature of the data. As has been mentioned, the data collection formed part of the African Cigarette Prices project. Fieldworkers of the ACP project were not given strict instructions on what prices to collect, thus the distribution of the collected prices is not representative of the actual distribution of prices on the market; it is rather what the fieldworkers were able to collect. Thus, one should not place any importance on the number of observations collected for each outlet type,

product packaging type, or alcohol category. For example, while spirits is the largest alcohol category in the dataset, we should note that beer is the alcoholic beverage of choice for most people in these areas. Although the data are not representative, we do find consistent price differences for both cigarettes and alcohol, as well as across outlet type, packaging type, and alcohol category.

We also only collect data around the Gaborone and Maseru borders, thus we cannot extend the findings to the rest of these countries and other parts of the borders. However, as we saw in Section 2, these areas are both centered around the national capital cities and represent major economic hubs in these countries.

The data collection process involved fieldworkers asking vendors the price of cigarettes and alcohol, rather than fieldworkers actually buying these products. Vendors may be cautious of revealing the price of very cheap, illegal cigarettes. It is therefore possible that there is measurement error in our estimates of the cheapest cigarettes. We do, however, find reasonably consistent estimates of price at the bottom end of the distribution, across the regions, brands, and outlet types.

Regarding the interview data, it is worth noting that, for the manager and owner interviews, there may be an under-reporting of cigarettes sourced illegally, as this admission may be perceived as risky for the business. However, fieldworkers were trained to treat the topic with sensitivity and reinforce the objective nature of the interview. The interviews were treated as unthreatening informal discussions rather than formal surveys.

Wine was excluded from the analysis because of the significant brand variation among wine products, and because of the low level of consumption of wine relative to the other alcohol types, specifically beer, which dominate these markets.

An issue that was raised by the reviewers of the first draft of this report highlighted that we need to consider the administrative capacity of these governments to implement levies. If a country does not have the administrative capacity to collect higher taxes and/or a special levy, it would be easily circumvented, and the revenue would be lost. According to the Ibrahim Index of African Governance (IIAG) out of 100, Africa and Sub-Saharan Africa are rated at 50.8, Lesotho at 58.2, Botswana at 72.7 and South Africa at 70.1 (IIAG, 2017). Thus, all three of the countries in this study are ranked substantially above the region; however, Lesotho ranks lowest.

5. Analysis of Cigarette Price Data

The following section reports the findings of the cigarette prices that were collected. We first evaluate the difference in prices between Gaborone and nearby South African towns. A levy on tobacco products of 30 percent is already in place in Botswana; thus, we review the possible impact of this levy on the difference in prices between the two countries. We then

focus on the difference in cigarette prices between Maseru and Ladybrand, where a levy on cigarettes has been proposed.

Cigarette Prices in Gaborone, Botswana, and Mafikeng/Zeerust, South Africa

The following table presents a summary of cigarette prices in both Gaborone and Mafikeng/Zeerust and surrounding South African towns.

Table 3. Cigarette Price Summary Statistics, Gaborone and Mafikeng/Zeerust (USD per pack)

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Gaborone						
Retail Outlet	4,20	4,15	0,78	2,08	6,61	396
Spaza Shop	4,16	4,32	0,46	3,21	4,97	19
Street Vendor	4,69	4,97	0,63	3,15	5,96	116
Gaborone Total	4,31	4,15	0,77	2,08	6,61	531
Mafikeng/Zeerust						
Retail Outlet	2,67	2,72	0,63	0,43	4,97	347
Spaza Shop	2,19	1,55	1,41	0,62	5,44	24
Street Vendor	3,50	4,27	1,38	1,55	4,66	10
Mafikeng/Zeerust Total	2,66	2,72	0,75	0,43	5,44	381

Notes: All prices displayed are in USD, per 20 cigarettes.

In all cases the difference in means between Gaborone and Mafikeng/Zeerust are statistically significant at the 1% level, with the exception of street vendors, where the difference in means is significant at the 5% level.

Overall, average cigarette prices are significantly higher in Gaborone than in nearby South African towns. We find relatively cheap cigarettes in South Africa, where the cheapest pack in Gaborone is nearly five times that in South Africa. In both regions, cigarette prices are highest at street vendors. Vendors generally sell very few products and sell cigarettes as loose singles, while formal retail outlets sell cigarettes in packs, which may drive this difference in price by outlet type.

To investigate this further, Table 4 summarizes the difference in cigarette prices by packaging type. In both Gaborone and South Africa, the majority of observed cigarettes are sold in packs of 20. When estimating the average price by packaging type, we observe significant differences in prices between the two regions. For packs of 20, the average price in Gaborone is 1.6 times that on the South African side of the border. The average price for a single in Gaborone is almost twice that of Mafikeng/Zeerust.

Table 4. Cigarette Prices by Packaging, Gaborone and Mafikeng/Zeerust (USD, per pack equivalent)

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Gaborone						
1	4,97	4,97	0,33	3,98	5,96	93
10	4,44	4,03	0,69	3,97	6,38	45
20	4,18	4,15	0,78	2,08	6,61	358
Gaborone Total	4,35	4,17	0,77	2,08	6,61	497
Mafikeng/Zeerust						
1	2,94	2,33	1,52	0,78	5,44	23
10	3,09	3,11	0,71	1,94	4,97	31
20	2,58	2,61	0,63	0,62	3,88	310
Mafikeng/Zeerust Total	2,65	2,72	0,74	0,62	5,44	366

Notes: All prices displayed are in USD, per 20 cigarettes.

In all cases the difference in means between Gaborone and Mafikeng/Zeerust are statistically significant at the 1% level.

Overall, we observe that the price of cigarettes is significantly higher on the Botswana side of the border than on the South African side, and this difference exceeds the 30 percent levy on cigarettes in Botswana. This finding is consistent overall and across outlet and packaging types. Table 9 of the Annex shows the price differences for identical products that were found on both sides of the border. The table shows that every product was more expensive in Botswana than in South Africa. The largest difference in price was 68.4 percent (Camel 20 pack), the median difference was 37.7 percent (Pacific 20 pack) and the smallest difference was 7.8 percent (Benson & Hedges 20 pack).

While overall the variance in prices across the regions is similar, for single sticks there is much more variation in South Africa than in Botswana.⁴ A test of the equality of variances rejects the hypothesis of equal variances at the 1 percent level. The minimum price for a single stick in South Africa is also significantly lower than in Gaborone where, as mentioned, the cheapest loose cigarette observed is almost five times higher than in Mafikeng/Zeerust. This strongly suggests that there is more illicit trade in single cigarettes in South Africa, where prices vary more and very cheap cigarettes are found, than in Botswana, where the price of singles is higher and more uniform. Because prices are lower on the South African side of the border, it is highly likely that, to the extent that bootlegging exists, cigarettes move

⁴ The singles present in Gaborone and Mafikeng/Zeerust are the same brands, particularly Craven A, Dunhill and Peter Stuyvesant, and the brands that are only present in one area are not the cause of the extreme price variation. Thus, there exists a large variance in price, despite similar brands/quality.

illegally from South Africa to Botswana. The absence of very cheap cigarettes in Gaborone suggests that if South African cigarettes are sold illegally in Gaborone, they are either sold at the local going rate, or that the data collection has not captured these illegal cigarettes. Bootlegged cigarettes are also more likely to be sold at informal outlets such as spaza shops and street vendors; however, we observe that the lowest prices of cigarettes sold in these outlets are still significantly higher than the average prices of cigarettes sold in similar outlets in South Africa. Thus, the evidence from the price data analysis suggests that, if smuggling exists, there is not enough smuggling to equalize prices between the Mafikeng/Zeerust area and Gaborone.

Lastly, it is also possible that citizens of Botswana travel to South Africa to purchase the relatively cheap cigarettes for consumption purposes, and consume these on either side of the border. The study's Botswana price data cannot pick up this activity, as these products are not available for sale in Botswana, however, as we will see in Section 7, there is evidence of this in the interviews.

Cigarette Prices in Maseru, Lesotho, and Ladybrand, South Africa

In the previous section, we noted that cigarette prices are significantly higher in Botswana than in South African towns near the border. It stands to reason that a main driver of this difference in prices is the Botswana levy on tobacco. Considering that the government of Lesotho intends to implement a similar levy, we now evaluate the current price difference between Maseru and Ladybrand.

Table 5 below presents a summary of the cigarette prices collected in Maseru, Lesotho, and Ladybrand, South Africa. For retail outlets and spaza shops respectively, the average price in Maseru is 6 and 5 percent higher than in Ladybrand, and these differences are not statistically significant. Cigarettes sold at street vendors in are substantially cheaper (13 percent) in Maseru than in Ladybrand.

In Table 6 we summarize cigarette prices by packaging type. When we compare the price of packs of 20, we observe that packs in Ladybrand are cheaper than those in Maseru. Single sticks, which are usually sold at street vendors, are more expensive in South Africa than Lesotho.

Table 10 in the Annex shows that, of the 20 cigarette products that appeared both in Maseru and Ladybrand, 15 products were most expensive in Lesotho, while five were more expensive in South Africa. The median comparable product (Camel 20 pack) was 8.1 percent more expensive in Maseru.

Overall, we observe that there is a difference in the price of cigarettes between Maseru and Ladybrand, but it is much less pronounced than the difference between Gaborone and nearby South African towns. In fact, for a number of pack sizes and outlet types, the price of cigarettes in Maseru is lower than in Ladybrand. The difference in cigarette prices is far more

Table 5. Cigarette Price Summary Statistics, Maseru and Ladybrand (USD per pack)

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Maseru						
Retail Outlet	2,79	2,88	0,63	0,78	3,88	53
Spaza Shop	3,04	3,11	1,17	0,78	4,66	88
Street Vendor	3,12	3,88	1,35	1,55	6,21	1791
Maseru Total	3,11	3,88	1,32	0,78	6,21	1932
Ladybrand						
Retail Outlet	2,62	2,68	0,71	0,62	4,97	234
Spaza Shop	2,91	3,11	0,74	1,24	3,88	48
Street Vendor	3,61	4,66	1,30	1,55	4,66	59
Ladybrand Total	2,83	2,84	0,92	0,62	4,97	341

Notes: All prices displayed are in USD, per 20 cigarettes.

The difference in means for the retail outlet and spaza shop groups are not statistically significant, while the difference in means overall and for street vendors are statistically significant at the 1% level.

Table 6. Cigarette Prices by Packaging, Maseru and Ladybrand (USD, per pack equivalent)

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Maseru						
1	3,12	3,88	1,34	1,55	6,21	1874
10	3,26	3,11	0,22	3,11	3,57	5
20	2,62	2,76	0,61	0,78	3,11	52
Maseru Total	3,11	3,88	1,32	0,78	6,21	1931
Ladybrand						
1	3,26	3,11	1,03	1,24	4,97	161
10	2,59	2,87	0,63	1,40	3,18	16
20	2,43	2,49	0,59	0,62	4,27	159
Ladybrand Total	2,84	2,84	0,92	0,62	4,97	336

Notes: All prices displayed are in USD, per 20 cigarettes.

The overall and 10 pack difference in mean cigarette price in Maseru and Ladybrand is statistically significant at the 1% level, while the difference in means for 20 packs is significant at the 10% level. The difference in means for single sticks is not statistically significant.

acute in Botswana, and a highly plausible reason for this is the levy on tobacco products that serves to increase the price of cigarettes.

6. Analysis of Alcohol Price Data

Besides placing a levy on cigarettes, the government of Lesotho is also planning to introduce a levy on alcohol products, similar to the alcohol levy in Botswana. For this reason, this section will report on the difference in the price of alcohol products between Gaborone and nearby South African towns, as well as between Maseru and Ladybrand.

Alcohol Prices in Gaborone, Botswana, and Mafikeng/Zeerust, South Africa

The table below presents the average alcohol prices in both Gaborone and the Mafikeng/Zeerust area. We categorize the prices broadly according to the type of alcohol product. The prices of beer are italicized because beer is the beverage of choice among drinkers in these areas.

Table 7. Alcohol Price Summary Statistics, Gaborone and Mafikeng/Zeerust

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Gaborone						
Beer	3,07	2,94	0,71	2,10	7,12	122
Cider	3,69	3,70	0,45	2,85	4,80	52
Spirits	41,66	27,72	63,77	5,55	1423,51	923
Spirit Cooler	5,07	5,49	1,81	1,88	8,28	32
Mafikeng/Zeerust						
Beer	2,12	2,12	0,50	1,04	4,01	145
Cider	1,92	1,92	0,13	1,83	2,02	2
Spirits	19,10	16,31	18,74	5,18	230,56	213

Notes: All prices displayed are in USD, per litre of beverage.

*"Other" is excluded from the analysis.

In all cases the difference in mean alcohol price in Gaborone and Mafikeng/Zeerust is statistically significant at the 1% level.

From Table 7 we see that, for each product category, alcohol is significantly more expensive on the Botswana side of the border. Beer products are approximately 45 percent more expensive in Gaborone, while the cheapest beer price observed in Botswana is more than double the price of the cheapest beer price on the South African side of the border. Ciders,

categorized similarly to beer, also have a significant price difference, where the average price in Gaborone is more than 90 percent greater than in Mafikeng/Zeerust, although there were only two prices collected there. Spirits also have a very large difference in price, however this category includes a wide range of sometimes incomparable products, including cheap and luxury products, which is a cause of this variation. Table 11 of Annex One describes direct comparisons of products on either side of the border. From the table, we note that for all—except one (Mokador 375 ml, Liqueur)—of the 119 products that were observed in both Gaborone and South Africa, the average price in Botswana was higher than in South Africa. The largest difference in directly comparable products was for a 750-ml bottle of Chivas Regal whisky, which was 229 percent more expensive in Gaborone. The median percentage difference in price between directly comparable products was 42.5 percent.

It stands to reason that the observed difference in prices is largely driven by Botswana's alcohol levy. As we observed for cigarette prices, the difference in alcohol prices across the Botswana border could provide motivation for bootlegging from South Africa to Botswana. However, we do not observe very low minimum prices in Gaborone which we might expect if bootlegging were common, and the minimum price in Gaborone is more than 80 percent higher than that in South Africa.

Alcohol Prices in Maseru, Lesotho, and Ladybrand, South Africa

Considering that the government of Lesotho intends to implement a similar alcohol levy to that in Botswana, we now investigate the current difference in alcohol prices between Maseru and Ladybrand.

The table below presents the average prices by alcohol product category for the two areas.

From Table 8 we see that, for the various categories of alcohol, mean prices are slightly higher in South Africa. The average beer price collected in Ladybrand is 20 percent higher than in Maseru, while the average cider price is 27 percent higher in Ladybrand than in Maseru. Spirits are significantly more expensive in South Africa, although it is again important to note that this category includes a large range of products. From Table 12 of the Annex (showing directly comparable products), eight of the 28 comparable products are more expensive in Lesotho. Only three out of twelve beer products are more expensive in Lesotho (Flying Fish 660 ml single bottle, Castle 340 bottle six pack, and Amstel 330 bottle 6 pack), and the largest difference in beer prices is a single 440 ml Heineken can, which was 18.7 percent more expensive in South Africa. The median percentage difference in price is 7 percent (more expensive in Ladybrand).

Table 8. Alcohol Price Summary Statistics, Maseru and Ladybrand

	MEAN	MEDIAN	ST. DEV.	MIN	MAX	N
Maseru						
Beer	2,00	2,05	0,39	1,26	2,97	100
Cider	2,74	2,82	0,49	1,60	3,95	67
Spirits	15,42	15,54	7,96	4,97	41,43	63
Spirit Cooler	3,50	3,39	0,52	3,03	5,18	17
Ladybrand						
Beer	2,40	2,47	0,58	1,04	4,71	45
Cider	3,49	3,53	0,73	1,88	5,27	51
Spirits	21,19	22,78	5,90	11,39	31,07	26
Spirit Cooler	4,59	4,45	0,67	3,53	5,88	19

Notes: All prices displayed are in USD, per litre of beverage.

Other is excluded from the analysis.

For each alcohol category, the difference in mean price in Maseru and Ladybrand is statistically significant at the 1% level.

Overall, following the alcohol levy in Botswana, alcohol prices are significantly higher in Gaborone than in nearby South African towns. We also did not observe any very cheap alcohol products in Gaborone, which we might have expected as an outcome of bootlegging. For Lesotho, alcohol prices are significantly higher in Ladybrand than in Maseru for each product category, so from the outset there is no significant motivation for bootlegging to Lesotho. Thus, an alcohol levy of approximately 20 percent will equalize the difference in prices between Maseru and nearby South Africa; this will simply "straighten out" the price differences that already exist.

7. Locals' Perceptions about Cross-Border Trade of Alcohol and Cigarettes

Besides collecting price data for the four regions, we conducted informal interviews with locals about their perceptions regarding cross-border trade between South Africa and Botswana, as well as between South Africa and Lesotho. These locals included shop managers/owners, street vendors, cigarette/alcohol consumers, and border post officials. Among other things, fieldworkers asked questions regarding the participants' opinions about the difference in price across the border; the presence of cross-border shopping; and the main products involved in cross-border shopping. This section summarizes the findings of these interviews.

Perceptions about Cross-Border Trade near the Gaborone Border

In total, the fieldworkers in Gaborone interviewed 22 participants, while fieldworkers on the South African side of the border interviewed 20 people, including street vendors, shopkeepers, consumers, and a border-post official.

From the interviews in Gaborone, respondents agree that prices of both cigarettes and alcohol in Botswana are higher than those in South Africa, and believe that the levies on these products are a cause of this difference. A general perception is that border controls are strong and that border officials will confiscate goods that are being brought into the country illegally. This, combined with the cost of transport, seems to be a deterrent for small scale cross-border shopping from South Africa. The shopkeepers and street vendors interviewed report sourcing their products from wholesalers in Botswana, such as Trans Africa, Jumbo, and Trade World. One respondent stated that it has become harder to move goods across the border in recent years. He recalls previously smuggling goods secretly, hiding alcohol “in certain compartments of their cars” in the “early years.” It was also noted that South Africa has a larger variety of alcohol products than Botswana, and a few consumers indicated that they would cross the border to buy alcohol products that are not available in Botswana, although on a small scale, and for personal use.

People interviewed on the South African side of the border agree that prices of cigarettes and alcohol are higher in Botswana than in South Africa. Most respondents commented that people travel from Botswana to South Africa to “party” in the evenings. This is apparently because Botswana has strict laws around the operating hours of bars, and relatively early closing hours. For this reason, consumers travel to South Africa to consume alcohol once the bars in Botswana are closed, or choose to visit South Africa with the purpose of drinking (one manager indicated that he hosts bachelor parties, weddings, etc. for people from Botswana). Although some vendors indicated that they were not aware of any of their products being purchased to be taken to Botswana, a number of shop owners and managers agreed that Botswana residents do purchase alcohol and cigarettes to take back home, but that this happens on a very small scale. All shopkeepers who report knowledge of their products being taken to Botswana indicate that consumers buy just a few packs or a carton or two of cigarettes, and small quantities of alcohol, and that this is for personal use. One shopkeeper reported that some customers have asked for small alcohol bottles so that they are compliant with the customs limit on alcohol (between one and two liters per traveler). Another shopkeeper recalls Botswanan customers purchasing alcohol products that are not available in Botswana, for example Hennessy VSOP Cognac.

One respondent indicated that cigarettes come into South Africa from Botswana. The bar owner recalled large trucks travelling from Botswana to South Africa carrying cigarettes from Zimbabwe and Nigeria. He believes that these trucks carry large quantities of cigarettes hidden in petrol tanks. This respondent also stated that the border is porous, and smugglers

can enter the country via small dirt roads, rather than coming through the border crossing. He also recalled police visiting his bar and telling him that there were investigations into smuggling into South Africa.

From the Gaborone and Mafikeng/Zeerust interviews, we find that the general perception is that, although there may have been bootlegging of cigarettes and alcohol into Botswana in the past, strict border controls have limited this activity in recent years. Where alcohol and cigarettes travel from the Mafikeng area into Botswana, this is believed to be on a small scale, no more than a few packs of cigarettes and small quantities of alcohol, and this is generally for personal consumption. There is an overall perception that people travel to South Africa from Botswana to continue their nights' entertainment after the bars close in Botswana and to enjoy the cheaper alcohol.

Perceptions about Cross-Border Trade near the Maseru Border

In total, fieldworkers in Maseru interviewed 30 participants, while those in Ladybrand interviewed 8 people, including street vendors, shopkeepers, consumers, and a border-post official.

Among the respondents in Ladybrand there is a general perception that the price of alcohol and cigarettes is similar in Maseru and Ladybrand, and thus they are not involved in cross-border trade because transport costs would make it relatively more expensive. There was some indication that individuals might travel to Lesotho to buy a locally produced beer called Maluti. This beer is rarely available on the South African side of the border and is a favorite among respondents. It was also noted by a number of Ladybrand respondents that locals rarely have passports (three of the eight respondents themselves did not possess a passport), and for this reason many residents of Ladybrand have never crossed the border, despite its close proximity.

Most respondents in Maseru held the belief that the price of alcohol and cigarettes is similar across the border, and that transport costs and taxes at the border make it impractical to buy goods from South Africa for resale, especially on a small scale. One shopkeeper indicated that, besides taxes and transport costs, there are many and long queues at the border, so she avoids buying products in South Africa. Most formal retail shop managers and owners indicated that they purchase bulk alcohol products from South Africa, specifically wine and beverages that are not available in Lesotho. However, others indicated that they did not have the required licenses to buy alcohol from South Africa, but would do so if they did. There is also a general opinion that there is a larger variety of alcoholic beverages in South Africa, and a few consumers reported travelling to South Africa to buy spirits that are not available locally, although only for personal consumption. In terms of beer, a number of consumers and shopkeepers indicated that there is a general preference for the local beer, Maluti, and so they would not bother buying beer from South Africa.

Most retail outlet managers reported sourcing cigarettes from local wholesalers. One vendor indicated that he would not buy cigarettes from across the border because it is difficult to distinguish legal from illegal cigarettes, and he did not want to be caught with illegal cigarettes at the border. One shop owner admitted to illegally bringing goods across the border. In particular, she smuggles in beer products that are no longer allowed to cross the border (one-liter Castle and Black Label bottles), as well as cigarettes, which she claims can easily be hidden in a loaded truck.

Overall, there is a general perception from locals that the price of alcohol and cigarettes is similar on either side of the border, thus there is little incentive to transport goods across the border for resale. Some products that were reported to move across the border were the varieties of alcohol that are not available in Lesotho; alternatively, alcohol is imported from South Africa in bulk. However, one retail owner did admit to smuggling products into Lesotho, specifically alcohol products that have recently been banned from crossing the border, and cigarettes, as these are easy to hide.

8. Conclusion

This study has investigated the possibility of bootlegging between South Africa and Botswana and Lesotho. To do this, we estimated the difference in cigarette and alcohol prices between Gaborone and nearby South African towns, as well as between Maseru and nearby Ladybrand. We also summarized the perceptions of locals about cross-border trade of alcohol and cigarettes.

The study's data and analysis show that despite levies of, respectively, 30 and 40 percent on tobacco and alcohol products in Botswana, smuggling is limited and has not come even close to equalizing prices between South Africa and Botswana. The interviews with locals in the area also produce little evidence of bootlegging. This indicates effective measures by customs and border control in Botswana, which limit the illegal movement of these goods. There have also been significant proceeds from the levies, which the government has earmarked to anti-tobacco and anti-alcohol initiatives.

The analysis indicated that, although there is a difference in prices between South Africa and Lesotho, it is much smaller than the price difference between Botswana and South Africa. Cigarettes are slightly more expensive in Maseru than in Ladybrand, while the average price of alcohol is higher in Ladybrand. Interviews with locals indicate that because prices are similar in the two countries, there is little incentive to engage in cross-border trade, specifically because of the costs of transport and taxes.

Since Lesotho scores above the African region in terms of public management, it is likely that smuggling—other than small amounts for personal consumption—from South Africa to Lesotho would be limited and that Lesotho could achieve substantial revenues from such levies. However, it is vital that Lesotho, like other countries planning significant increases in

excises for high-value, low-volume products like tobacco and alcohol, take complementary steps to strengthen customs administration. This is more important in the case of tobacco, where prices in Maseru are already above those in Ladybrand, than in the case of alcohol, where prices in Maseru are lower.

In addition, while this study has focused on the impact of smuggling on tax revenues, the main purpose of raising tobacco and alcohol taxes is to achieve the health benefits that follow from reducing consumption of these products. Increased revenues are an important positive externality. But uncertainty about their magnitude is not a reason to prevent the large increases in taxes needed to get smokers and those who abuse alcohol to stop or sharply reduce their consumption.

References

- Botswana Unified Revenue Service (BURS). 2016. Celebrating Progress, Gearing for Growth. Annual Report. <http://www.burs.org/bw/index.php/legal-year-reports?download=447:2016-burs-annual-report>.
- Google Maps. 2018. <https://www.google.co.za/maps/@-25.2269628,26.1036569,8.96z>.
- Google Maps. 2018. <https://www.google.co.za/maps/@-29.2689704,27.461395,11.5z>.
- IIAG. 2017. Ibrahim Index of African Governance. Overall Governance Index.
- Lesotho Demographic Survey 2011. Lesotho Bureau of Statistics. <http://www.bos.gov.ls/nada/index.php/catalog/6/study-description>
- National Treasury. 2017. Budget Review 2017. <http://www.treasury.gov.za/documents/national%20budget/2017/review/FullBR.pdf>
- Population and Housing Census 2011. Statistics Botswana.
- SACU. 1969. Southern African Customs Union (SACU) Agreement, 1969.

Annexes

Annex 1

Table 9. Detailed Cigarette Price Summary, Gaborone and Mafikeng/Zeerust

PRODUCT (BRAND; PACK SIZE)	GABORONE MEAN USD/PACK	GABORONE N	MAFIKENG/ ZEERUST MEAN USD/PACK	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Camel; 20	4,61	23	2,74	46	68,4
Kent; 20	4,63	29	2,96	11	56,5
Winston; 20	3,39	7	2,20	20	54,0
Peter Stuyvesant; 20	4,19	77	2,77	35	51,4
LD; 20	2,68	9	1,84	6	45,7
Marlboro; 20	4,26	33	2,96	17	44,0
Vogue; 20	4,66	11	3,25	3	43,4
Rothmans; 20	4,24	9	3,00	7	41,6
Peter Stuyvesant; 10	4,46	29	3,15	12	41,6
Craven A; 10	4,39	12	3,11	4	41,5
Kent; 200	3,92	2	2,84	1	37,9
Pacific; 20	2,67	8	1,94	2	37,7
Forum; 20	2,08	2	1,55	4	34,1
Dunhill; 20	4,52	98	3,41	34	32,5
Dunhill; 10	4,39	4	3,31	6	32,5
Craven A; 20	4,04	21	3,06	12	32,0
Chesterfield; 20	3,53	23	2,70	16	30,6
Glamour; 20	3,26	2	2,60	3	25,6
Peter Stuyvesant; 1	4,98	68	4,14	3	20,1
Dunhill; 1	5,47	3	4,66	4	17,3
Peter Stuyvesant; 30	3,58	18	3,10	11	15,6

Table 9. Detailed Cigarette Price Summary, Gaborone and Mafikeng/Zeerust, Cont.

PRODUCT (BRAND; PACK SIZE)	GABORONE MEAN USD/PACK	GABORONE N	MAFIKENG/ ZEERUST MEAN USD/PACK	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Craven A; 1	4,90	22	4,27	2	14,7
Benson & Hedges; 20	2,36	4	2,19	16	7,8

Notes: All prices displayed are in USD, per 20 cigarettes.

The "Botswana Premium" indicates the percentage difference between the average price in Gaborone and the average price in Mafikeng/Zeerust, for good *i* (brand and pack size).

Specifically, $Premium_i = \frac{(Botswana_i - South Africa_i)}{South Africa_i}$ where $Botswana_i$ is the average price for good *i* in Gaborone, and $South Africa_i$ is the average price for good *i* in the Mafikeng/Zeerust area. A premium can only be calculated for products, *i*, where there is at least one price available in both Botswana and South Africa. Products for which a price has not been collected in either area are not shown here.

Table 10. Detailed Cigarette Price Summary, Maseru and Ladybrand

PRODUCT (BRAND; PACK SIZE)	MASERU MEAN USD/PACK	MASERU N	LADYBRAND MEAN USD/PACK	LADYBRAND N	LESOTHO PREMIUM (+) / DISCOUNT (-) (%)
Savannah; 1	3,11	1	1,55	5	100,1
Pall Mall; 1	3,11	1	2,38	17	30,8
Craven A; 1	4,05	58	3,11	7	30,2
Rothmans; 1	4,01	6	3,11	3	29,2
Chesterfield; 1	3,11	2	2,44	7	27,3
Kent; 1	3,89	1	3,11	3	25,0
Camel; 1	4,18	109	3,50	2	19,7
Peter Stuyvesant; 10	3,42	1	2,95	6	15,8
Peter Stuyvesant; 1	4,10	418	3,69	45	11,0
Camel; 20	2,80	2	2,59	20	8,1
Kent; 20	2,95	2	2,84	3	4,1
Pall Mall; 20	2,14	1	2,06	6	3,8
Dunhill; 1	4,29	509	4,19	47	2,4
Dunhill; 10	3,22	4	3,16	3	2,1
Peter Stuyvesant; 20	2,79	12	2,74	15	1,5
Mills; 20	3,03	1	3,07	1	-1,2

Table 10. Detailed Cigarette Price Summary, Maseru and Ladybrand, Cont.

PRODUCT (BRAND; PACK SIZE)	MASERU MEAN USD/PACK	MASERU N	LADYBRAND MEAN USD/PACK	LADYBRAND N	LESOTHO PREMIUM (+) / DISCOUNT (-) (%)
Peter Stuyvesant; 30	2,75	1	2,86	3	-3,9
Dunhill; 20	3,02	12	3,14	11	-4,0
Rothmans; 20	2,77	7	2,91	3	-4,8
Craven A; 20	2,77	7	2,94	3	-5,6

Notes: All prices displayed are in USD, per liter of beverage.

The "Lesotho Premium / Discount" indicates the percentage difference between the average price in Maseru and the average price in Ladybrand, for good i (brand and pack size).

Specifically, $Premium_i/Discount_i = \frac{Lesotho_i - South Africa_i}{South Africa_i}$, where $Lesotho_i$ is the average price for good i in Maseru, and $South Africa_i$ is the average price for good i in Ladybrand. A premium can only be calculated for products, i , where there is at least one price available in both Maseru and Ladybrand. Products for which a price has not been collected in either area are not shown here.

Table 11. Detailed Alcohol Price Summary, Gaborone and Mafikeng/Zeerust

PRODUCT (BRAND; NO. ITEMS; BOTTLE/ CAN; MLS PER ITEM)	GABORONE MEAN USD/L	GABORONE N	MAFIKENG / ZEERUST MEAN USD/L	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Beer					
Amstel 6; Can; 440	2,85	1	1,74	3	64,4
Amstel; 1; Can; 440	3,43	2	2,12	1	62,1
Heineken; 1; Bottle; 650	3,67	2	2,31	3	58,8
Hansa; 1; Bottle; 750	2,14	2	1,45	3	47,8
Carling Black Label 6; Can; 500	2,71	1	1,85	2	46,6
Castle; 1; Bottle; 660	2,71	3	1,88	1	43,9
Carling Black Label; 1; Bottle; 750	2,31	3	1,66	2	39,5
Castle; 1; Bottle; 750	2,15	3	1,55	4	38,3
Windhoek; 1; Bottle; 330	3,54	3	2,7	1	31
Windhoek; 1; Can; 440	2,99	2	2,3	2	30,2
Amstel; 1; Bottle; 440	2,97	1	2,3	1	29,4
Heineken 6; Can; 440	3,27	2	2,53	1	29,1
Castle; 1; Can; 500	2,73	1	2,12	3	28,8
Windhoek 24; Bottle; 440	2,47	1	1,98	2	25

Table 11. Detailed Alcohol Price Summary, Gaborone and Mafikeng/Zeerust, Cont.

PRODUCT (BRAND; NO. ITEMS; BOTTLE/ CAN; MLS PER ITEM)	GABORONE MEAN USD/L	GABORONE N	MAFIKENG / ZEERUST MEAN USD/L	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Castle 6; Bottle; 340	2,69	2	2,26	3	18,9
Carling Black Label 6; Bottle; 340	2,92	1	2,48	1	18
Carling Black Label; 1; Can; 500	2,42	2	2,06	2	17,4
Windhoek 6; Can; 440	2,58	4	2,21	2	17,1
Castle; 1; Bottle; 340	2,9	4	2,51	5	15,5
Carling Black Label; 1; Bottle; 340	2,93	4	2,63	2	11,4
Carling Black Label; 1; Can; 330	2,97	2	2,82	1	5,4
Spirits					
Chivas Regal; 1; Bottle; 750	92,17	11	27,96	1	229,6
Gilbey's; 1; Bottle; 750	14,89	9	5,18	6	187,6
Wellington; 1; Bottle; 750	26,57	2	11,29	1	135,3
Johnnie Walker; 1; Bottle; 750	155,76	32	70,62	7	120,5
Ciroc; 1; Bottle; 750	84,91	4	39,25	1	116,3
First Watch; 1; Bottle; 1000	23,15	1	10,87	1	112,9
Viceroy; 1; Bottle; 750	23,6	5	11,91	2	98,1
Bell's; 1; Bottle; 750	40,96	4	21,31	5	92,2
Olmecca; 1; Bottle; 750	42,45	11	22,27	2	90,6
KWV; 1; Bottle; 750	23,89	8	12,57	3	90,1
First Watch; 1; Bottle; 750	23,94	5	12,69	2	88,7
Wellington; 1; Bottle; 200	32,13	3	17,09	1	88,1
Mainstay; 1; Bottle; 750	24,08	2	13,26	1	81,6
Three Ships; 1; Bottle; 750	27,28	9	15,02	1	81,6
Cape To Rio; 1; Bottle; 750	21,62	3	11,91	1	81,5
Smirnoff; 1; Bottle; 750	24,3	14	13,46	4	80,5
Scottish Leader; 1; Bottle; 750	28,87	9	16,05	1	79,8
J&B; 1; Bottle; 750	32,27	6	17,98	7	79,5
Captain Morgan; 1; Bottle; 750	28,99	12	16,21	6	78,8
Black & White; 1; Bottle; 750	26,22	5	14,71	4	78,3
Gordon's; 1; Bottle; 1000	26,32	1	14,84	1	77,4

Table 11. Detailed Alcohol Price Summary, Gaborone and Mafikeng/Zeerust, Cont.

PRODUCT (BRAND; NO. ITEMS; BOTTLE/ CAN; MLS PER ITEM)	GABORONE MEAN USD/L	GABORONE N	MAFIKENG / ZEERUST MEAN USD/L	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
First Watch; 1; Bottle; 200	32,26	4	18,26	2	76,7
White Horse; 1; Bottle; 750	28,34	3	16,31	4	73,7
Count Pushkin; 1; Bottle; 750	20,56	5	12,01	1	71,1
Harrier; 1; Bottle; 750	19,98	5	11,91	1	67,7
Vat 691; Bottle; 750	22,21	6	13,26	3	67,6
First Watch; 1; Bottle; 375	31	2	18,64	1	66,3
Stroh; 1; Bottle; 500	64,49	1	38,84	1	66
Saluta; 1; Bottle; 200	15,98	1	9,71	1	64,5
Vat 691; Bottle; 375	26,96	3	16,57	2	62,7
Gilbey's; 1; Bottle; 200	14,21	10	8,79	7	61,6
Grey Goose; 1; Bottle; 750	81,75	1	51,79	2	57,9
Bain's; 1; Bottle; 750	38,33	4	24,34	1	57,5
Stretton's; 1; Bottle; 375	21,47	2	13,67	1	57,1
Richelieu; 1; Bottle; 750	29,71	7	19,2	3	54,7
Count Pushkin; 1; Bottle; 375	20,59	4	13,36	1	54,1
Patron; 1; Bottle; 750	115,83	3	75,61	1	53,2
Bell's; 1; Bottle; 200	39,06	2	25,54	4	53
Viceroy; 1; Bottle; 200	26,7	2	17,48	1	52,7
Bell's; 1; Bottle; 375	39,52	4	25,89	2	52,6
Romanoff; 1; Bottle; 750	18,89	3	12,43	1	52
Klip Drift; 1; Bottle; 750	28,56	12	18,88	4	51,3
Gordon's; 1; Bottle; 750	19,32	4	12,84	2	50,5
J&B; 1; Bottle; 375	37,3	4	24,86	1	50,1
Two Keys; 1; Bottle; 375	24,12	2	16,36	1	47,4
J&B; 1; Bottle; 200	36,63	3	24,97	3	46,7
Romanoff; 1; Bottle; 200	21,03	4	14,37	1	46,4
Mellow-Wood; 1; Bottle; 375	24,34	5	16,68	2	46
Johnnie Walker; 1; Bottle; 200	44,56	2	30,68	1	45,2
Bertrams; 1; Bottle; 750	26,3	4	18,13	1	45,1

Table 11. Detailed Alcohol Price Summary, Gaborone and Mafikeng/Zeerust, Cont.

PRODUCT (BRAND; NO. ITEMS; BOTTLE/ CAN; MLS PER ITEM)	GABORONE MEAN USD/L	GABORONE N	MAFIKENG / ZEERUST MEAN USD/L	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Smirnoff; 1; Bottle; 200	22,99	8	16	5	43,6
White Horse; 1; Bottle; 375	26,86	1	18,85	2	42,5
Viceroy; 1; Bottle; 375	23,85	5	16,99	1	40,4
Stretton's; 1; Bottle; 750	23,18	5	16,57	1	39,9
Jameson; 1; Bottle; 375	58,72	2	42,05	1	39,6
Mainstay; 1; Bottle; 200	22,64	3	16,31	1	38,8
Klip Drift; 1; Bottle; 375	23,24	6	16,99	2	36,8
Oude Meester; 1; Bottle; 375	26,35	3	19,26	1	36,8
Copperband; 1; Bottle; 375	8,07	5	5,9	1	36,6
Clubman; 1; Bottle; 375	8,04	2	5,9	1	36,1
Zorba; 1; Bottle; 375	8,02	5	5,9	1	35,8
Vin Coco; 1; Bottle; 375	8	4	5,9	1	35,5
Russian Bear; 1; Bottle; 750	23,38	15	17,3	2	35,2
Castle Brand; 1; Bottle; 375	7,98	4	5,9	1	35,1
Knights; 1; Bottle; 750	20,74	1	15,54	1	33,5
Clubman; 1; Bottle; 200	9,5	2	7,19	1	32,3
Copperband; 1; Bottle; 200	9,5	2	7,19	1	32,3
Clubman; 1; Bottle; 750	7,5	2	5,7	1	31,7
Mellow-Wood; 1; Bottle; 200	24,55	4	18,64	2	31,7
Copperband; 1; Bottle; 750	7,5	5	5,7	1	31,6
Castle Brand; 1; Bottle; 200	9,44	1	7,19	1	31,4
Castle Brand; 1; Bottle; 750	7,48	5	5,7	1	31,4
Vin Coco; 1; Bottle; 200	9,44	1	7,19	1	31,4
Klip Drift; 1; Bottle; 200	29,01	9	22,14	2	31
Black & White; 1; Bottle; 200	26,81	1	20,49	4	30,9
Romanoff; 1; Bottle; 375	17,62	2	13,46	2	30,9
Knights; 1; Bottle; 200	24,61	2	19,03	1	29,3
Harrier; 1; Bottle; 200	22,5	4	17,48	1	28,8
Captain Morgan; 1; Bottle; 200	26,91	3	20,91	3	28,7

Table 11. Detailed Alcohol Price Summary, Gaborone and Mafikeng/Zeerust, Cont.

PRODUCT (BRAND; NO. ITEMS; BOTTLE/ CAN; MLS PER ITEM)	GABORONE MEAN USD/L	GABORONE N	MAFIKENG / ZEERUST MEAN USD/L	MAFIKENG/ ZEERUST N	BOTSWANA PREMIUM (%)
Zorba; 1; Bottle; 750	7,28	4	5,7	1	27,9
Richelieu; 1; Bottle; 200	25,74	3	20,2	1	27,4
Vin Coco; 1; Bottle; 750	7,25	4	5,7	1	27,2
Zorba; 1; Bottle; 200	9,07	1	7,19	1	26,2
Brandyale; 1; Bottle; 750	7,16	4	5,7	1	25,8
Seven Seas; 1; Bottle; 750	16,79	1	13,46	1	24,7
Gordon's; 1; Bottle; 200	22,76	4	18,35	2	24
Limosin; 1; Bottle; 375	21,29	4	17,61	1	20,9
Gordon's; 1; Bottle; 375	21,06	4	17,5	2	20,3
Amarula; 1; Bottle; 750	17,87	2	15,02	1	19
Oude Meester; 1; Bottle; 200	26,26	2	22,14	1	18,6
Chateau; 1; Bottle; 750	18,41	1	15,8	2	16,6
Johnnie Walker; 1; Bottle; 375	48,5	9	43,5	1	11,5
Chateau; 1; Bottle; 375	19,5	2	18,23	1	7
Mokador; 1; Bottle; 375	8,18	2	10,25	1	-20,3
Other					
Sedgewick's Old Brown; 1; Bottle; 750	5,58	3	3,97	3	40,5
Sedgewick's Old Brown; 1; Bottle; 375	6,21	2	5,44	2	14,2
Sedgewick's Old Brown; 1; Bottle; 200	7,29	2	6,51	2	12,1

Notes: All prices displayed are in USD, per liter of beverage.

The "Botswana Premium" indicates the percentage difference between the average price in Gaborone and the average price in Mafikeng/Zeerust, for good *i* (brand and packaging).

Specifically, $Premium_i = \frac{(Botswana_i - South Africa_i)}{South Africa_i}$ where $Botswana_i$ is the average price for good *i* in Gaborone, and $South Africa_i$ is the average price for good *i* in the Mafikeng/Zeerust area. A premium can only be calculated for products, *i*, where there is at least one price available in both Botswana and South Africa. Products for which a price has not been collected in either area are not shown here.

Table 12. Detailed Alcohol Price Summary, Maseru and Ladybrand

PRODUCT (BRAND; NO. ITEMS; BOTTLE/CAN; MIs PER ITEM)	MASERU MEAN USD/L	MASERU N	LADYBRAND MEAN USD/L	LADYBRAND N	LESOTHO PREMIUM (+) / DISCOUNT (-) (%)
Beer					
Flying Fish; 1; Bottle; 660	2,00	2	1,88	1	6,25
Castle; 6; Bottle; 340	2,63	1	2,47	2	6,21
Amstel; 6; Bottle; 330	2,61	2	2,47	1	5,59
Hansa; 1; Bottle; 750	1,54	4	1,55	1	-0,83
Castle; 1; Bottle; 660	1,94	2	2,00	1	-2,94
Castle; 1; Can; 440	2,30	1	2,43	4	-5,35
Castle; 1; Bottle; 750	1,64	7	1,76	3	-7,14
Carling Black Label; 1; Can; 330	2,59	1	2,82	1	-8,22
Carling Black Label; 1; Bottle; 750	1,69	3	1,86	1	-9,26
Amstel; 1; Can; 440	2,18	3	2,47	2	-11,81
Windhoek; 1; Can; 440	2,30	3	2,65	1	-13,24
Heineken; 1; Can; 440	2,30	1	2,82	1	-18,67
Cider					
Redd's; 1; Can; 440	2,65	1	2,12	1	25,15
Bernini; 6; Bottle; 275	3,95	1	3,20	1	23,55
Savanna; 6; Bottle; 330	3,07	7	3,02	4	1,51
Redd's; 1; Bottle; 660	1,77	4	1,88	2	-6,25
Savanna; 1; Bottle; 500	3,16	3	3,42	1	-7,53
Hunter's; 1; Bottle; 660	2,69	5	2,94	2	-8,46
Hunter's; 1; Bottle; 330	2,98	3	3,61	6	-17,27
Savanna; 1; Bottle; 330	3,14	3	3,88	4	-19,13
Hunter's; 1; Can; 330	2,83	2	3,53	2	-19,92
Hunter's; 1; Can; 440	2,68	5	3,44	2	-21,99
Spirits					
Russian Bear; 1; Bottle; 750	15,02	1	11,91	1	26,10
Skyy; 1; Bottle; 750	23,82	1	21,75	4	9,55
Smirnoff; 1; Bottle; 750	15,54	2	17,48	4	-11,11

Table 12. Detailed Alcohol Price Summary, Maseru and Ladybrand

PRODUCT (BRAND; NO. ITEMS; BOTTLE/CAN; Mls PER ITEM)	MASERU MEAN USD/L	MASERU N	LADYBRAND MEAN USD/L	LADYBRAND N	LESOTHO PREMIUM (+) / DISCOUNT (-) (%)
Spirit Cooler					
Smirnoff; 6; Can; 250	3,99	2	4,40	3	-9,34
Red Square; 6; Bottle; 275	3,39	3	3,86	3	-12,14
Klip Drift; 1; Can; 440	3,18	1	3,88	2	-18,12

Notes: All prices displayed are in USD, per liter of beverage.

The "Lesotho Premium / Discount" indicates the percentage difference between the average price in Maseru and the average price in Ladybrand, for good *i* (brand and packaging).

Specifically, $Premium_i/Discount_i = \frac{(\overline{Lesotho}_i - \overline{South Africa}_i)}{\overline{South Africa}_i}$, where $\overline{Lesotho}_i$ is the average price for good *i* in Maseru, and $\overline{South Africa}_i$ is the average price for good *i* in Ladybrand. A premium can only be calculated for products, *i*, where there is at least one price available in both Maseru and Ladybrand. Products for which a price has not been collected in either area are not shown here.

KENYA

20

KENYA:

Controlling Illicit Cigarette Trade

Hana Ross¹

Chapter Summary

In response to the presence of illicit cigarettes in the market in the early 2000s, Kenya implemented and tested various measures to control tobacco tax evasion. These measures had varying degrees of effectiveness, as documented in the literature (both published and unpublished), conference proceedings and related materials, online searches, and analyses based on data of the National Statistical Office of Kenya. The latest intervention, based on the modern data-driven technology in track and trace systems (TTSs), combined with electronic cargo monitoring of exports, seems to be the most effective, as it is more resistant to tampering and reduces reliance on human capacity. The tracing solution implemented in Kenya increased the size of the legitimate cigarette market, while being cheaper than the previous piecemeal solutions. The positive experience with the system had good spillover effects, allowing Kenya to expand the system to other excisable goods, as well as goods, from beer to cosmetics, subject to counterfeiting.

Despite these successes, Kenya needs to stay vigilant because of the ever-adapting methods of supplying the illicit cigarette market and because of the risks of lowering enforcement

¹ University of Cape Town, South Africa

Note: The support of Caxton Ngeywo and Joseph Sirengo of the Kenya Revenue Authority is gratefully acknowledged, in addition to support from Vincent Kimosop.

priorities in the tobacco market. Even though the new system brought in more tax revenue, the increase has been modest relative to the growing size of the legitimate market. Therefore, the current technological solution should be expanded to allow for proper tracking. In addition, the lack of an independent estimate of the size of the illicit tobacco market hinders the proper assessment of efforts to control the market. The estimates provided by the tobacco industry or commercial entities cannot be trusted for several reasons: lack of transparency in their methodology; frequent massive, suspect updates in the estimates that cannot be justified; and the well-documented efforts by the tobacco industry in a number of countries to exaggerate illicit trade to discourage tax increases. The government should therefore invest in regular assessments of the situation, including estimates of the size of the illicit tobacco market.

The experience of Kenya in addressing the illicit trade highlights the feasibility and importance of strengthening both the system and enforcement, including the related penalties and tobacco tax administration, although there are recommendations here for stronger action on both counts. The efforts of the government are all the more impressive, given Kenya's broader difficulties in addressing accountability issues in public-sector management. The improvement in the tobacco tax system and enforcement was not merely a technical endeavor. It involved consensus building, the participation of key stakeholders, and consistent and comprehensive approaches to address tax evasion, because piecemeal measures have only short-term effects.

The government should consider ratifying the Protocol to Eliminate Illicit Trade in Tobacco Products. This would contribute to sustained political commitment to a systematic effort to combat the illicit trade within Kenya and help the government secure regional collaboration that would reduce the illicit trade both domestically and in neighboring countries.

International evidence shows that tax administration is the main cause of illicit trade. Tobacco tax rates play a relatively modest role. The government of Kenya, with its system to control the illicit trade in place, should not allow the illicit trade to be used as an excuse for not pursuing more vigorous tobacco tax reform. Moreover, the tax reform should draw on the key reform elements recommended by the World Bank on the basis of evidence from a broad range of low-, middle-, and high-income countries. These include policies that are highlighted in catchwords and phrases, such as "go big, go fast"; "attack affordability"; "change expectations"; and "tax by quantity." The importance for the government of these points should not be underestimated, given the two-tiered system and the extremely large discrepancy between the rapid growth in the number of cigarettes sold and the slow growth and recent declines in real tobacco-tax revenues. It is important that the tax per cigarette be increased more quickly than inflation so that cigarettes become less, not more affordable over time. This will also bring fiscal and health benefits to the country.

1. Background

Globally, Kenya would be classified as a country with relatively low smoking prevalence. However, in the African context, the prevalence puts Kenya at the top of the pile. In the early 2000s, approximately 21.3 percent of men and 1.0 percent of women smoked tobacco.² The prevalence among youth was relatively low at that time (8.7 percent among boys and 4.7 percent among girls), but there were signs of a growing appeal of tobacco products to the young generation.³

By 2007, prevalence had increased both among adults (26.0 percent of men and 2.0 percent of women smoked⁴) and among youth (12.7 percent of boys and 6.5 percent of girls smoked⁵). However, the government managed to reverse this trend among both adults and young people by following some of the best tobacco control practices recommended in the Framework Convention on Tobacco Control (FCTC), even though the real tax and real price of cigarettes declined during this time. By 2014, 15.1 percent of men and 0.8 percent of women smoked,⁶ while 9.6 percent of boys and 4.0 percent of girls reported they were smokers. Measures adopted by the government to control the illicit trade in tobacco products also contributed to this positive trend.

2. Initial Assessment of the Illicit Cigarette Market

In the early 2000s, Kenya was perceived as an illicit cigarette transit point in East Africa, while Tanzania was the main source of the contraband,^{7,8} and the Democratic Republic of Congo, Sudan, and Uganda were the main target destinations.⁹ An increase in the availability and quality of illicit cigarettes was reported between 2000 and 2002.¹⁰

This prompted a government audit in 2003. The audit revealed serious cigarette tax avoidance and evasion schemes, such as the fraudulent declaration of cigarettes for export that were then sold tax free domestically, undeclared domestic production to avoid paying any tax, undeclared imports of raw tobacco and finished products to avoid import taxes, under-declared values of products to evade higher tax rates, and supplying counterfeit cigarettes to the domestic market.^{11,12}

² Tobacco Atlas, 2nd edition, 2006.

³ Global Youth Tobacco Survey, Kenya, 2001.

⁴ Atlas of Health Statistics of the African Region 2011. World Health Organization. Regional Office for Africa, 2011.

⁵ Global Youth Tobacco Survey, Kenya, 2007.

⁶ World Health Organization. 2014. Global Adults Tobacco Survey (GATS), Kenya Country Report.

⁷ ERC Group. World cigarettes. The 2009 Survey. Suffolk, ERC; 2009.

⁸ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

⁹ Euromonitor. Illicit trade in tobacco products 2012; 2013.

¹⁰ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

¹¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹² ERC Group. World cigarettes. The 2009 Survey. Suffolk, ERC; 2009.

Table 1. Illicit Cigarette Trade in the Total Cigarette Market, Kenya, 2003–16

	2003*	2004	2005	2006	2007	2008	2009	2010*	2011	2012	2013	2014*	2015	2016
ERC 2007					16.7									
ERC 2010								12.0						
ERC 2015					20.6					11.0				
BAT						8.12		12.0	20.0	8.0				
EM 2012				11.3	11.5	11.8	12.4	12.9	13.5					
EM 2015	13.0	13.0	13.0	12.8	12.9	13.3	13.6	13.9	14.0	10.8	10.8	10.8		
EM 2016	30.8	30.9	30.8	30.3	30.7	31.3	32.0	32.4	32.6	26.5	26.5	26.6	26.6	27.3
EM 2017	11.3	11.3	11.3	11.1	11.2	11.5	11.8	12.1	12.1	9.4	9.4	9.4	9.4	9.7
KRA	15.0										12.0	5.0	5.0	5.0

Sources: ERC Group 2007, 2010, 2015; Eriksen, Mackay, and Ross 2013; Euromonitor International 2012, 2015, 2016, 2017a, 2017b; Gachiri 2012; Muthaura 2013; Nargis 2012; Ngeywo 2017.

Note: BAT = British American Tobacco, EM = Euromonitor International. ERC = ERC Group. KRA = Kenya Revenue Authority. Euromonitor estimates fluctuate tremendously and are not consistent across reports published in different years. Similarly, the two estimates generated by ERC for 2007 are not consistent. This casts a serious doubt on the reliability of these estimates.

* Indicates a significant change in policy to address illicit trade

The size of the problem was not clear (Table 1). Euromonitor International reported in various publications that the illicit market in 2003 represented between 11 percent and 31 percent of the total market, while the ERC Group (ERC) put that estimate at 20 percent–26 percent in 2007.

The Kenya Revenue Authority (KRA) estimate that the illicit cigarette trade deprives the country of about K Sh 1 billion (US\$11.3 million) in taxes annually.¹³ Another KRA estimate claimed that the illicit cigarette trade cost the country more than K Sh 70 billion (US\$790 million) in jobs, tax revenues, and investment losses.¹⁴ The methodologies used to generate these estimates are unknown.

¹³ Ngeywo CM. Senior Assistant Commissioner, Kenya Revenue Authority, Report of the meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling. Gaborone, Botswana; 3-5 June 2012. The World Bank, 2012.

¹⁴ Muchangi J. Kenya: cigarette smuggling in country. *Nairobi Star*; 7 March 2012.

3. First Measures to Address the Illicit Cigarette Market

The results of the 2003 audit prompted the government to take several actions to address cigarette tax avoidance and tax evasion. First, it changed the tax regime from an ad valorem system using the ex-factory price to a specific tiered tax system using retail prices to define the four progressive tax categories.¹⁵ This was supposed to eliminate tax evasion related to the under-declaration of the value of cigarettes.

In addition to the change in tax structure, the government introduced paper tax stamps on all cigarette packs sold in the domestic market. This measure was primarily aimed at local producers and was supposed to eliminate the under-declaration of production destined for the domestic market. Since a clear majority of cigarettes consumed in Kenya are domestically produced, only a small volume of imported products supplied by a few importers had to affix tax stamps to cigarette packs before they entered the Kenya market.¹⁶

The stamps provided by the KRA were affixed at the premises of the manufacturers (either in Kenya or abroad, in the case of imports) to serve as a proof of payment. Each stamp had a serial number as well as a unique identifier for a particular type of cigarette: an orange stamp was used for filter cigarettes, and a green stamp was used for nonfilter cigarettes. The manufacturers and importers were required to submit monthly reports on the usage and stocks of these stamps.¹⁷ The new tax stamp program was accompanied by regular compliance checks and audits by the Customs and Excise Department.¹⁸

Thanks to these measures, monthly excise tax revenue in 2003 increased from K Sh 230 million to K Sh 350 million,¹⁹ and legal cigarette and cigar sales rose by 52 percent from 2003 to 2004 (Figure 19.1). The ERC also noted in a later report that these government efforts reduced the illicit cigarette trade.²⁰ In light of the positive experience with tax stamps on cigarettes, the government extended the excise stamp regime to wines and spirits in 2007 and began to consider the use of the stamps on beer, water, and juices.²¹ The stamps were initially supplied to the KRA by De La Rue of the United Kingdom and the Canadian Bank Note Company and, since 2007, by an Indian security-printing firm, Madras, that charged K Sh 2 (US\$0.023) for the printing and the delivery of each stamp.²²

¹⁵ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹⁶ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

¹⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

¹⁸ Vincent Kimosop, information obtained from the KRA on August 8, 2018.

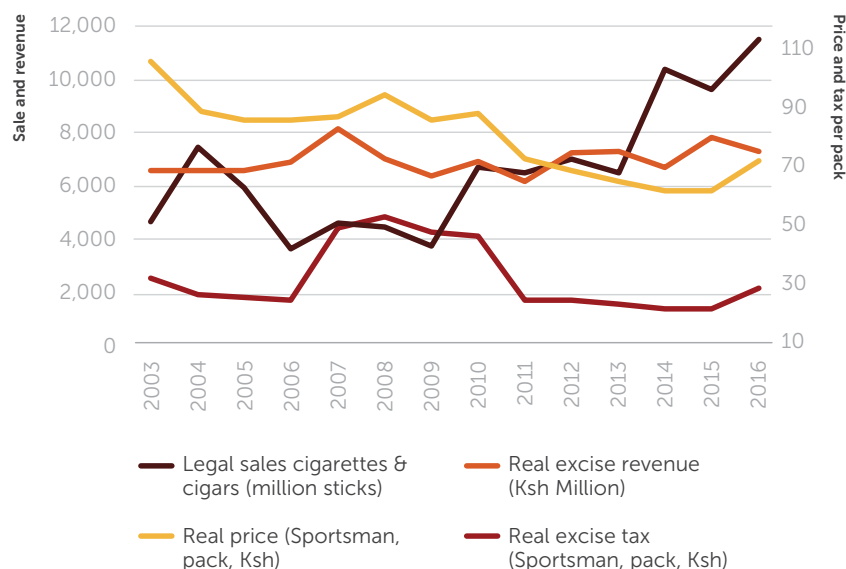
¹⁹ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala; 4 March 2013.

²⁰ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015.

²¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

²² Taxman targets contraband traders with new duty stamps; <https://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>, January 11, 2012.

Figure 1. Legal Cigarette Sales, Excise Revenue, Price, and Tax, Kenya, 2003–16



Source: KNBS 2016, 2017.
 Note: The base year is 2009.

4. Evaluation of the 2003 Measures and the Decision to Upgrade to TTS

However, within a few years, the tax stamp regime revealed weaknesses. The tax stamps were easy to counterfeit or steal; they could not be linked to a particular brand or quantity of production; and they had to be counted manually, which led to inaccuracies. These shortcomings, together with the complex tiered tax structure, made the stamps inadequate for tax accounting and for enforcement purposes.²³ When the size of the legal market began to shrink again in 2005 and then even further in 2006, it became obvious that the methods in place were not adequate to control the illicit cigarette market (see Figure 19.1).²⁴

After a long deliberation and site visits to places with advanced solutions for controlling illicit trade, such as Brazil, the KRA proposed in 2008 to implement a track and trace system (TTS) and issued a tender for the supply of such a system.^{25 26} In preparation for the tender,

²³ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

²⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

²⁵ Wahome M. Taxman targets contraband traders with new duty stamps. 11 January 2012. Available at: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

²⁶ Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

the KRA wrote a concept paper that assessed the availability of various technical solutions to address the system's loopholes and developed an effective technical specification, while paying attention to costs.²⁷

In the same year, excise tax rates were substantially increased in search of additional revenue in the midst of a political and economic crisis. Specific tax rates were increased by 40 percent and 25 percent, depending on the type of cigarette.²⁸ Even though the system still relied on specific tiered taxes, the tiers were now based primarily on the physical features of a pack and secondarily on price.²⁹

5. Temporary Measures and Cargo Monitoring

When it became obvious that selecting a TTS provider would be a lengthy process, the KRA decided to implement temporary measures. First, in 2010, it carried out a major review of the effectiveness of tax stamps.³⁰ The review strongly reaffirmed earlier concerns about serious weaknesses in the system: the stamps and serial numbers were easy to counterfeit; they were not useful for tax accounting because a stamp could not be related to a particular brand or quantity; they did not aid enforcement given the lack of universally available verification tools; and they had to be counted manually, which led to the theft of stamps in storage or in transit as well as ineffective stock management.

The KRA was ready to update the tax stamp system and was debating between the use of paper and digital technology.³¹ In the end, the agency opted for paper stamps with enhanced security features. The new stamps were serially numbered, had ultraviolet markings, the coat of arms, the KRA logo, Kenya Revenue Authority wording, and denoted the package size or products. The stamps had to be clearly visible when the pack was displayed for sale and placed on a pack in such a manner that the stamp was destroyed upon opening a pack.³² The stamps had to be verified at four points in the supply chain.³³

²⁷ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

²⁸ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

²⁹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³¹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³² Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

³³ Nargis N. Report on the economics of tobacco and tobacco control in Kenya. World Health Organization; 29 October 2012, draft; and Euromonitor, 2012.

These measures increased the cost of the tax stamp by K Sh 0.124 each, from K Sh 2 (US\$0.023) to K Sh 2.124 (US\$0.024), or K Sh 66.5 million (US\$750,000) a year.^{34 35} Thanks to the updated tax stamp regime introduced in 2010 and vigorous enforcement, the KRA closed three tobacco factories because of their failure to sell and distribute only duty-paid products and recovered at least US\$50 million in unpaid taxes.³⁶ This demonstrated the cost effectiveness of the newly adopted measures. Furthermore, the KRA closed 7 of 10 tobacco importers because of their failure to sell and distribute only duty-paid products.³⁷

The 2010 enhanced tax stamp regime was accompanied by a series of other measures designed to reduce tobacco tax evasion. As of 2010, all local cigarette manufacturers were required to be licensed, while all tobacco and cigarette importers were required to be registered with the KRA. The licenses had to be renewed annually³⁸ and required detailed disclosure of the identities of directors, inventories of the production plant and equipment, a list of all brands manufactured, information about input-output ratios, and details about accounting systems.³⁹ Failure to comply with the law was punishable by a fine of up to K Sh 1.5 million and a prison term not exceeding three years, as well as forfeiture of the goods in question.⁴⁰ In addition, the government overhauled its accounting system to track cigarette production more accurately and launched an electronic cargo tracking system (ECTS).

Newly established tax enforcement units⁴¹ deployed resident tax officers to conduct periodic checks of manufacturing facilities to determine how many production lines were active and what raw materials were being used and to compare input material with the actual output.⁴² These units discovered, for example, that Mastermind, the company with the second-largest market share in Kenya, engaged in brand misclassification to reduce tax liability. The KRA charged Mastermind K Sh 1.7 billion (US\$20 million) in outstanding taxes in August 2009.⁴³

To prevent the fraudulent declaration of cigarettes for export, any production destined for export was subject to a bond deposit in the amount of the excise tax and value added tax.

³⁴ Nargis N. Report on the economics of tobacco and tobacco control in Kenya. World Health Organization; 29 October 2012, draft; and Euromonitor, 2012.

³⁵ Wahome M. Taxman targets contraband traders with new duty stamps 11 January 2012 [14 October 2015]. Available from: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

³⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

³⁸ Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

³⁹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁰ Excise Duty. Kenya Revenue Authority. Downloaded from http://www.kra.go.ke/pdf/Excise_Duty.pdf 1/15/18

⁴¹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁴² Muthaura EK. Tobacco tax administration country experiences in Kenya. PowerPoint presentation. Workshop on Tobacco Tax Administration and Collection in Benin and Togo, 06-07 August 2013.

⁴³ ERC Group. World cigarettes. The 2010 Survey. Suffolk, ERC; 2010

The bond was only released once the goods had reached the intended destination and the excise tax had been paid according to local laws. Such country-level bilateral cooperation and information sharing also supported joint operations at the borders, including patrols.⁴⁴

The ECTS monitors cigarettes produced for export and goods in transit, with the help of new technologies. It involves oversight of the loading of all products, sealing the export vehicles to ensure that items intended for export exit the country, and tracking the cargo on route with the use of radio frequency identification to make sure that vehicles reach the intended destination without deviating from the established route. The authorities of both Kenya and the importing country jointly verify and clear all cargos at the border.⁴⁵ The ECTS also provides event information, including departure, long parking, arrival, and disarming of the seal.⁴⁶ The Chinese company Ascend provided electronic seals for the ECTS to secure container or truck doors.⁴⁷ The ECTS relies on global positioning system/general packet radio service technologies,⁴⁸ which enable data about the location of the vehicle to be sent or received at any time through digital cellular communication.⁴⁹ This ensures that trucks keep to the designated routes and reach the intended destination in a timely fashion. Any deviation in excess of 50 meters on either side of the route or tampering with the seal generates an alert sent directly to the revenue authorities.⁵⁰ Before the truck leaves the loading facilities, cargo dispatch information is sent to the relevant authority in the importing country. Any tax remissions or refunds of the excise and value-added tax are granted only after confirmation of imports is sent back by that authority to the KRA.⁵¹ The ECTS promotes intergovernmental collaboration, including joint border patrols.⁵²

⁴⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁵ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁴⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁸ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁴⁹ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵¹ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw; 9-11 December 2014.

⁵² Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

6. Impact of Cargo Monitoring and Temporary Measures

The ECTS reduces the number of checkpoints and the associated staffing needs, as well as insurance costs, thanks to improved security.⁵³ It generates an arrival report and allows revenue authorities to screen out companies that claim abnormally high tax refunds on exports.^{54 55} As a result of the ECTS, exports from Kenya to Côte d'Ivoire, Eritrea, Mali, and Sudan were discontinued⁵⁶ because some companies ceased to export cigarettes given their inability to provide evidence that the imports were received.⁵⁷ Additional evidence of the efficacy of the system was a substantial increase—up to 30 percent—in legal cigarette sales near the western border of Kenya, previously known for an illicit cigarette market supplied with products that had been declared for export.⁵⁸

The cargo monitoring system has become more important as Kenya has developed into a regional manufacturing center supplying markets in Mauritius, Rwanda, and Uganda, where British American Tobacco (BAT) had ceased local production in the 2000s. By 2013, about 26 percent of national production was being exported from Kenya.⁵⁹

The new measures addressing the illicit cigarette trade and introduced in 2008–10 paid off, as legal sales of cigarettes and cigars expanded by 67 percent in 2010 relative to 2009, and tax revenue went up as well, even though at a slower pace due to the poor tax structure and stagnating tax rates (Table 2; see Figure 1).

In July 2011, the government replaced the tiered specific tax regime with a single rate ad valorem tax regime with a specific floor set at 35 percent of the retail selling price, or K Sh 1,200 (about US\$10) per thousand cigarettes, whichever is higher.⁶⁰ The change was designed to reduce both tax evasion (the false declaration of the number of cigarettes produced in various tax categories) and tax avoidance (reducing the official retail selling

⁵³ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁴ Ngeywo CM. Senior Assistant Commissioner, Kenya Revenue Authority, Report of the meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling. Gaborone, Botswana; 3-5 June 2012. The World Bank, 2012.

⁵⁵ Ngeywo CM. Presentation to CTFK Uganda parliamentary partners, Ministry of Finance. Serene Hotel, Kampala; 04 March 2013.

⁵⁶ United Nations. United Nations Comtrade Database 2015 [16 October 2015]. Available from: <http://comtrade.un.org/data/>.

⁵⁷ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁵⁸ Ngeywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone; 3-5 June 2012.

⁵⁹ ERC Group. World cigarettes. The 2015 Survey. Suffolk, ERC; 2015

⁶⁰ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

Table 2. Excise Duty Rates, Kenya, 2003–18

INDICATOR	2003–04	2005	2006	2007	2008–10	JULY 2011– NOVEMBER 2015	DECEMBER 2015 – MARCH 2017	APRIL 2017–18	
Rates	450–1,400	495–1,540	495–1,650	500–2,000	700–2,500	1,200 or 35% of retail selling price	2,500 for filtered	2,500 for filtered; 1,800 for nonfiltered	
Tax system	4 specific progressive tiers based on price	4 specific progressive tiers based on price	4 specific progressive tiers based on price	4 specific progressive tiers based on price	4 specific progressive tiers based on price	4 specific progressive tiers based on price and pack's physical features	Uniform specific with minimum ad valorem floor	Uniform specific	2 specific tiers based on a physical feature

K Sh per 1,000

Sources: EM 2017a; ERC 2015; Government of Kenya 2015, 2017; Ngeywo 2013.

Note: July 2011: K Sh 1,200 per 1,000 or 35 percent of the retail selling price, whichever is higher (specific system with minimum ad valorem floor); the minister had the power to adjust the rates for inflation without parliamentary approval. The calculation of retail selling price has been legally challenged. December 2015: a uniform specific tax of K Sh 2,500 per 1,000. The specific rate of excise duty is to be adjusted for inflation at the beginning of every financial year. April 2017: reinstatement of the two-tiered system. The specific rate of excise duty is to be adjusted for inflation every two years.

price to qualify for a lower tax rate), while having a neutral impact on tax revenue.^{61 62 63 64} The change in the tax structure permitted a 45 percent drop in the excise tax rate on the popular mid-price brands, such as Sportsman. This caused an 8.7 percent decline in real tax revenue in 2011, while nominal revenue increased by only 4 percent. However, by 2012, revenue had recovered—a 14.2 percent increase in real terms and a 24.9 percent increase in nominal terms relative to 2011—because of reduced opportunities for tax avoidance. Legal sales rose by 0.7 percent and 3.0 percent in 2011 and 2012, respectively, while the tax yield per cigarette went up (see Figure 1). In the end, the 2011 tax reform, together with the anti-tax evasion measures, eliminated tax losses worth K Sh 1 billion (US\$11.3 million) in excise tax revenue.⁶⁵

⁶¹ Ngeywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone: 3-5 June 2012.

⁶² Nargis N, Stoklosa M, Ikamari L, et al. Cigarette Taxation in Kenya at the Crossroads: Evidence and Policy Implications. Ontario, Canada: University of Waterloo, October 2015.

⁶³ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

⁶⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁶⁵ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

In early 2012, even a representative of BAT Kenya, the market-dominant company, acknowledged a decline in the illicit cigarette market thanks to government efforts and placed the estimate of the illicit market share at 8 percent of the total market.⁶⁶ BAT particularly praised the simplified ad valorem tax system that made tax calculations easier and raised compliance.⁶⁷ Both the ERC and Euromonitor reported a drop in the share of illegal cigarettes on the market in 2012 relative to 2011. The ERC estimate was 12 percent of the total market, while Euromonitor⁶⁸ reported a range from 9 percent to 27 percent of the market (see Table 1).

7. Building up the Track and Trace System

By the end of 2012, the controls implemented by the KRA showed substantial progress in moving toward a strong TTS.⁶⁹ Excise stamps were now available in four colors to aid enforcement: orange for cigarettes longer than 72 millimeters and filtered cigarettes; light green for cigarettes equal or less than 72 millimeters and nonfiltered cigarettes; blue for imported cigarettes; and maroon for cigarettes destined for the Navy, Army, Air Force Institute, and the Armed Forces. The stamps were premarked with a unique identifier reflecting a particular type or brand of cigarettes.⁷⁰ Cigarette seizures were declining, and tobacco excise revenue was growing annually by about 20 percent.⁷¹ Nonetheless, integration into a single data-sharing point was still missing. In December 2012, after being delayed by legal issues for about five years, the KRA finally selected a provider of the TTS. A Swiss company, SICPA, won the tender and, in April 2013, signed a five-year contract with the KRA to control tobacco and alcohol products.⁷² The contract was worth close to K Sh 732 million (US\$9.5 million) annually. Other bidders included three Indian firms (Madras, Holistic, and Security Printing Press), De La Rue of the United Kingdom, Authentecs Inc. of the United States, and EDAPS of Ukraine.⁷⁴ ⁷⁵

⁶⁶ BAT does not disclose their method of estimating the size of the illicit market.

⁶⁷ Gachiri J. Agencies war on illicit cigarettes now gains ground. *The Business Daily*; 11 March 2012. Available at: <http://www.businessdailyafrica.com/-/539552/1363968/-/54i6pkz/-/index.html>.

⁶⁸ Euromonitor estimates fluctuate tremendously and are not consistent across reports published in different years. This casts serious doubt on the reliability of the Euromonitor estimates. Neither Euromonitor nor ERC discloses the method of estimating the size of the illicit market.

⁶⁹ Ngegywo CM, Kenya Revenue Authority. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. PowerPoint presentation at the World Bank meeting on the economics of tobacco control in Southern Africa: the issues of taxation and smuggling held in Gaborone: 3-5 June 2012.

⁷⁰ Customs And Excise Act. Subsidiary Legislation. Chapter 472. Revised 2014.

⁷¹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁷² Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

⁷³ SICPA, personal communication with Pierre Viaud, Senior Director Public Affairs & Government Relations on 9/8/15.

⁷⁴ Wahome M. Taxman targets contraband traders with new duty stamps. 11 January 2012. Available at: <http://www.businessdailyafrica.com/Taxman-targets-contraband-traders-with-new-duty-stamps/-/539546/1304018/-/14k7v9v/-/index.html>.

⁷⁵ Wahome M. New KRA unit sets sights on higher taxes from drinks. 13 January 2013. Available at: <http://www.businessdailyafrica.com/-New-KRA-unit-sets-sights-on-higher-taxes-from-drinks/-/539546/1664690/-/vhukr4/-/index.html>.

SICPA set up the excisable goods management system (EGMS) for tobacco and alcohol products (see Annex A). The EGMS allows for production counting, tracking and tracing products, stock control, tax revenue forecasting, tax stamp forecasting and processing, accounts management, and the collection of other business intelligence.^{76 77} This facilitates the detection of counterfeit goods, prevents smuggling, and eliminates the falsification of production volumes. The EGMS also reduces the cost of brand protection and aids production monitoring among legitimate business.⁷⁸

Implementing the EGMS requires minimum infrastructure, such as high-speed broadband Internet and a reliable telecommunication network covering the areas of the country in which TTS equipment is installed (for example, tax authority headquarters, factories, warehouses, and ports). It also needs a reliable power grid with uninterruptible power supply equipment and backup power sources (generators and inverters) at each major site at which system equipment is installed.⁷⁹

The EGMS was implemented in three phases, relying on SICPA's previous experience in Brazil. The rollout of the system took approximately 11 months, up to March 2014.⁸⁰ The first phase involved the launch of electronic digital stamps in April 2013. Each stamp has a unique identifier using a standard data matrix code, as well as multiple material security layers (see Annex B), as follows: ^{81 82 83}

- » Overt security features for authentication by the general public, such as holograms and color shifting
- » Semicovert security features for authentication in the supply chain (retailers and distributors)
- » Overt security features, such as fluorescent fibers and security ink, exclusively for the use of the tax authority for authentication during random field verification and tracing
- » Forensic taggants for laboratory authentication to support prosecution

⁷⁶ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁷⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. PowerPoint presentation. Workshop on Tobacco Tax Administration and Collection in Benin and Togo, 06-07 August 2013.

⁷⁸ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁷⁹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁸⁰ SICPA, personal communication with Pierre Viaud, Senior Director Public Affairs & Government Relations on 9/8/15.

⁸¹ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁸² Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

⁸³ Contract between the KRA and SICPA, 2015.

- » Ultraviolet fluorescent features visible under ultraviolet light
- » Anti-Stokes fluorescent prints detectable by specialized devices
- » Minitext printing revealed with a magnifying glass
- » Ultraviolet fibers visible under ultraviolet light in dry paper stamps
- » Visible two-dimensional codes for product verification, activation, and traceability by smartphones
- » Human readable codes for verification by short message service and the KRA web portal
- » Tamper-proof security cuts

This phase was completed in December 2013.⁸⁴ Thanks to these features, the new tax stamp is difficult to counterfeit or to sell to third parties.

A tax stamp that serves as proof of payment of both excise and the manufacturer value-added tax⁸⁵ is permanently associated with the product and must be affixed to each pack in such a manner that removal would make it unusable.⁸⁶

The second phase involved the automation of the control and monitoring system. Manufacturers were required to install photosensitive readers (flow meters) on manufacturing lines that automatically send detailed production data in real time to KRA servers. Each individual tax stamp affixed on the production line is activated and associated with a brand and a package size.⁸⁷ A reader can electronically scan up to 200 containers of packs on a packing line and send data on the quantity and type of products being manufactured to the KRA every 15 minutes. Such automatic and detailed counting is designed to prevent the common practice of fraudulently declaring the production of lower-taxed inexpensive cigarettes, while manufacturing more expensive brands subject to a higher tax bracket. Production line monitoring represents a game changer that shifts the burden of proof in tax liability cases from the KRA to manufacturers. It also aids tax revenue forecasting and supports the ordering and delivery of stamps to manufacturers and importers. A lot of attention is paid to data security to protect data in the central database.⁸⁸ By the end of February 2014, 25 production lines were equipped with readers and monitored.⁸⁹

⁸⁴ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

⁸⁵ Vincent Kimosop, information obtained from the KRA on August 8, 2018.

⁸⁶ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁸⁷ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁸⁸ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

⁸⁹ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

The third phase consisted of setting up market surveillance. An enforcement unit with 300 members was supposed to be formed between 2013 and 2015.⁹⁰ Instead, a market surveillance unit consisting of 83 officers was formed, 59 of whom were employed permanently. The unit focuses on all excisable goods and carries out inspections at any time and at any place in the distribution channel; it has the power to seize illicit products and arrest the offender on the spot.⁹¹⁹² The unit is equipped with handheld devices that can swipe a hidden photomagnetic line embedded in the stamp and transmit real-time data to the central KRA server. The server checks the date of issue of the stamp, the producer's name, the product category, and the brand. Using this information, it automatically verifies the authenticity of the product and the tax compliance status. This takes the human element of manual checking out of the verification process, thus eliminating mistakes and enhancing speed and integrity. The handheld device can also be used offline for the authentication of the stamp and for tracking and tracing the stamp.⁹³

8. Enforcing the New Control System

Cigarette distributors and retailers have a device that allows for the authentication of any tobacco products before accepting them into their outlets.⁹⁴ Even though distributors and retailers are not licensed, they are criminally liable if they sell products without the appropriate excise tax paid. They can be fined up to K Sh 5 million (US\$48,000) and be imprisoned for up to three years.⁹⁵ All major supermarkets participate in the system and are connected to KRA servers. The KRA also released an app in 2016 known as the KRA Stamp Checker, which allows the public to verify the genuineness of cigarettes and alcohol using mobile phones.⁹⁶

The Excise Duty Act and the Tax Procedures Act adopted in November 2015 clarified the new obligations of the manufacturers, suppliers, and importers of excisable goods.⁹⁷ All cigarette manufacturers and importers must be licensed. Failure to obtain a license is punishable by fines up to K Sh 5 million (US\$48,000) or up to three times the excise duty on goods to which the offense relates. Violators can also be imprisoned for up to three years.⁹⁸ As of May

⁹⁰ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014.

Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

⁹¹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁹² The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹³ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

⁹⁴ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

⁹⁵ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹⁶ Dennis. Hustle Yethu. How to Use KRA Stamp Checker To verify the Genuineness and Authenticity of a Product.

⁹⁷ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

⁹⁸ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

2018, only two cigarette manufacturers (BAT and Mastermind Tobacco) and 10 importers (Bridge Motivation Travel, Brockley Investments, Gemini Mart, Ibinda, Kevin International, Leaf Tobacco and Commodities, Nicentury Development Company, RG Tobacco, Simba Mbili, and Sunova Enterprises) were licensed in Kenya.

The EGMS is used for both domestic and imported products. Cigarette importers purchase electronic digital stamps in Kenya and send them to their facilities abroad, where they are affixed to each pack destined for Kenya.⁹⁹ All domestic producers and importers must activate the excise stamps online.¹⁰⁰ They become liable for excise duty at the moment of removal of the goods from the factory or at the time of importation.¹⁰¹ Tobacco products designated for export do not have tax stamps, but are marked according to the law of the importing country.¹⁰² Packs that are falsely exported and reimported into Kenya can thus be easily spotted in the Kenyan market. These goods are also subject to a tight electronic cargo monitoring system introduced in 2010.

To implement the EGMS, the KRA assembled a multidisciplinary technical team consisting of tax, information and communication technology, legal, and procurement experts.¹⁰³ Before and during the EGMS implementation, the KRA carried out critical consultations with the other two agencies that have a mandate to control the illicit tobacco trade—the Kenya Bureau of Standards (KEBS) and the Anti-Counterfeit Agency—as well as the Kenya Private Sector Alliance and other stakeholders to make sure they were kept informed and on board with the project.¹⁰⁴ This helped secure intergovernmental agency enforcement.¹⁰⁵

In 2013, the KRA signed a memorandum of understanding with the Ethics and Anti-Corruption Commission that expanded the scope of cooperation between the two agencies in combating and preventing corruption and economic crime.¹⁰⁶ In addition, the KRA developed an evaluation plan to assess the performance of the new system and a rapid intervention plan in case the rollout was not going as envisioned.¹⁰⁷

⁹⁹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁰⁰ African Tax Administration Forum. African Tax Outlook. Hatfield, South Africa: 2016.

¹⁰¹ The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

¹⁰² The Excise Duty Act, 2015, Kenya Gazette Supplement No. 181 (Acts No. 23), Nairobi, 6th November, 2015.

¹⁰³ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁰⁴ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014.

Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹⁰⁵ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁰⁶ Memorandum of Understanding Between the Kenya Revenue Authority (KRA) and the Ethics and Anti-Corruption Commission (EACC) on Combating and Preventing Corruption, Economic Crime and Unethical Practices at KRA. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹⁰⁷ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

9. Effectiveness of the EGMS

Implementing the EGMS turned out to be cheaper than the cost of the previous system, which relied on tax stamps without the track and trace capabilities.^{108 109} The total cost of printing and delivering the EGMS tax stamp was K Sh 1.50 per pack¹¹⁰ compared with K Sh 2.124 for the previous tax stamp.

The system is self-funding. Companies are paying for the photosensitive readers to be placed on their manufacturing lines and are allowed to expense this cost, thus reducing their tax liability.^{111 112}

In December 2014, the KRA introduced a 2 percent fee (the Solatium Compensatory Contribution) on the total prior year audited revenue of local manufacturers and importers according to Tobacco Control Regulations.¹¹³ This fee is used to fund tobacco control research and tobacco cessation and rehabilitation programs. BAT challenged the fee in court, but the final court decision in February 2017 sided with the KRA and allowed the fee to be levied on domestic manufacturers and importers.¹¹⁴

The EGMS was accompanied by the rollout of an iTax system, which facilitates online tax payments and helps improve income tax compliance.¹¹⁵ This reduced the cost of tax compliance and enhanced service delivery.¹¹⁶ Companies report better access to information and more rapid delivery of tax stamps.¹¹⁷

The implementation of the EGMS has led to an increase in tobacco tax revenue. The largest tax revenue rise was recorded in imported cigarettes, which increased by an incredible 4,728

¹⁰⁸ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁰⁹ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹¹⁰ SICPA, personal communication with Jérôme Duperrut, Associate Director; Public Affairs & Government Relations on 1/22/18.

¹¹¹ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹¹² Ngeywo CM. Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. Presentation at the WCTOH, Abu Dhabi. 17 March 2015.

¹¹³ Euromonitor International. Tobacco in Kenya. Euromonitor International, 2017.

¹¹⁴ Tobacco Control Fund to be set up. Feb. 24, 2017, By John Muchangi, http://www.the-star.co.ke/news/2017/02/24/tobacco-control-fund-to-be-set-up_c1512630

¹¹⁵ Remarks at the Excisable Stakeholders Forum on Excisable Goods Management. March 14, 2014. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹¹⁶ Ngeywo CM. Control of supply chain, tax stamps and other tracking technology, and enforcement: the experience of Kenya and relevance for SADC countries. Kenya Revenue Authority. Gaborone; 3-5 June 2012.

¹¹⁷ Ngeywo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015

percent from July to December 2014.¹¹⁸ Overall, 2014 tax compliance expanded by 45 percent,^{119 120} while costs went down.¹²¹

The new KRA enforcement units seized more than 300,000 illegal products from about 900 outlets and prosecuted more than 150 offenders between February and June 2014 alone.¹²² Overall, the KRA reported the seizure of 20 million cigarettes in 2014.¹²³

The evaluation of the performance of the system over a longer period is complicated by simultaneous changes in the tax rates and the overall economy (see Table 2).

The Kenya National Bureau of Statistics reported a 76 percent increase in legitimate cigarette and cigar sales from 2013 to 2016 (see Figure 1), which is clearly a result of improved tax administration, given the declining trend in smoking prevalence,^{124 125 126} the limited population growth,¹²⁷ and the relatively modest per capita growth in gross domestic product (GDP) (3.2 percent a year during this period).¹²⁸

However, the excise tax revenue from cigarettes and cigars rose only modestly during 2013–16, 22 percent in nominal terms and by less than 1 percent in real terms despite a substantial increase in the excise tax rate in 2016 (see Figure 1). Excise tax collection on beer rose by 16 percent (6 percent in real terms) and on wine and spirits by 103 percent (36 percent in real terms) during the same period, with an unchanged tax rate during that time.^{129 130 131}

In fiscal year 2016/17 (July 2016–June 2017), excise tax revenue on beer and tobacco grew 13.3 percent, while excise tax revenue on spirits grew by 22.7 percent. The KRA attributes this

¹¹⁸ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹¹⁹ Euromonitor International. Tobacco in Kenya. Euromonitor International, 2015.

¹²⁰ African Tax Administration Forum. African Tax Outlook. Hatfield, South Africa: 2016.

¹²¹ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹²² World Health Organization (WHO). WHO Report on the Global Tobacco Epidemic, 2015: Raising Taxes on Tobacco. Geneva: World Health Organization, 2015.

¹²³ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹²⁴ Central Bureau of Statistics (CBS) [Kenya], Ministry of Health (MOH) [Kenya], Macro O, 2004. Kenya Demographic and Health Survey 2003. CBS, MOH, and ORC Macro., Calverton, Maryland.

¹²⁵ (KNBS) KNBS, International I. Kenya Demographic and Health Survey 2014. Calverton, Maryland: KNBS and ICF International. 2014.

¹²⁶ WHO report on the global tobacco epidemic, 2017: monitoring tobacco use and prevention policies. Geneva: World Health Organization; 2017.

¹²⁷ Kenya National Bureau of Statistics, Ministry of State for Planning, National Development and Vision 2030. 2009 Kenya National Population and Housing Census: Population Dynamics. Nairobi, Kenya: KNBS, 2012.

¹²⁸ Tradingeconomics. World Bank. Updated on June of 2018. <https://tradingeconomics.com/kenya/gdp-per-capita>.

¹²⁹ Kenya National Bureau of Statistics (KNBS). Economic Survey 2016. In: Production Statistics, Macroeconomic Statistics, Strategy and Development, Finance and Administration, Population and Social Statistics, Information and Communication Technology, editors. Nairobi: KNBS; 2016. p. 123.

¹³⁰ John M. Mutua. A citizen's handbook on taxation in Kenya. Institute of Economic Affairs, 2012.

¹³¹ Alcoholic Drinks in Kenya. Euromonitor International. August 2017.

growth to enhanced compliance thanks to the EGMS.¹³² The International Monetary Fund has also praised Kenya for the implementation of the EGMS and iTax, which contributed significantly to a marked improvement in fiscal year 2016/17 revenue collection.¹³³

Given this favorable performance, the EGMS was expanded on November 1, 2017, from tobacco, wine, beer, and spirits to bottled water, juices, soda in PET containers, energy drinks, other nonalcoholic beverages, food supplements, and cosmetics.¹³⁴

In the context of the extension of EGMS to other excisable products, the cost of an EGMS stamp charged by the system provider and collected from the tobacco industry increased from K Sh 1.50 per pack to K Sh 2.80 per pack.¹³⁵ However, this still represented only around 2 percent of the retail price of the most widely sold brand. The KRA continuously reviews the performance of the EGMS, ensuring the robustness and stability of the system.¹³⁶

In 2017, the KRA initiated the launch of a new state-of-the-art integrated customs management system. When fully implemented, the system will provide best-practice features, including cargo value benchmarking to address undervaluation, the self-adjustment of valuation, automatic stock management, the auto-upload of cargo import data from shipping manifests to prevent import falsification, and the auto-exchange of information with iTax to counter noncompliant traders. This will ensure that correct quantities are reported and that tax liabilities are properly assessed by integrating the data provided by various tax departments and the taxpayers.¹³⁷ Before the system is fully functional, the Simba system, supported by a few functions of the integrated customs management system, is handling cargo transactions.¹³⁸ These systems are helping the KRA to add a large number of new taxpayers into the database and strengthening the collection of other taxes.¹³⁹

The KRA has already deployed three more scanners to enhance the nonintrusive inspection of cargos at the port of Mombasa. The personnel managing the scanning function are not involved in the analysis and interpretation of the scanner images, to eliminate a motivation for undue influence.¹⁴⁰ The KRA plans to employ technology that both scans and objectively interprets the images.¹⁴¹

¹³² Annual Revenue Performance FY 2016/2017. KRA Press release 20th July, 2017. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹³³ Kenya. IMF Country Report No. 17/25, International Monetary Fund. January 2017

¹³⁴ Public Notice. Excise Stamps on Bottled Water, Juices, Soda, other Non-Alcoholic Beverages and Cosmetics. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>.

¹³⁵ SICPA, personal communication with Jérôme Duperrut, Associate Director; Public Affairs & Government Relations on 1/22/18.

¹³⁶ Ngeyo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹³⁷ Annual Revenue Performance FY 2016/2017. KRA Press release 20th July, 2017. Downloaded from <http://www.revenue.go.ke/index.php/notices/speeches/1/11/18>

¹³⁸ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹³⁹ Kenya. IMF Country Report No. 17/25, International Monetary Fund. January 2017.

¹⁴⁰ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴¹ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

Despite these efforts, the KRA reported a rise in illicit tobacco trade activities in April–December 2017.¹⁴² The KRA attributes this increase to the prolonged election campaign and related political tensions, coupled with an economic slowdown. During the election campaign, the police were focusing on maintaining the overall peace, thereby paying less attention to the enforcement of anti-illicit trade measures. As a result, excise revenue declined by 9.9 percent in July–December 2017 compared with the same period in the previous year.¹⁴³ This points to the importance of constant vigilance and enforcement in the fight against illicit trading.

10. Discussion

Even though the government faces public management challenges in general, it was able to harness political support to adopt and implement the strengthening of tobacco tax administration. Its approach to controlling illicit trade evolved from piecemeal measures to a comprehensive system of controls. This was an important development because addressing various aspects of the illicit market in isolation had only a short-term effect.¹⁴⁴ In addition, the costs of the EGMS were lower relative to the costs of the previous disjointed system.

The implementation of a comprehensive system required a systematic approach, stakeholder participation, and an initial investment in infrastructure and enforcement.¹⁴⁵ However, the costs of the system, including the upfront costs, were covered by the tobacco industry.

It was important to communicate the benefits of the system to all stakeholders and to demonstrate that the system protects various interests, including business interests, because it aids brand protection and production monitoring for legitimate businesses.¹⁴⁶

It was vital that the EGMS should create a permanent association between the product and the code and the stamp and that this stamp should be unusable after first use. Expanding enforcement beyond the KRA by facilitating the participation of the public and retailers and distributors helped in monitoring the system's performance and reduced the opportunities to distribute illicit products. Conducting frequent enforcement checks and the ability to obtain evidence of violations on the spot without a requirement for additional authentication promote efficient and cost-effective enforcement.

¹⁴² Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴³ Revenue data 2016 – 2017. Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁴⁴ Muthaura EK. Tobacco tax administration country experiences in Kenya. Workshop on Tobacco Tax Administration and Collection in Benin and Togo; 06-07 August 2013.

¹⁴⁵ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

¹⁴⁶ Ngeywo CM, Kenya Revenue Authority. Implementation of a Track and Trace System for Tobacco in Kenya. PowerPoint presentation at the Multi-Sectorial Workshop on the adoption of the Protocol to eliminate illicit trade in Tobacco Products for ASEAN Countries held in Naypyitaw: 9-11 December 2014.

Another important feature of the system is the limited human involvement in daily operations and data security. For example, production data are gathered without any input from manufacturers, and the data collected during an inspection are automatically transmitted to the central server once a product code is scanned. This prevents errors and system manipulation.

The system is continuously monitored and reviewed to ensure its robustness, stability, and ability to deal with possible mutations in tax evasion schemes.¹⁴⁷ It also provides input for future system upgrades such as tracking and aggregation, which are not currently supported.¹⁴⁸

The EGMS has limitations. It has a restricted capacity to check counterfeit cigarettes unless they are distributed over official retail channels. This is exacerbated by the fact that the Anti-Counterfeit Agency has sufficient resources to operate only in three cities: Kisumu, Mombasa, and Nairobi.¹⁴⁹ However, counterfeit products are responsible for only about 10 percent of the tax evasion in Kenya.¹⁵⁰

To address this weakness, the KRA recommends that the track and trace solution be extended to cover the whole cigarette supply chain up to retail. The KRA also wants to explore the feasibility of using the TTS on individual cigarettes instead of packs.¹⁵¹ Such measures should improve excise revenue growth, which seems to be lagging behind the growing size of the legal market.

There is weak coordination and limited data sharing between the three government agencies in charge that have overlapping mandates (the KRA, the Anti-Counterfeit Agency, and the Kenya Bureau of Standards).¹⁵² These institutions should be allowed to prosecute on behalf of each other given that they perform similar roles in dealing with the illicit tobacco trade. They should also harmonize their penalties: they are currently applying different penalties for similar offenses.¹⁵³

The law does not allow for penalties that are sufficiently punitive to deter the illicit trade. Most of the laws tie fines to the value of seizures or fail to define minimum fines. For example, illicit traders engaging in small-quantity, but high-volume trade may receive only small fines. This lack of punitive fines constrains efforts to curb the illicit cigarette trade in Kenya.¹⁵⁴ To correct this, the law should be amended to follow the principles outlined in the Protocol to Eliminate Illicit Trade in Tobacco Products.

¹⁴⁷ Ngeyo CM, Kenya Revenue Authority. Kenya's experience in implementing and financing a tracking and tracing system. PowerPoint presentation at the World Conference on Tobacco Control or Health, Abu Dhabi. 17 March 2015.

¹⁴⁸ Contract between KRA and SICPA, 2015.

¹⁴⁹ Kenya Institute for Public Policy Research and Analysis. Factsheet: illicit trade in tobacco products in Kenya. May 2014.

¹⁵⁰ Ngeyo CM, Ministry of Finance. PowerPoint presentation on April 18th, 2017, Washington DC.

¹⁵¹ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁵² Euromonitor International. Cigarettes in Kenya. Euromonitor International, 2016.

¹⁵³ Kenya Revenue Authority, communication with the World Bank, 6/08/18.

¹⁵⁴ Kenya Institute for Public Policy Research and Analysis. Factsheet: illicit trade in tobacco products in Kenya. May 2014.

The KRA should also receive more funding and other support in carrying out enforcement operations. For example, the originally envisioned 300-member enforcement unit was shrunk to 83 officers, and only 59 of these officers are employed permanently. These officers are in charge of all excisable goods, not only tobacco.

Kenya and its neighbors would clearly benefit from a region-wide solution. The KRA is therefore engaging in a dialog on possible collaboration within the East African Community. The KRA has proposed tax harmonization within the community that has both short-term and long-term components, such as the harmonization of tax structures (that is, adopting specific tax regimes and a single tax description for all types of cigarettes) and the harmonization of rates to avoid disparities in tax incidence.¹⁵⁵

Even though the KRA reports that the illicit cigarette market declined from 15 percent of the total market in 2003–13 to 5 percent after the implementation of the EGMS,¹⁵⁶ the methodology of generating these estimates is not publicly available. The KRA would benefit from the regular generation of estimates of the size of the illicit cigarette market using a transparent methodology. Because a pack of cigarettes in Kenya carries distinctive and secured features, there are multiple methods available to study the size of and changes in the illicit cigarette market.¹⁵⁷ Such a study could be outsourced to an academic or interdisciplinary research institution not associated with the tobacco industry. Given that each of the methods has strengths and weaknesses, two or more methods should be simultaneously employed to cross-verify the results. Estimating the size of the illicit cigarette market would enhance the capacity of the government and others to evaluate the EGMS's performance.

TTSs such as the one adopted in Kenya are the key requirement of the World Health Organization's (WHO) FCTC Protocol to Eliminate Illicit Trade in Tobacco Products. Even though Kenya is not a party to the Protocol (although the government signed the Protocol in December 2013), its experience demonstrates that even a lower-middle-income country has the capacity to implement such a system successfully. This can encourage other countries to sign and ratify the Protocol, which came into force in September 2018 after being ratified and acceded to by more than 40 states. The presence of TTSs in more countries will only enhance the effectiveness of such systems.

The government of Kenya must remain vigilant to protect the country's market from illicit tobacco products and to continue to reduce smoking prevalence. Despite the recent successes on both fronts, there is room for improvement. The excise tax structure and the excise tax level still do not comply with the FCTC Article 6 guidelines. Given the system

¹⁵⁵ Ngeywo CM, Ministry of Finance. PowerPoint presentation to CTFK Uganda parliamentary partners held at Serene Hotel, Kampala: 4 March 2013.

¹⁵⁶ Ngeywo CM, Ministry of Finance. PowerPoint presentation on April 18th, 2017, Washington DC.

¹⁵⁷ Hana Ross. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486 http://www.tobaccoecon.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Understanding-and-measuring-tax-avoidance-and-evasion-A-methodological-guide1.pdf

established to control the illicit trade, the government should not allow the existence of illicit trade to be used as an excuse for not pursuing more vigorous tobacco tax reform. That tax reform should draw on the key reform elements recommended by the World Bank on the basis of evidence from a broad variety of low , middle-, and high-income countries. These policies are highlighted in catchwords and phrases, such as go big, go fast; attack affordability; change expectations; and tax by quantity.

If these principles are followed, the tobacco-related death toll will eventually start declining. Such statistics draw attention to the public-health aspects of tobacco control that should not be neglected, despite the importance of the revenue-generating potential of many tobacco control measures such as the fight against the illicit trade.

SENEGAL

21

SENEGAL:

Addressing Illicit Tobacco Trade

Mayoro Diop and Aboubakry Gollock¹

Chapter Summary

Senegal, like all member countries of the West African Economic and Monetary Union (WAEMU), is a signatory to the Protocol to Eliminate Illicit Trade in Tobacco Products (the Protocol). In recent years, Senegal has launched major legislative, regulatory, and tax reforms to curb tobacco consumption. Senegal is often considered to be at the forefront of the fight against tobacco and its illicit trade within WAEMU and the Economic Community of West African States (ECOWAS). It is important to assess, however, whether Senegal is seizing all opportunities at its disposal to combat illicit tobacco flows.

The analysis shows achievements but also insufficiencies in Senegal's implementation of the Protocol to date. A delay has occurred, notably, in implementing Law No. 2014-14, of March 28, 2014, on the manufacturing, packaging, labeling, sale, and use of tobacco.

On the one hand, for example, the indication "Sale in Senegal" must now appear on all cigarette packages sold in the country, and the mandatory inclusion of health alerts on packaging is already in force. On the other hand, the absence of a robust traceability system

¹M. Diop (Formerly with the National Agency for Statistics and Demography, and the National School of Statistics and Economic Analysis, Senegal) & A. Gollock (Faculty of Economics and Management, Cheikh Anta Diop University, Senegal).

constrains the fight against illicit tobacco. Stamps or vignettes are not yet used to facilitate tracking and tracing. Nor is there a rigorous control system to monitor tobacco companies' product inventories and exports.

Senegal's Ministry of the Economy, Finance and Planning has set up a mixed enforcement brigade to tackle illicit tobacco trade, bringing together the Directorate General of Customs and the Directorate General of Taxes and Domains. However, substantial implementation challenges remain. For example, there are as yet no specific data collection provisions regarding seizures of illicit tobacco products. Accordingly, documentation of these operations is inconsistent.

Moreover, tobacco product seizures are perceived as unproductive by the customs and tax-administration agents charged to carry them out. The seizures do not give rise to incentive bonuses for enforcement personnel, leaving agents with little motivation to pursue perpetrators. There is also no formal mechanism for inter-ministerial coordination in the fight against illicit tobacco. Expertise and knowledge sharing for the implementation of the Protocol are limited. Rigorous monitoring of the illicit tobacco trade using appropriate indicators is lacking; strengthened monitoring is crucial to appreciate the problem's magnitude and track trends. At subregional and regional levels, joint initiatives to tackle illicit tobacco remain rare. To effectively combat the illicit trade, rigorous control mechanisms across the entire supply chain, international technical and judicial cooperation, and appropriate criminal and civil sanctions should be put in place.

The recommendations of this analysis primarily focus on: effective application of the anti-tobacco laws currently in place in Senegal; further reform of existing legislation; development of the tracking and tracing system for tobacco products; enhancement of governance as a means to combat illicit trade in tobacco; data collection and research; and regional/subregional coordination and cooperation on illicit trade. Specific recommendations include:

- » Accelerate full implementation of Law 2014-14 on the manufacture, packaging, labeling, sale, and use of tobacco products.
- » Improve existing mechanisms for coordinating interventions, national players, and technical and financial partners on the basis of recognized best practices, some of which are set forth in the Protocol.
- » Establish a robust tracking and tracing system to monitor all stages of the production, distribution, sale, and use of tobacco products.
- » Prepare detailed estimates of the scope of illicit tobacco trade in Senegal, and its economic and public-health impacts, to provide decision makers with reliable evidence for policy.
- » Advocate with WAEMU and ECOWAS Member States to promote regional cooperation in the fight against illicit tobacco.

Introduction

Illicit trade in tobacco products is a global problem. It threatens the health of populations, promotes criminality, reduces tax revenues, increases health expenditures, and causes other negative effects (WHO 2017). The fraudulent sale of tobacco products is estimated to be equivalent to 10-12 percent of global cigarette consumption and costs some US\$40 to 50 billion per year in lost revenues (WHO 2015). Illicit trade in tobacco products encompasses multiple challenges in the fields of public health, public finances, and national and regional security.

In recent years, Senegal has undertaken a number of initiatives to reform its tobacco taxation system. Specifically, Senegal, like all other West African Economic and Monetary Union (WAEMU) member countries, is a signatory to the Protocol to Eliminate Illicit Trade in Tobacco Products adopted at the fifth session of the Conference of the Parties to the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), on November 12, 2012.

1. Methodology

1.2 Estimation of Illicit Trade

Measuring the scope of illicit trade in tobacco products in Senegal is a complex exercise owing to the sensitivity of the data and data availability problems. For Ross (2015), two aspects are particularly important: the research methods on the quantification of illicit trade in tobacco and the criteria for assessing the reliability of articles on this subject.

This analysis uses a method of estimating illicit tobacco trade based on the Blecher approach (2010). The data from the 2015 GATS survey were used to estimate the total consumption of cigarettes in Senegal. The method calculates the total consumption of cigarettes and then adjusts this data for the known legal market to estimate the unknown illicit market.

1.3 Assessment of Readiness to Implement the Protocol

To assess Senegal's results (compliance, progress, innovations) in combating illicit trade in tobacco, this analysis applied the self-assessment checklist of the Protocol to Eliminate Illicit Trade in Tobacco Products to Senegal.

This checklist was supplemented by a questionnaire administered to the main entities involved in combating tobacco in general, and illicit trade in particular, in Senegal.

This analysis also conducted audits and data collection and verification operations (data triangulation and/or process analyses) with the following entities: the tobacco industry (Manufacture of West African Tobacco and Philip Morris), the Ministry of Economy, Finance and Planning (specifically the General Directorate of Customs and the General Directorate

of Taxes and Public Lands), the Ministry of Trade, the Ministry of Health, the Tobacco Control Unit, and civil society organizations. This made it possible to verify whether, in its practices, mechanisms, and existing laws, Senegal respects the measures recommended by the Protocol to Eliminate Illicit Trade.

2. Results

2.1 Tobacco Use and Public Health in Senegal

Tobacco use is one of the main causes of avoidable death in the world. It is a major risk factor for cancers; cardiovascular diseases such as hypertension, coronary heart disease, myocardial infarction, and strokes; and many other diseases (WHO 2017).

Studies on the prevalence of tobacco in Senegal focus primarily on ad hoc surveys and often a specific segment of the population.

The Global Adult Tobacco Survey (ANSD 2015), carried out among the adult population (15 years of age and over) using a random sample of 4,514 representative households, has provided the most reliable figures to date on the prevalence of tobacco use in Senegal. It shows that 6.0 percent of the adult population consumes tobacco products, 11.0 percent of men and 1.2 percent of women. 0.7 percent of the adult population uses smokeless tobacco, with women constituting the largest proportion of this market at 1 percent, as against 0.3 percent for men. Tobacco use is more prevalent among the most active and productive segment of the population (25-64 age group), usually the parents of the youngest group (0-15 years).

Questions on tobacco use were included in the STEPwise survey (ANSD 2016) that was conducted among the population aged 18 to 69 years across the entire country in order to identify and monitor risk factors for non-communicable diseases. The survey was carried out on the basis of a nationally representative three-tiered stratified random sample of 6,306 individuals and took account of respondents' residential milieu (urban and rural). The results generally confirm those obtained by the GATS (2015) on the prevalence of tobacco use in Senegal. Overall tobacco consumption was found to be 5.9 percent, with 15.6 percent of men and 0.4 percent of women reporting tobacco use.

The Global Youth Tobacco Surveys (GYTS 2002, 2007), carried out in schools across the country, focused specifically on adolescents between the ages of 13 and 15. Although relatively dated, these surveys provide information on broad trends in the prevalence of tobacco use in this segment of the population, changing consumption patterns, and the issues and challenges of combating tobacco consumption now and in the years ahead. The survey shows that the proportion of children who smoked their first cigarette before the age of 10 increased from 19.3 percent in 2002 to 25.9 percent in 2007 (GYTS, 2002, 2007). In 2002, 13.2 percent of schoolchildren (boys: 20.2 percent, girls: 4.4 percent) smoked cigarettes and 5.4 percent (boys: 7.3 percent, girls: 2.9 percent) consumed other tobacco products. In

2007, 7.5 percent of schoolchildren (boys: 12.1 percent, girls: 2.7 percent) smoked cigarettes, a decrease of about 6 percentage points compared to 2002. However, consumption of other tobacco products, such as shisha, rose from 5.4 percent to 9.3 percent (boys: 11.7 percent, girls: 7 percent). Since 2007, this trend seems to be confirmed among teenagers in Dakar. Outings to smoke shisha are in fashion, and during social gatherings among young people in the capital, shisha is widely consumed. The trend is so persistent and worrying that the authorities have taken steps to restrict consumption in some places frequented by young people.

Of particular concern, comparing the results of the two surveys shows an upward trend in the proportion of young people who wanted to begin smoking, rising from 15.6 percent in 2002 to 31 percent in 2007. This increase was significant both for girls (13.9 percent to 27.7 percent) and for boys (17.7 percent to 37.2 percent)

All surveys also indicate that exposure to tobacco smoke remains high in Senegal: 30.4 percent of adults are exposed in their workplace, 20.6 percent at home, and 20.8 percent in restaurants (GATS 2015). The GYTS data (2002, 2007) show that at least one child in five has at least one parent who smokes. In 2002, 45.8 percent of schoolchildren lived in houses where other persons smoked in their presence, and more than six out of ten (62.6 percent) were exposed to tobacco smoke outside their place of residence. In 2007, 47.6 percent of GYTS respondents lived in a house where other persons smoked in their presence, an increase of approximately two percentage points from the 2002 level.

Senegal, like most developing countries, has an epidemiological transition model characterized by the coexistence of infectious diseases and non-communicable diseases (NCDs). Some authors expect that 46 percent of deaths in sub-Saharan Africa will be linked to NCDs by 2030 (Gaylin et al. 1997; WHO 2004). The results of the STEP survey do not establish a direct causal relationship between the current prevalence of smoking and that of NCDs in Senegal. Nevertheless, it is amply demonstrated in the scientific literature that tobacco is a risk factor that exacerbates major chronic NCDs. The results of the survey show that hypertension, which can be related to or aggravated by smoking, affects 24 percent of Senegal's population, with women who smoke heavily being more affected. According to the cancer country profile prepared by the WHO for Senegal (2004), smoking, physical inactivity, obesity, and household solid fuel use constitute the main risk factors for cancer among adults in Senegal.

Beyond these chronic illnesses, the analysis of the effects of tobacco on public health in countries such as Senegal must take into account other diseases such as tuberculosis, AIDS, and maternal and infant health problems. These are public-health problems that have a disproportionate impact on the countries of the subregion. The link between their progress and tobacco consumption is well established today, but there are no specific studies on these issues in Senegal. In terms of the relationship between tobacco and maternal and infant health, it is established that smoking is the main factor in modifiable morbidity and mortality risks associated with pregnancy (CalEPA 2005; Cnattingius 2004). The challenge for Senegal is to reduce the passive smoking of women of childbearing age. Smoking prevalence among

Senegalese women is very low. However, women are commonly exposed to second-hand smoke in their families. This makes them vulnerable to the negative health effects of tobacco during pregnancy and after childbirth. Infertility and ectopic pregnancies are more frequent among women who smoke (Cnatingius 2004). A review of the work of Guérin et al. (2006) indicates some effects of passive smoking on women and babies, including: low birth weight, sudden infant death syndrome, and premature delivery. A meta-analysis by Pattenden et al. (2006) indicates that prenatal exposure to tobacco smoke also results in respiratory problems for the baby, regardless of postnatal exposure.

To date there have been no studies assessing the impact of illicit trade in tobacco on the prevalence of smoking and the health of the population of Senegal.

2.2 Senegal Targeted by Tobacco Companies

Sub-Saharan Africa is increasingly targeted by tobacco producers and distributors in their strategy to expand and penetrate developing-country markets. Conditions favorable to the implantation of tobacco firms are present in these countries, including: rapid economic growth, demographic expansion, young populations, weak anti-tobacco legislation, porous borders, the existence of free-trade zones, and low tobacco risk aversion among government authorities compared to those in industrialized countries.

Senegal's geographic and strategic position make it a special target for tobacco industry efforts to better penetrate the African market. An analysis of tobacco import and export tables shows that Senegal plays a key role in the industry's strategy for supplying the subregional market and the continent as a whole with tobacco products (Annexes 1 and 4). The culmination of the tobacco industry's strategy for penetration into Senegal was the implantation of the multinational firm Philip Morris in the country in 2007, with the support of the Senegal Investment Promotion Agency (APIX). Since the arrival of Philip Morris, national production of cigarettes has grown steadily. Its value rose from US\$ 126 million in 2012 to US\$ 172.4 million in 2015, a 36.8 percent increase. A similar trend has been seen in the export of tobacco products from Senegal to other African countries following processing of the imported raw tobacco (Annex 1).

Analysis of the changes in the prevalence of tobacco use and the strategies of the tobacco companies in Senegal show disturbing trends. If not reversed, these patterns risk making the country fertile ground for the expansion of domestic tobacco consumption and for rising exports of tobacco products to the rest of continent.

2.3 Tobacco Control in Senegal

Tobacco control in Senegal is governed by national laws and subregional community provisions (involving those of WAEMU and the Economic Community of West African States, ECOWAS), as well as international treaties, including the Protocol to Eliminate Illicit Trade in Tobacco Products.

National measures. At the national level, Senegal has taken a number of recent anti-tobacco measures (Annex 2). Law No. 12/2014 of March 14, 2014, on the manufacture, packaging, labeling, sale, and use of tobacco has entered into effect. Likewise, the new General Tax Code (2013) has made improvements to the country's tobacco tax legislation with the establishment of a higher ad valorem tax ceiling (45 percent), the elimination of the distinction between premium and economy brands, and the introduction of a minimum price for the tobacco tax base. While these steps are important, Senegal's policy of a 45 percent ad valorem ceiling on tobacco taxes conflicts with more recent directives by other bodies which draw on the FCTC. In practice, taxes on cigarettes and other tobacco products in Senegal remain relatively low, at 38 percent of average retail price (WHO 2017:138). To date, tax reforms and other tobacco control measures have not achieved the desired effects on tobacco consumption in the country. This gives added importance to initiatives now being undertaken by the subregional economic communities in which Senegal participates.

Subregional efforts. Overall, Senegalese law, except with respect to exemptions, is compliant with WAEMU provisions on tobacco taxes, particularly Directive No. 03/98/CM/WAEMU of December 22, 1998, harmonizing the excise tax laws of the Member States, as amended by Directive No. 03/2009. However, it should be noted that, as of this writing, the tobacco tax rates and structures operative in WAEMU and ECOWAS have remained suboptimal compared to those applied in countries that have recorded the most significant results in their anti-tobacco efforts, such as the United Kingdom, France, and Canada. Efforts are underway to strengthen tobacco control within these subregional organizations.

In October 2017, regional experts validated the draft harmonization of laws establishing a system for tracking, tracing, and tax audit of tobacco products manufactured or imported in ECOWAS Member States. The draft directive aims to harmonize relevant laws and regulations in the Member States to facilitate the smooth functioning of the internal tobacco-product market. The model calls for ECOWAS Member States to establish and maintain a unified track-and-trace system for all tobacco products imported or produced in the territory using a unique identifier. Once adopted, the directive will also oblige ECOWAS Member States to ensure that all economic operators involved in the trade of tobacco products (from the manufacturer to the last economic operator before the first point of sale) record the entry of all unit packets in their possession, as well as all the intermediate movements and the final output of unit packets from their possession. However, the project has not yet been adopted by most of the organization's Member States.

The Government of Senegal is among the parties to the draft ECOWAS directive that recommends the elimination of all tax exemptions on tobacco products and the mandatory application of a combination of ad valorem taxes (50 percent minimum), price applied by the manufacturers (price exit factory), and specific taxes (US\$ 0.20 per package of 20 cigarettes).

Harmonizing ECOWAS and WAEMU approaches. An important challenge will be the adoption and transposition of this draft ECOWAS directive into the national laws of the WAEMU

countries. The WAEMU countries (also members of ECOWAS) are generally more inclined to transpose WAEMU directives into their national tax legislation than ECOWAS directives. A second challenge is for Senegal, as a member of these two regional organizations, to assert its right to apply the maximum ECOWAS rate, which is 100 percent of the price applied by the manufacturers (price exit factory), and to induce other countries to align with it for the upward harmonization of tobacco taxes toward the ECOWAS and WHO target rates. A third ongoing challenge is the production of scientific evidence taking account of national and regional socioeconomic and health realities to assess the real and potential impact of the application of tobacco control policies in general, as well as policies to reduce the expansion of illicit trade in tobacco. A fourth concern is the involvement of key stakeholders in the production of this information and the establishment of sustainable cooperation mechanisms, so that the evidence generated can continue to inform the choices of decision makers and promote change.

Global initiatives. At the international level, Senegal is a signatory to the Protocol to Eliminate Illicit Trade in Tobacco Products. This treaty was adopted in November 2012 in Seoul and then opened for signature on January 10, 2013, at WHO headquarters. The Protocol implements Article 15 of the WHO FCTC, which sets out the main measures to be implemented to effectively control illicit trade in tobacco products. The commitment to adopt a more restrictive instrument in this area was raised at the first Conference of Parties to the FCTC. It arose out of evidence of the scope of illicit traffic in tobacco products (more than one cigarette in ten around the world) and the resulting particularly significant challenges in terms of tax revenues, the effectiveness of public health policies, and the effectiveness of policies to combat organized crime.

The Protocol aims to eliminate all forms of illicit trade in tobacco products by means of a series of measures to be taken by countries individually or in cooperation with other countries. The prevention of illicit trade focuses on:

- » Securing the supply chain of tobacco products through a series of measures that form the “heart” of the Protocol, such as the tracking and tracing regime for tobacco products;
- » Establishing a global tracking and tracing regime within five years of the Protocol’s entry into force, comprising national and regional tracking and tracing systems and a global information-sharing hub located within the Secretariat of the Convention;
- » Introducing other provisions to ensure control of the supply chain, including licensing and record-keeping requirements, as well as the regulation of internet sales, duty-free sales, and international transit.

Other significant parts of the Protocol deal with due diligence, international cooperation, and enforcement. The Protocol sets out the general obligations of the Parties (Article 4), measures on supply chain control (Articles 6 to 13), offenses (Articles 14 to 19), and international cooperation (Articles 20 to 31).

2.4 Public Health, Tax, and Security Challenges in the Illicit Tobacco Trade in Senegal

Illicit trade in tobacco products entails a number of challenges, particularly relating to public health, public finances, and national and regional security.

PUBLIC HEALTH CHALLENGES

In the area of public health, it must be stressed from the outset that the consumption of tobacco products is dangerous for the population, whether these products are sold legally or illegally, or whether they are genuine or counterfeit. Smoking kills more than half of its confirmed users prematurely, by an average of over 10 years (Peto and Jha 2014). All tobacco products are harmful to health.

However, smuggling, counterfeiting, and the illegal manufacture of tobacco products are aggravating factors for public health and constitute additional obstacles to the achievement of tobacco control policy objectives. Illicit products, which are sold on formal and informal markets, are offered at lower prices, making them more accessible to the population. The development of illicit trade thus counteracts the impact of smoking disincentives and anti-smoking campaigns, particularly those targeting the youngest and most vulnerable populations. In addition, contraband tobacco products sold in Senegal do not typically display the dissuasive health warnings introduced in the country following the enactment of the new anti-tobacco law. This is the case, for example, with several cigarette brands sold in Senegal's border areas, which do not respect the prevailing laws on packaging. Distributors of illicit tobacco products generally have a greater propensity to violate the restrictions on the sale of tobacco to minors in comparison with licensed distributors, precisely because of the informal nature of their marketing channels. The size of the informal sector tends to exacerbate this situation in the WAEMU countries. Finally, illicit trade in tobacco products is responsible for a shortfall in government revenues that could be used to finance public policies, including health policies.

No study has yet evaluated the impact of eliminating illicit tobacco trade on public health in Senegal. However, estimates indicate that the elimination of the global illicit trade in cigarettes would save more than 160,000 lives each year worldwide, starting from 2030 (Joossens and Raw 2009).

TAX ISSUES

Although tobacco products are dangerous, their production and marketing bring in tax revenues to the Government of Senegal. For example, in 2013, the Government collected approximately US\$ 26 million in excise taxes and US\$ 15.2 million in VAT, for a total of about US\$ 40.3 million. In 2016, excise taxes totaled some US\$ 28.4 million and VAT some US\$ 16 million, for a total of US\$ 44.4 million (see Annex). The development of the illicit trade in

tobacco products reduces the Government's ability to expand the tax base and collect taxes on tobacco products. It blunts the expected boosting impact of higher taxes on tax revenues.

Another significant tax challenge related to illicit trade is the concern that smuggling has been used by the tobacco industry to gain leverage with governments for access to their markets under tax concessions (Legresley et al. 2008) or to limit proactive tax measures in countries' anti-tobacco efforts. The tobacco industry often uses the Senegalese press to "warn" national authorities and the population of the supposed risks of rising illicit trade in tobacco following tax increases. This strategy likely aims to delay decisions on major tax reforms that could reduce tobacco consumption in the country. One solution is to enhance controls and implement sufficiently dissuasive sanctions to discourage any inducement to illicit trade.

SECURITY CHALLENGES

The Sahel zone, in which Senegal and the other WAEMU countries are located, faces significant security challenges.² These include inadequate surveillance of the cigarette supply and distribution chains, but also a range of other worrying conditions: rampant terrorism, regional vulnerability to war, widespread financial and political crime, porous borders, ineffective law enforcement, insurrectionist movements in some areas, all complicated by endemic poverty and corrosive corruption.

Illicit trade can flourish in this fertile ground through the operation of criminal networks and potentially terrorist organizations that are harmful to public and international security. The proceeds from the smuggling of cigarettes are laundered and used to finance the activities of such networks. Meanwhile, key tobacco control measures, notably including higher excise taxes on legally traded tobacco products, create potential profit margins for tobacco smugglers, alongside these measures' powerful health and social benefits.

2.5 Estimate of the Scope of Illicit Trade in Tobacco in Senegal

The calculations of this analysis, based on Senegalese data from the most recent GATS survey, show that the illicit market totaled some 9 percent in 2015. This rate is quite close to that for Africa as a whole (10.6 percent) and is generally in line with the estimated global proportion of 9.9 percent (WHO 2017).

² The Sahel refers to a band of Africa marking the ecological and climatic transition between the Saharan area in the north and the savannahs to the south, where the rains are substantial. In the west-to-east direction, the Sahel stretches from the Atlantic to the Red Sea. Different authors variably delimit the precise area covered. Thus, for some, the Sahel includes all territories bordering the Sahara; there is therefore a northern Sahel and a southern Sahel. In this report, it refers to the latter, when the term Sahel is used without a further qualifier. The Sahel zone covers, in whole or in part, the following countries: Algeria (extreme south), Burkina Faso (north), Cape Verde, Chad (center), Mauritania (south), Mali, Niger, Nigeria (far north), Senegal, Sudan (center, including Darfur and Kordofan). The countries of the Horn of Africa are sometimes added: Djibouti, Ethiopia, Eritrea, and Somalia.

2.6 Assessment of the Framework for Combating Illicit Trade in Tobacco Products

Senegal signed the FCTC on June 19, 2003 and ratified it on January 27, 2005. The convention entered into effect on April 27, 2005. Senegal has made significant progress in combating tobacco, the culmination of which was the signing of Decree No. 2016-1008 on July 26, 2016, implementing Law No. 2014-12 of March 28, 2014, on the manufacture, packaging, labeling, sale, and use of tobacco. Senegal thus has a law that is basically in line with the framework convention as regards the implementation of health warnings, for example. The establishment of designated smoking areas is effective in some public and private institutions. Overall, however, the level of application of the law remains problematic.

Senegal acceded to the Protocol to Eliminate Illicit Trade in Tobacco Products on August 31, 2016. The fight against illicit trade requires a specific mechanism with well-defined procedures, responsibilities, and resources. The involvement of a number of public agencies is necessary to meet the obligations and achieve the objectives. The framework established by the Government of Senegal to combat illicit trade in tobacco thus brings together a number of ministries, agencies, and other entities.

STAKEHOLDERS IN THE FIGHT AGAINST ILLICIT TOBACCO TRADE

The Ministry of Economy, Finance and Planning's (MEFP) joint team to combat illicit trade in tobacco products includes the General Directorate of Customs (DGD) and the General Directorate of Taxation and Public Lands (DGID). The joint team's mission is to combat the smuggling and counterfeiting of tobacco products and to conduct verifications throughout the supply chain (e.g., routine unannounced inspections).³ The MEFP is responsible for the team's governance. The team and its member agencies have achieved some notable successes. DGD actions at Dakar airport (Annex 3) and throughout the national territory have resulted in large seizures of illicit tobacco products.

However, the seizures (Annex 3), which are generally destroyed at the end of the operations, are considered unproductive by customs and tax administration agents. Because the products are not subsequently sold, they bring in little in terms of customs and tax revenues. Moreover, the agents conducting the seizures are not awarded bonuses, reducing their motivation to hunt down perpetrators. The establishment of an incentive fund for combating illicit trade in tobacco could increase the motivation of those involved in frontline enforcement operations. It should be noted that the verification mechanism established by the joint team is not fully in line with the requirements of the Protocol for effectively combating illicit trade, since the mechanism currently in place does not allow for the tracing of tobacco products.

³ Important quantities of tobacco products have been seized by the DGD on Senegalese territory and in some border regions, including recent seizures of cigarettes valued at 13 million FCFA in Saint-Louis (DGD 2017).

Broadly speaking, Senegal needs to improve its legal framework to support and facilitate the implementation of the Protocol. The analysis of the application of Protocol provisions does show that Senegal has a legal framework in conformity with Protocol Article 6 (License, equivalent system of homologation or control), according to which parties shall establish a mandatory licensing system for anyone manufacturing, importing, or exporting tobacco products or manufacturing equipment. Parties have the discretion to authorize other activities, such as retailing tobacco products or growing tobacco. In Senegal's case, Decree 2016-1008 of July 26, 2016, takes into account these requirements.

The Ministry of Trade, via the Domestic Trade Directorate, conducts control operations throughout the national production and distribution chain. These controls and verifications of the marketing chain often result in seizures of smuggled or counterfeit tobacco products. In border regions such as Saint-Louis, Kaolack, Ziguinchor, and Kolda, domestic trade units cooperate with other entities including the police, the gendarmerie, and the customs service to exchange information and carry out operations for the control and seizure of illicit cigarettes. The Ministry of the Interior is also involved in combating illicit trade in tobacco products. It cooperates with the MEFP in operations for the seizure of such products.

The Ministry of Health and Social Action focuses more on the establishment and implementation of anti-tobacco laws. It has created a National Anti-Tobacco Program (PNLT) that reports to its Prevention Directorate. The Ministry also acts through regional and departmental committees, which are fora for dialogue and discussion of anti-tobacco measures aimed at reducing the prevalence of smoking and protecting the population. These committees, which are headed by governors (in the case of regions) and prefects (in the case of departments), bring together the main local stakeholders in anti-tobacco efforts in their areas. They facilitate the mobilization of partner resources, support local players, and assist the Anti-Tobacco Program in harmonizing its strategies and interventions. The committees also conduct anti-smoking actions, monitor illicit trade in tobacco, and participate in activities to promote the implementation of laws and regulations at the regional and departmental levels. They may also provide input on the national anti-smoking policy, particularly on its instruments, such as national plans.

Civil society partners include associations and entities that are active in anti-smoking efforts in general and efforts to combat illicit trade in particular. These include the Senegalese Anti-Tobacco League (LISTAB), created in 2011, which did a great deal of work toward the approval of the anti-tobacco law. LISTAB's mission is to help reduce the prevalence of smoking and protect the population against exposure to tobacco smoke. The civil society players working to combat illicit trade in tobacco include religious leaders, members of the Association of Health, Population and Development Journalists (AJSPD), legal experts, economists, and consumers' associations. These stakeholders intervene to increase awareness of the harmful consequences of smoking and advocate with the population for the application of laws combatting tobacco and illicit trade in tobacco.

Clearly, many stakeholders are active in efforts to combat tobacco in Senegal. However, the multi-player mechanism for combating illicit trade in tobacco does have limitations. There is no formal framework for coordination among the entities involved, nor a clear and consistent governance system to determine the roles and responsibilities of the various public agencies. In addition, the DGD's system for collecting data on illicit trade has not established specific provisions concerning tobacco products to allow for monitoring of trends.

TOBACCO PRODUCT TRACKING AND TRACING SYSTEM

The status quo: important advances, but a system that remains incomplete. The current arrangement for tracking trade in tobacco products between Senegal and other countries is under the responsibility of the DGD. This system is not in compliance with Article 8 of the Protocol, which discusses tracking systems. In particular, Senegal's current approach does not make it possible to trace the entire supply network. In addition to the DGD, other entities representing the Ministries of Trade and Health and Social Action also monitor the supply chain to prevent illicit trade in tobacco products. They conduct unannounced inspections and verifications of distributors, merchants, and transporters operating on road corridors.

All cigarettes sold within the national territory are subject to labeling requirements. The words "Vente au Sénégal" must appear on all packages. Since August 28, 2017, new cigarette packages with color photos covering 70 percent of the front, back, and sides have been in circulation. Posters at cigarette outlets warn consumers of the risk of imprisonment for buyers and sellers of illicit cigarettes.

Different labels for exemptions and exports and multi-layered security mechanisms for tracking and tracing (digital labeling, barcodes, holograms, chips, etc.) have not yet been developed. Senegal does not yet have a system of stamps or stickers for use in tracking and tracing tobacco products, as recommended by the Protocol and already practiced in countries such as Kenya.

Under the current system, Senegalese authorities experience difficulties controlling the potential illegal sale of producers' tobacco product stocks and monitoring informal channels through which products officially destined for export may be diverted. The tax administration's tracking of changes in tobacco company inventories is weak.

Inconsistencies in reported production for export. Senegal's tobacco exports increased 40.5 percent between 2012 and 2013. However, there are differences in the amounts declared for export by the tobacco industry and the quantities identified in data collected by the National Agency of Statistics and Demography (ANSD). The amounts declared by the tobacco industry are significantly lower than those identified by the ANSD. This discrepancy surged from a value of around CFAF 8 billion in 2012 to approximately CFAF 27 billion in 2015, immediately following the implementation of the 2014 tax reform.

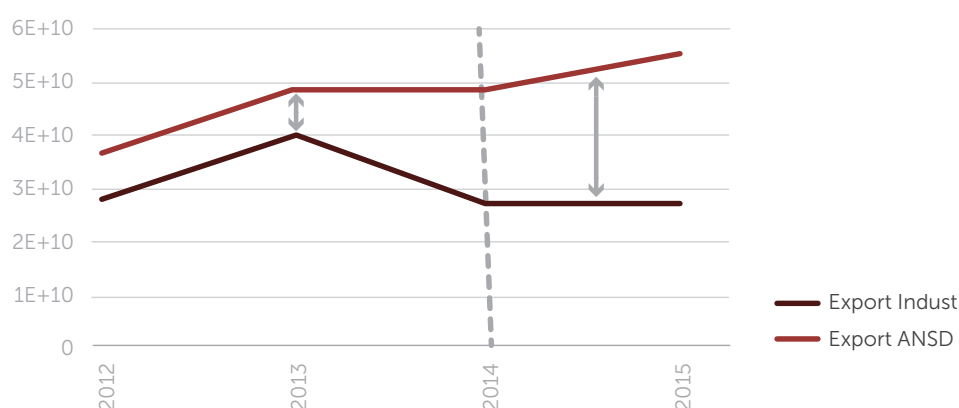
This gap between the export data provided by the ANSD and the declarations of the tobacco industry to the DGID raises a number of questions. Which data are more reliable? If the

Table 1. Value of Tobacco Product Exports, 2012-2015, Tobacco Firms' Reports versus National Agency of Statistics and Demography Calculations (CFAF)

	2012	2013	2014	2015
Exports declared by tobacco industry	28,687,425,056	40,322,443,540	27,233,426,409	27,816,965,966
Exports (ANSD statistics)	36,816,357,672	48,542,975,129	48,308,265,172	55,316,823,159
Difference	8,128,932,616	8,220,531,589	21,074,838,763	27,499,857,193

Source: ANSD and the tobacco industry (2017)

Figure 2. Cigarette Exports from Senegal, 2012-2015, Tobacco Industry Reports versus National Agency of Statistics and Demography Calculations



Sources: ANSD, tobacco companies (2017)

ANSD data are more reliable, the tobacco companies are presumably under-declaring. This gap is connected with a major concern regarding the players behind the illicit trade in tobacco products. According to some authors, in some countries, most cigarettes traded illicitly are manufactured by the legal tobacco industry (Lalam 2012). Additional research (beyond the scope of this study) would be necessary to confirm or refute this thesis in the case of Senegal.

The tracking of tobacco products intended for export (and thus exempt from taxes) to their declared destinations in foreign countries is deficient, under Senegal's current system. The specific characteristics of WAEMU and ECOWAS make the situation more worrisome, in terms of the potential proliferation of illicit trade. Products nominally intended for export may subsequently be brought back into Senegal via informal channels, if there is a significant difference in prices between countries, and if customs controls at the border are inadequate. This promotes illicit trade in tobacco, increases the tax revenue shortfall owing to

the non-payment of the VAT, and facilitates tax evasion. To tackle this deficiency, authorities must systematically triangulate the data on exports declared by the tobacco industry and those issued by the customs administrations and statistics institutes of the WAEMU countries to verify whether the declared exports really leave the country, arrive at their destination, and do not return to Senegal via informal channels. Clearly the tracking system now in place in Senegal does not yet meet the necessary standards.

Moving toward a robust model of “track-and-trace.” As a signatory to the FCTC and the Protocol, Senegal is required to comply with the global tracking and tracing regime within five years following the Protocol’s entry into effect. When operational, the planned global network should include national or regional tracking and tracing systems that are linked to the “global information-sharing focal point” at the Convention Secretariat through national or regional nodal points. “Unique identification markings” must be affixed to packages, cartons and any outside packaging of cigarettes and, within ten years, to other tobacco products.

To finance improvements in Senegal’s tracking and tracing system, it has been decided to proceed as stipulated in the Protocol, i.e., that the cost be covered by the tobacco industry. However, the procedures for implementation of this option have not yet been clearly defined. The tracing system implemented by Kenya, for example, may be used as a benchmark.

3. Public Policy Recommendations

The concluding recommendations focus primarily on: effective application of the anti-tobacco laws currently in effect; reform of existing legislation; development of the tracking and tracing system for tobacco products; enhancement of governance as a means to combat illicit trade in tobacco; data collection and research; and regional/subregional coordination and cooperation on illicit trade.

3.1 Effective Application and Reform of the Laws Now in Effect

- » Accelerate the application of Decree No. 2016-1008 of July 26, 2016, implementing Law No. 2014-14 of March 28, 2014, on the manufacture, packaging, labeling, sale, and use of tobacco products, so as to achieve effective implementation and enforcement of the law throughout the national territory.
- » In the short term, establish a more suitable legal framework to facilitate application of the Protocol to Eliminate Illicit Trade in Tobacco Products in Senegal. Senegal has made progress in its anti-smoking efforts, but a key issue remains the extent to which current legislation corresponds to the Protocol. The General Tax Code and Customs Code offer opportunities for improvements that can lead to successful application of the Protocol’s provisions.
- » Significantly increase the fines and penalties applicable to offenders in order to discourage the illicit trade in tobacco products.

3.2 Governance Mechanisms to Combat Illicit Trade in Tobacco

- » Improve the existing mechanism for coordinating interventions, national players, and technical and financial partners on the basis of best international practices, some of which are mentioned in the Protocol. Successful practices involve, for example, mechanisms to strengthen information sharing between the parties; assistance and cooperation (training, technical assistance, and cooperation in scientific, technical, and technological fields); investigation and prosecution of offenders; and other measures.
- » Create a multisectoral mechanism to fight illicit trade with a clear, consistent system of governance. This will make it possible to better define the roles and responsibilities of the various public agencies. The assignment of this task to the national coordinating mechanism created under Article 5(2)(a) of the FCTC could constitute an alternative solution to the creation of a new structure and should be enacted by ministerial memorandum. According to the report submitted to the Conference of Parties, a large number of countries have indicated that control of the supply chain is the responsibility of the finance, customs, and/or trade sectors.

3.3 Tracking and Tracing

- » Establish a full-fledged tracking and tracing system to monitor production and supply chains. The system should include tracking inventory changes at tobacco companies to avoid the development of parallel production and distribution channels and, consequently, tax revenue losses.
- » This system should be totally independent of the tobacco industry but financed by it, as recommended by the Protocol.
- » Study the feasibility of establishing an x-ray control system under the authority of Customs with the involvement of other partners in fighting illicit trade.
- » Better monitor exports and ensure that tobacco company declarations match the quantities of tobacco that leave the national territory.

3.4 Data Collection and Research on Illicit Trade in Tobacco

- » Study and prepare detailed estimates of the scope of illicit trade in tobacco products in Senegal, its impact on the economy and public health, and related issues to provide decision makers with robust research that can inform anti-smoking policies.
- » Establish a sustainable centralized mechanism for collecting data on illicit trade in tobacco products by establishing formal cooperation between the DGID, the DGD, the Domestic Trade Directorate, ANSD, and the grassroots regional and departmental committees. This

mechanism should promote data collection on illicit trade and allow for an analysis of the characteristics of the tobacco products seized, including the type of product, the brand name, the location of the seizure, the modus operandi, the planned destination, whether counterfeits are involved, the quantity, and the weight. The starting point for the implementation of this recommendation is the preparation of memorandums asking the units concerned to systematically collect data on any seizures they conduct.

- » Conduct investigations in selected border areas (Kaolack, Kaffrine, Ziguinchor and Saint-Louis) to identify illicit tobacco products marketed in these areas.
- » Establish benchmarks based on countries that have successfully combated illicit trade in tobacco products. Steps may include systematic reviews of best practices and field visits to countries that have achieved notable success in combating illicit trade.
- » Build the capacities of the members of the national technical committee and regional and departmental anti-smoking committees.
- » Establish a fund for combating illicit trade in tobacco products, a portion of which will be used to motivate the participants involved.

3.5 Regional/Subregional Coordination on Illicit Trade

Successful implementation of the Protocol and achievement of results in the efforts to combat illicit trade in the ECOWAS and WAEMU areas require:

- » Revision of the agreements between some countries and tobacco manufacturers in light of the provisions of the Protocol;
- » Advocacy with WAEMU and ECOWAS Member States to promote international cooperation in information-sharing;
- » Advocacy with WAEMU and ECOWAS Member States to raise the WAEMU maximum tax rate to the WHO-recommended level of 75 percent of retail price, or at least to the European Union minimum level of 60 percent.

4. Conclusion

Senegal has made progress in combating tobacco and implementing the Protocol to Eliminate Illicit Trade in Tobacco Products. However, these efforts remain insufficient. They must be enhanced to achieve additional tangible results, considering the issues and challenges involved in combating illicit trade at the national and regional level. Monitoring and evaluating progress will require in-depth, independent research aimed to: more accurately measure the volume of illicit trade; assess its characteristics; document the organization of illicit markets and the players involved; measure illicit tobacco's impact on public health and the national and subregional economy; and evaluate the coordination and efficacy of control interventions.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

An analysis of links between illicit tobacco and broader covert financial flows will help clarify relationships between illicit tobacco trade and the financing of terrorism or other criminal activities. This is a concern because illicit trade in tobacco products is considered to be one of the main sources of financing for terrorist activities in sub-Saharan Africa today, alongside drug trafficking. This provides Senegal and other countries of the region with additional incentives to track and combat illicit tobacco flows.

References

- ANSD. 2015. Enquête mondiale sur le tabagisme chez les adultes, [www.ansd.sn/.../1 GATS%20 rapport%20principal%20SENEGAL_ANSD](http://www.ansd.sn/.../1%20GATS%20rapport%20principal%20SENEGAL_ANSD).
- ANSD. 2016. Enquête nationale sur les facteurs de risque des maladies non transmissibles, STEPS 2015 «Rapport préliminaire: les indicateurs-clés ». http://www.ansd.sn/ressources/publications/DV-STEPS-1-06-2016%20-%20MF-fin_ANSD%20vf.pdf
- Blecher E. 2010. A mountain on a molehill: is the illicit trade in cigarettes undermining tobacco control policy in South Africa? *Trends in Organized Crime* 13(4):299-315.
- Borgne, A. et Grangé, G. 2003. «Tabac et grossesse. Peut-on aider les femmes enceintes qui fument ? ». *Journal de gynécologie obstétrique et de biologie de la reproduction*. 32 (suppl. au n° 1), p. 1S41-1S45.
- CalEPA - California Environment Protection Agency. Air Resources Board, Office of Environmental Health Hazard Assessment. 2005. Proposed Identification of Environmental Tobacco Smoke as a Toxic Air Contaminant, Final Report.
- Cnattingius. 2004. The epidemiology of smoking during pregnancy: smoking prevalence, maternal characteristics, and pregnancy outcomes, *Nicotine & Tobacco Research* Volume 6, Supplement 2 (April 2004).
- Décret 2016-1008 portant application de la loi n°2014-14 du 28 mars 2014 relative à la fabrication, au conditionnement, à l'étiquetage, à la vente et à l'usage du tabac.
- DGD. 2017. Statistiques produites par la Direction Générale des Douanes, Sénégal.
- Gaylin DS, Kates J. 1997. Refocusing the lens: epidemiologic transition theory, mortality differentials, and the AIDS pandemic. *Soc Sci Med*. 44(5):609-214.
- Guérin, D., Guyon, L., Fournier, M., Gillet, M., Payette, Y. et J. Laguë. 2006. La fumée de tabac secondaire. Effets sur la santé et politiques de contrôle de l'usage du tabac dans les lieux publics. Montréal: Institut national de santé publique du Québec.
- GYTS (Global Youth Tobacco Survey). 2002, 2007.
- Joossen, L and Raw M. 2011. Tobacco Control Scale 2010 in Europe. Brussels: Association of European Cancer Leagues.
- Lalam N., Weinberger D., Lermenier A. Martineau H. 2012. L'observation du marché illicite de tabac en France, OFDT-INHESJ.
- Legresley, E., K. Lee, M. E. Muggli, P. Patel, J. Collin, and R. D. Hurt. 2008. British American tobacco and the "insidious impact of illicit trade" in cigarettes across Africa. *Tobacco Control* 17(5):339-346.
- Pattenden, S., Antova, T., Neuberger, M., Nikiforov, B., De Sario, M., Grize, L., Heinrich, J., Hruby, F., Janssen, N., Luttmann-Gibson, H., Privalova, L., Rudnai, P., Splichalova, A., Zlotkowska, R., Fletcher, T. (2006). «Parental smoking and children's respiratory health: independent effects of prenatal and postnatal exposure ». *Tobacco Control*. 15 (4), p. 294-301.
- Peto R, Jha P. 2014. Global effects of smoking, of quitting, and of taxing tobacco. *N Engl J Med* 370:60-68. <http://www.nejm.org/doi/full/10.1056/nejmra1308383>

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

Ross H. 2015. Understanding and measuring tax avoidance and evasion: A methodological guide. Washington, DC. DOI: 10.13140/RG.2.1.3420.0486.

WHO (World Health Organization). 2004. Tobacco Increases the Poverty of Countries. Geneva: WHO. http://www.who.int/tobacco/communications/events/wntd/2004/tobaccofacts_nations/en/

WHO (World Health Organization). 2015. Illegal trade of tobacco products: What you should know to stop it, WHO/NMH/PND/15.3. Geneva: WHO. <http://www.who.int/campaigns/no-tobacco-day/2015/brochure/en/> (Accessed November 2017).

WHO (World Health Organization). 2017. Tobacco Fact Sheet No. 339, May 2017. Geneva: WHO. <http://www.who.int/mediacentre/factsheets/fs339/en/> (Accessed November 2017).

Annexes

Annex 1: Summary of Tobacco-Product Exports from Senegal

YEAR	ZONE	CIF VALUE (CFAF)	NET WEIGHT (KG)
2013	WAEMU	7,002,438,551	480,259
	ECOWAS	13,991,793,657	1,198,096
	OTHER	11,219,390,263	931,285
	Subtotal 1	32,213,622,471	2,609,640
2014	WAEMU	6,055,623,680	391,739
	ECOWAS	13,335,592,289	1,320,438
	OTHER	9,289,868,318	668,868
	Subtotal 2	28,681,084,287	2,381,045
2015	WAEMU	9,498,860,579	632,450
	ECOWAS	19,007,190,764	1,679,390
	OTHER	9,957,818,015	767,939
	Subtotal 3	38,463,869,358	3,079,779
2016	WAEMU	18,079,399,275	1,151,056
	ECOWAS	27,866,652,749	2,156,069
	OTHER	8,051,656,110	553,585
	Subtotal 4	53,997,708,134	3,860,710
TOTAL		153,356,284,250	11,931,174

Source: DGD

Annex 2: Main Tobacco Control Laws in Senegal, 1980-2016

LAW	KEY PROVISIONS
Law No. 81-58 of November 9, 1981	<ul style="list-style-type: none"> › Prohibition on tobacco advertising and its use in some public places
Law No. 85-23 of February 25, 1985	<ul style="list-style-type: none"> › Amendment of Law No. 81-58: criminal sanctions set out in Article 13 and review of list of places where smoking is permitted
Law No. 92-40 of July 9, 1992 establishing the General Tax Code	<ul style="list-style-type: none"> › Uniform rate of 30% applicable to all products. No distinction between the different types of products.
Law No. 2002-07 of February 22, 2002	<ul style="list-style-type: none"> › Differentiation of tax rates for economy cigarettes (50%) and luxury cigarettes (30%).
Law No. 2004-30 of August 12, 2004	<ul style="list-style-type: none"> › Higher tax level: 16% excise tax for economy cigarettes and 40% for premium cigarettes. › Introduction of a new category of cigarettes called "standard cigarettes" with a tax rate of 31%.
Law No. 2004-36 of December 14, 2004	<ul style="list-style-type: none"> › Ratification of the WHO Framework Convention on Tobacco Control
Law No. 2009-19 of March 9, 2009	<ul style="list-style-type: none"> › Excise tax rate increased to 20% for economy cigarettes and 45% for premium cigarettes › Elimination of the standard category introduced into the nomenclature in 2004
Order No. 14202 of December 12, 2011	<ul style="list-style-type: none"> › Maintenance of some cigarettes in the premium category (reaction to the declassification strategies adopted by tobacco companies to pay lower taxes on so-called premium category cigarettes)
Law No. 2012-31 of December 31, 2012 (entry into force in January 2013)	<ul style="list-style-type: none"> › Increase of tax rates: 40% for economy cigarettes and 45% for premium cigarettes. › Amendment of Article 434 of the General Tax Code (CGI)
Law No. 2014-29 of October 27, 2014 (entry into force in November 2014)	<ul style="list-style-type: none"> › Introduction of a single rate of 45% › Distinction between economy and premium cigarettes is eliminated. Thus, an increase in the tax rate on economy cigarettes of 5%.
Decree No. 2016-1008 implementing Law No. 2014-14 of March 28, 2014	<ul style="list-style-type: none"> › Application of Law No. 2014-14 of 28 March 2014 on the manufacture, packaging, labeling and use of tobacco.

Annex 3: Cigarette Seizures at the Dakar Airport Customs Post, 2015-2017

CIGARETTE SEIZURES AT THE AIRPORT			
	2015	2016	2017*
Number of cartons	6,781	7,381	7,130
Value	40,686,000	43,986,000	43,780,000

Source: DGD,2017

*DGD estimations as of May 27, 2017

Annex 4: Summary of Tobacco-Product Imports to Senegal, by Origin

YEAR	ZONE	CIF VALUE	NET WEIGHT	TAXES (ASSESSED)
		(CFAF)	(KG)	(CFAF)
2013	WAEMU	246,064	1	327,095
	ECOWAS	1,733,795	257	3,677,887
	OTHER	89,564,111	9,472	155,981,248
	Subtotal 1	91,543,970	9,730	159,986,230
2014	WAEMU	0	0	0
	ECOWAS	0	0	0
	OTHER	106,288,674	15,114	226,147,253
	Subtotal 2	106,288,674	15,114	226,147,253
2015	WAEMU	0	0	0
	ECOWAS	0	0	0
	OTHER	75,327,110	5,839	133,144,655
	Subtotal 3	75,327,110	5,839	133,144,655
2016	WAEMU	171,060,403	18,453	122,308,189
	ECOWAS	171,060,403	18,453	122,308,189
	OTHER	195,525,291	20,863	383,240,994
	Subtotal 4	537,646,097	57,769	627,857,372
TOTAL	810,805,851	88,452	1,147,135,510	

Source: DGD (2017)

TOBACCO TAX ADMINISTRATION

22

TOBACCO TAX ADMINISTRATION

A Perspective from the IMF

Janos Nagy¹

Chapter Summary

Illegal cultivation, production, and trade are a widespread problem associated with tobacco products, given their easy portability and the high profit margins. A single container or truck-load of illegal cigarettes can yield up to US\$2 million in profits. The annual revenue loss in tobacco taxation worldwide is estimated at roughly US\$40 billion–US\$50 billion, that is, the equivalent of about 10 percent of global cigarette consumption.

Tobacco products are susceptible to bootlegging, smuggling, and fraud, especially excise fraud, which extends from standard customs and commercial fraud to undeclared activities such as the diversion of legally produced cigarettes from international transit routes directly to retail markets, the illegal domestic production and sale of cigarettes, and legal or illegal production for export.

Illegal trade is a context-specific activity, and administrative and control measures need to be tailored to this context. Understanding the size, characteristics, and patterns of illegal production and trade is a prerequisite to developing effective antifraud strategies. Regional and international coordination can substantially improve the efficiency of national efforts.

The central concern in the administration of value added taxes and excise taxes on tobacco is to control the import, production, and distribution of taxed products tightly. This control

¹Fiscal Affairs Department, International Monetary Fund (IMF).

should be exercised at all points of the supply chain, from the fields where tobacco is grown or the port of entry to the final purchase by the individual consumer. Excise stamps as well as other markings affixed to the packs of cigarette can facilitate the collection of excise taxes, as well as audits and enforcement actions at various stages of distribution. The stamps should be furnished with strong security features similar to those used with banknotes and passports.

Legislation should define compulsory requirements, guarantees, and safeguards under which tobacco products can be imported or produced and distributed. Only licensed economic operators should be involved. Licenses should be issued based on concrete physical, administrative, and financial conditions.

General Considerations

Given heightened incentives for fraud because of the higher tax rate and portability of tobacco products, the central concern in the administration of tobacco taxes is to tightly control the import/production and distribution of excised products. Although perfectly controlling the supply chain cannot realistically be a pre-requisite to start increasing excises, given that incentives to fraud are broadly related to the tax wedge, increasing taxes should go hand in hand with tighter controls. This control should as much as possible be exercised at all points of the supply chain, from the fields where tobacco leaves are grown or port of entry, to the final purchase by the individual consumer of the product². Such controls need a clear legal framework and dedicated services or functions in the revenue administration.

The legal framework needs to contain some key elements. The categories and particular tobacco products subject to excise taxation must be clearly defined, keeping in mind possible substitution patterns. Guiding taxation principles, the base, the rates, the method of calculation, and the exact point of taxation in the production/supply and distribution chain³ also need to be clearly defined. The legislation must also serve as the basis for the special excise administration and control measures designed to mitigate this increased risk of fraud. Administrative and control measures need to be tailored to the specifics of the local context, for each stage of the processing and distribution.

In most countries, excise taxes are due to central government, and a centrally organized excise administration is responsible for the management and collection of excise taxes,

Note: Excerpted from IMF How To Note 16/03, "Fiscal Policy: How to Design and Enforce Tobacco Excises." © International Monetary Fund. Reprinted with permission. The views expressed in this paper belong solely to the authors. Nothing contained in this paper should be reported as representing IMF policy or the views of the IMF, its Executive Board, member governments, or any other entity mentioned herein.

² Controls of cultivation are looser as illegal farming is more difficult to conceal than trade of final products.

³ Excises should be collected as early as possible in the distribution chain (for example, at the time of import processing and at domestic tobacco factories) in order to keep the number of taxpayers as low as possible, and therefore the controls simple, inexpensive, and effective.

including tobacco taxes⁴. Excise administrations are often part of the tax administration, although the customs administration sometimes collects both import and domestic excise taxes. In most countries, the customs administration collects excise taxes on imported excisable goods together with customs duties. In rare cases, if excise revenue is high or the taxation system is peculiar, countries might have an excise service separate from the tax and customs administrations (as for example in the United States).

In low-compliance environments, more physical and onsite checks should be performed by the excise administration (for example, inspection of inventories) and corresponding administrative capacity is required. In a highly compliant environment, company audit capacities are often adequate.

Specific Administrative and Control Measures

Only licensed and strictly controlled economic operators should be involved at any stage of import, production, and distribution (including retail). Legislation should define compulsory requirements, guarantees, safeguards, and related controls, under which tobacco products can be imported or produced and distributed. The license should include concrete physical, administrative, and financial conditions, and adherence to these conditions must be regularly controlled and non-compliance severely penalized, including by suspending or withdrawing the license.

Clear and complete records should be kept, and information supplied seamlessly to the excise administration. Operators need to keep up-to-date records of the flows of materials used for production and of inventories. The content and the format of the records need to be defined by law and in the license. These records should be reported at prescribed intervals and/or kept available to the excise authority for remote and/or onsite control purposes. The records should reflect and correspond with the actual physical status of inventories. It is important that the records and the information supplied by the economic operator facilitate the controls for both the operator and the authorities. If the concentration of the industry allows or the fiscal risks justify, the production plant can be supervised on site by the excise administration on a permanent basis.

Excise stamps as well as other markings affixed to the packs of cigarette can facilitate the collection of excise taxes and controls, as well as audits and enforcement actions at various stages of distribution. A tax stamp (or "banderole") is issued by the excise authority at the value of the excise tax. It is purchased by the producer or importer and applied on each product sold as a proof of payment of the excise tax on that product (and the VAT in certain

⁴ In certain countries, in addition to federal or central government taxes, local governments (in the case of the United States, both state and local governments) are also entitled to impose excise duties on tobacco products using their own tax/excise services. Such arrangements require close coordination among the different levels of government.

countries). For this reason, stamps should have strong security features similar to those used for banknotes and passports. The high cost of such stamps and consequent use of low-quality stamps has often led to counterfeit stamps and fraud in many countries, hence a general concern about the efficiency of stamps as a proof of payment for taxes. For these reasons, many countries have replaced tax stamps by fiscal stickers that contain or give access to product-specific useful information (often through bar codes). While fiscal stickers do not aim to prove the payment of taxes (as stamps do), they are useful for taxation, control, and auditing purposes⁵. Some countries require pre-printed indication of duty paid status of tobacco for the specified markets (for example, the United Kingdom, France) on the pack itself. The burden and cost of applying markings always rests with the producer/importer except the cost of production and sale of the excise stamp. During periods of forestalling (for example, prior to excise rate change) the quantity and therefore the costs of printing and distributing tax stamps may significantly increase and governments should ensure that the excise administration has sufficient funds to cover such extra costs, although forestalling should altogether be prevented in the first place through appropriate regulation.

Sophisticated marking systems can go all the way to track and tracing. This process would require producers to apply appropriate signs on packs and packages (master cartons) to track every product along the distribution chain. The date, time, and place of production; origin; intermediaries; intended destination; and taxation status can therefore be identified and controlled to determine the genuineness and point of diversion of smuggled tobacco products (basic information such as the taxation status should also be made easily understandable to consumers). Track and tracing systems require heavy infrastructure and must be able to deal with complex transactions and distribution chains and are therefore costly. Given the need to adapt to changing commercial practices, the system should be operated by a dedicated organization in coordination with the industry, and all contained information should remain accessible to the excise administration at all times.

The point of payment and related conditions must be clearly defined in the law. Points of payment and methods are established after consideration of risks, technology, liquidity, and costs. Usually, the point of taxation is when the product leaves the factory premises (or customs/tax warehouse in case of imports), before retail distribution. The number of such producers and importers are typically limited and they are well known to the excise authorities. Usually, the producers and importers file their declaration and pay the taxes periodically, on a monthly basis on a pre-defined day of the month following the removal of tobacco products from the warehouses. The excise legislation should prevent the excessive forestalling, accumulation, and sale of stocks using earlier and lower-value tax stamps, and regulations should limit the

⁵ Tax stamps must include a maximum retail price if an ad valorem excise on the final price is applied, otherwise the effective ad valorem rate would be lower than the statutory rate. This might in turn require additional legal and regulatory guidelines on price controls, as well as the administrative means to implement the controls or at least monitor the retail conditions. Fiscal stickers may also in these cases include a maximum price, but not necessarily.

quantities and/or time allowed for the sale of such stocks. Specific procedures should be defined for damaged stocks, returns, and other special events.

Transit, warehouse, and free zone operations entail elevated risks of fraud and adequate special measures should be applied. Financial guarantees commensurate with the amounts of all duties and taxes due can be demanded. The quantities produced and transacted can also be limited and special physical control measures applied, such as the separation of processing operations from the sealed storage of taxed and untaxed products. Physical and direct control by the officials of the excise authority during a part or the whole operation can be applied (for example, physical escort of the transit consignment from border to border by individual trucks or in a convoy, application of radio or satellite tracking systems to goods or conveyances/vehicles/containers).

Authorities should impose severe restrictions on duty free and internet sales. In principle, duty free shops exist to facilitate the sale of products for export at a low risk, and convenient place and time. Therefore, it is recommended that duty free shops be licensed only at the exit sides of airports and seaports and to sell tobacco only for outbound passengers⁶. Sales of excisable products in duty free shops at land borders and inland within the country are not recommended. Consideration should be given to reduce duty free allowances within the limits of international standards if deemed necessary and practical. Sales of tobacco over the internet and similar difficult-to-control channels should be subject to strict control, and consideration given to prohibiting them⁷.

Due diligence, appropriate responsibility, and care should be legally mandated for the licensed operators. This includes the design and operation of their own internal control systems to prevent fraud and make their processes transparent. Operators should also be legally bound to report any suspicious cases and cooperate fully with the authorities in the investigation of fraud cases including sharing internal information on processes and business operations.

Fighting Tobacco-Related Excise Fraud

Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. The latter is usually a small problem, and significant clandestine factories are limited to countries where enforcement capabilities are generally weak and/or corruption high. On the other hand, illegal trade and production of final products is a widespread problem, given the high profit margins: a single container or truckload of illegal cigarettes can yield up to US\$2 million in profits. The consensus among experts puts the annual revenue loss in tobacco taxation within the European Union at roughly €10 billion, and worldwide at US\$40–50 billion—that is, about 600 billion sticks, or

⁶ Duty free allowances should be limited by frequency, length of absence from the country, and quantity.

⁷ See article 11 of the Protocol to Eliminate Illicit Trade in Tobacco Products.

10 percent of global consumption (ITIC, 2013; Merriman, 2001; Joossens, 2011; European Commission, 2013; Euromonitor, 2015).

Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions (Box 1). There are two types of such trade. *Bootlegging* is the illegal resale outside the country of origin of legally purchased duty-paid cigarettes. It is the textbook illegal trade of classical international trade theory, but it is marginal for tobacco (although potentially a significant problem in Europe). Bootlegging is generally caused by wide tax differences between neighboring countries with weak or no border controls (for example, internal borders between member states in customs unions). It can also be related to abuse of international travelers' allowances, cross-border shopping, and so forth. *Smuggling* is the cross-border trade in untaxed cigarettes. Smuggling is by far the most significant type of illegal trade: up to 90 percent of the total. In general, excise fraud extends from standard customs/commercial fraud (for example, mis-declaration of quantities, values, origin, and classification) to undeclared activities such as (1) the diversion of legally produced cigarettes from international transit routes directly to the retail market, (2) illegal domestic production and sale of cigarettes, and (3) legal or illegal production for export. In the last two cases, illegal production might also involve counterfeit cigarettes (for example, branded cigarettes illegally produced by non-owners of the brand, abusers of industrial and intellectual property rights)⁸. Tax exemptions are also often linked to smuggling (for example, loose transit and transshipment systems, free zones). Because smuggling involves untaxed cigarettes, it generally remains largely unaffected by mild to moderate decreases in taxes and responds more to controls and repression.

Bootlegging, and smuggling even more so, generally involves criminal networks. The complexity of smuggling operations requires carefully designed and well-orchestrated plans that only sophisticated criminal networks can undertake. For this reason, detection, seizure, and elimination of illegal products must be accompanied by thorough and systematic investigations (often with undercover methods) and successful criminal prosecution including forfeiture of proceeds from crime to uproot entire networks. Organized groups active in these trades are often also active in other illegal activities—such as illegal migration or smuggling of arms, drugs, and illegal medicines—and can be very dangerous, hence the need for an appropriate security apparatus.

Sound and coherent VAT, excise and criminal laws, and regional and international coordination are important first steps to minimize the incentives and opportunities for smuggling and bootlegging. Clear policy rationales; well-defined administrative procedures; regional coordination on matters of rates, base, and trade (for example, personal allowances); comprehensive, stringent, and coherent excise regulations (as opposed to scattered customs and criminal procedures) with strict and direct/unconditional tax liability; and so forth

⁸ Illegal production can take place in illegal production facilities (often semi-mobile units), or in legal facilities, with or without the knowledge of the facilities' managers.

all contribute to fighting fraud. In addition, international coordination (notably through the WHO Framework Convention on Tobacco Control and the related Protocol to Eliminate Illicit Trade in Tobacco Products) can significantly improve the efficiency of national efforts. Smuggling and in particular smuggling of tobacco products should notably be criminalized, with adequate level of penalties and other sanctions including confiscation of proceeds of tobacco-related crime.

It is essential to gather information on both legal and illegal trade and production, movement, import, and export of tobacco products, including the raw materials and equipment/material used in production⁹. This includes public information, industry, own data, and informants, as well as the exchange of information with other government agencies and with international partners (for example, regional organizations like the European Anti-Fraud Office). Analyzing the information helps governments understand the situation and trends, define the risks, and from there identify measures to tackle the problems. Standard control measures can then be adjusted at every step, from pre-arrival controls to post-clearance audits. The faster this process takes place, the greater the chances to minimize revenue loss. At a broader level, understanding the size, characteristics, and patterns of the illegal production and trade is a pre-requisite to developing effective anti-fraud strategies and actions; strategies to fight smuggling in countries where it has a 2 percent share of the market will not be the same as those used in countries where it has a 10 percent share (for example, Europe) or a much larger share (for example, Brunei).

Border controls are a first line of action. Depending on the modus operandi, revenue risk, and available human and material resources, officers with required qualifications and experience should be assigned to border controls. Front-line officers should be supported by appropriate intelligence, background support and service, guidance and supervision from management, and technical aids to enforcement. The format and the integrated control technology as well as the cooperation with other agencies at the border station are important factors in effective controls.

Mobile excise control units stopping vehicles and verifying the legality of excisable goods within the country are often useful. Inland mobile controls should be carried out along important transport corridors, communication centers, and bottlenecks like bridges, ferries, and passes. Such inland mobile controls can detect illegal imports and unauthorized domestic products while they are transported inside the country. Support to these operations requires tight coordination among police, border guards, and other such services (for example, joint patrols). Controls along the green borders (that is, between two official border crossings) should be organized in coordination with border police and customs services of neighboring countries.

⁹ For example, tobacco leaves, cut and fine-cut tobacco, cigarettes and other tobacco products, materials used for producing cigarettes like paper and filters, and those used for packing.

Investing in appropriate equipment is necessary. Most general anti-smuggling equipment like X-ray scanners (including scanners for small parcels, containers, trucks, and trains), endoscopes, mirrors, night vision equipment, cameras, automatic license plate readers, and mobile offices can also be used to support the detection of illegal tobacco shipments. In many low-income countries, basic equipment such as rifles, communication devices, motorcycles, utility vehicles, and small speedboats might be prioritized. Specific tools include tobacco detector equipment and tobacco scenting dogs. The same dogs can be trained to detect both tobacco and narcotic drugs.

Excise administration staff will require dedicated training. Special emphasis should be given to tobacco processing technologies, distribution methods, taxation principles, rules, practices, inward processing relief, and illegal trafficking patterns. Training staff to resist threats and bribes from criminals is equally important and is most effective if pursued through the implementation of a professional anti-corruption program supported by a code of conduct, disciplinary measures, and proper human resource management. Resource allocation should take into account the revenue weight, revenue risks, and special requirements of dealing with tobacco.

Seizure, storage, and destruction of illegal tobacco should be mandatory for excise and customs authorities. This generally involves burning, grinding, and depositing at waste management plants. As for legitimate tobacco, the storage, transport, and destruction of seized and confiscated goods require extra care and caution, as well as transparent and documented processes. This can also create significant and unexpected additional expenses, in particular at times of massive and successful law enforcement operations, and authorities should plan for the necessary budget resources.

BOX 1. REVENUE RAISING, INCREMENTAL TAX ADJUSTMENTS, AND ILLEGAL TRADE: THE CANADIAN CASE

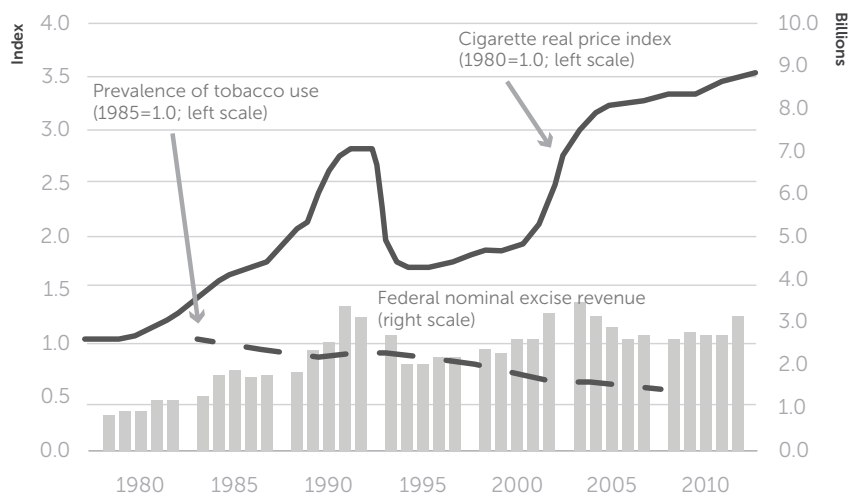
The Canadian federal and provincial governments gradually increased cigarette taxes so as to almost triple the real (that is, inflation-adjusted) retail price between 1980 and 1992/1993. Federal nominal revenue surged from Can\$0.7 billion to Can\$3.3 billion over this period (Figure 1). The increase did not result in smuggling until the early 1990s, when previously almost non-existent untaxed exports of Canadian cigarettes to the United States surged and re-entered Canada as duty not paid (DNP) cigarettes (Figure 2.2). In 1993, it was estimated that roughly one-third of the Canadian market consisted of DNP cigarettes.

Tough measures against tobacco manufacturers and their employees involved in the scam (Austen, 2008; Canada Revenue Agency, 2008), significant but temporary tax cuts, new export taxes, and tougher police controls allowed the government

to control the situation and paved the way for taxes to increase again. This time, the tax increases took place at a much faster pace given the political acceptability of the tax and a good understanding of the demand (Figure 2.1). Revenue surged again to previous levels, despite a sharp decrease in the prevalence of smoking. Large-scale illegal trade, however, came back after 2004 with actual production of new brands on the same indigenous reservations that had been used in the 1990s by smugglers to re-import cigarettes, because of their peculiar legal and geographical characteristics. This triggered a second wave of enforcement efforts by Canadian authorities (including an enhanced stamping regime), and revenue increased again from 2010.

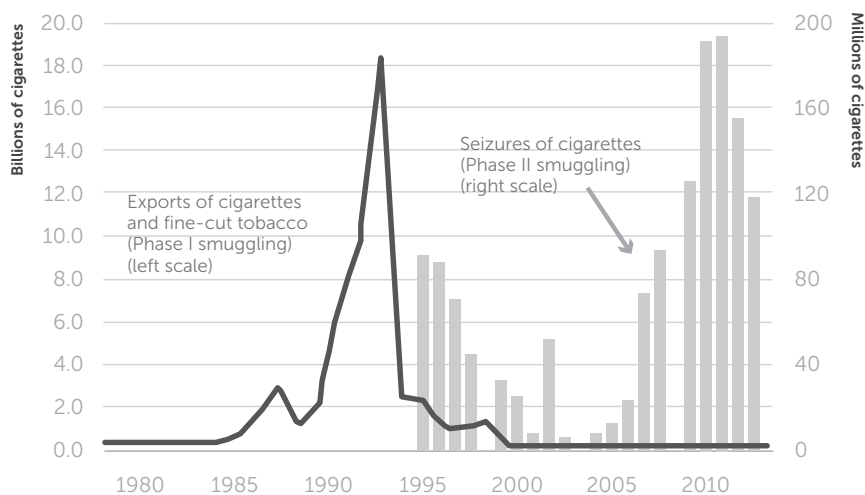
No two countries are alike, but the Canadian case illustrates a few key points. First, the revenue increase has been substantial despite smuggling. In Canada, real (inflation-adjusted) tobacco-related revenue was roughly 50 percent higher in 2011 than in 1980, despite a 50 percent lower prevalence rate and significant illegal trade. However, the social cost of smuggling (for example, rising crime) can be high, especially among communities closely affected by it, and the attitude toward paying taxes more generally can also greatly suffer. Second, gradually raising rates is an efficient way of understanding the demand and market reactions to higher prices, as can be seen from the faster increases after 2000. Third, tight control over the tax base is a key element of any revenue-raising strategy in any country. Situations in which parts of the country come under a different legal regime or are beyond the reach of the law make it difficult to enforce high excises, whether this is related to jurisdictional peculiarities, political reasons, war, logistics, and so forth. Fourth, once in place, criminal networks are hard to dismantle and require a multi-pronged strategy that extends beyond simple repression (royal Canadian Mounted Police, 2008). Many individuals involved in the mid-2000s Canadian smuggling episode learned the trade in the early 1990s and took over old distribution networks, to the dismay of tobacco manufacturers, whose activities led to the initial growth in contraband (Canada Revenue Agency, 2008; Marsden, 2009; Imperial Tobacco Canada, 2009; Kemball, 2009). Finally, understanding the nature of smuggling is crucial to fighting it: even in a single country, solutions that worked once may not work twice.

Figure 1. Canada: Tobacco Price and Federal Excise Revenue



Sources: Statistics, Canada, Health Canada.

Figure 2. Canada: Estimated Smuggling and Seizures



Sources: Statistics Canada, Royal Canadian Mounted Police.

References

- Anderson, S. P., A. de Palma, and B. Kreider. 2001. "Tax Incidence in Differentiated Product Oligopoly." *Journal of Public Economics* 81(2):173–92.
- Austen, I. 2008. "Canadian Companies Settle Cigarette Smuggling Case." *New York Times*, August 1.
- Barber, S., A. Ahsan, S. M. Adioetomo, and D. Setyonaluri 2008. *Tobacco Economics in Indonesia*. Paris: International Union Against Tuberculosis and Lung Disease.
- Barendregt, J.J., L. Bonneux, and P. J. van der Maas. 1997. "The Health Care Costs of Smoking." *New England Journal of Medicine* 337(15): 1052–57.
- Bird, R. M. 1997. "Analysis of Earmarked Taxes." *Tax Notes International* 14(25): 2095–2116.
- , and J. Jun. 2005. "Earmarking in Theory and Korean Practice." ITP Paper 0513, University of Toronto. Canada Revenue Agency. 2008. "Comprehensive Settlement Agreements between Federal and Provincial Governments and Imperial Tobacco Canada Ltd. and Rothmans, Benson & Hedges Inc." (<http://www.cra-arc.gc.ca/gncy/tbcc/menu-eng.html>).
- Chaloupka, F. J. 2008. "The Effects of Pricing and Tax Policies on Youth Tobacco Use." Paper presented at the Global Consultation on Effective Youth Tobacco Control Policy Interventions, World Health Organization, Geneva.
- , and K. Warner. 2000. "The Economics of Smoking." In *Handbook of Health Economics*, edited by A. Culyer and J. Newhouse, 1539–1628. Netherland: Elsevier.
- Christiansen, V., and S. Smith. 2012. "Externality-Correcting Taxes and Regulation." *Scandinavian Journal of Economics* 114(2): 358–83.
- Crossen, S. 2006. "Tobacco Taxation in the European Union." CESifo Working Paper 1718, CESifo Group, Munich.
- Crawford, I., M. Keen, and S. Smith. 2010. "Value Added Tax and Excises." In *Dimensions of Tax Design: The Mirrlees Review*, edited by the Institute for Fiscal Studies. Oxford: Oxford University Press.
- Crawford, I., and S. Tanner. 1995. "Bringing it All Back Home: Alcohol Taxation and Cross-Border Shopping." *Fiscal Studies* 16(2): 94–114.
- Delipalla, S., and M. Keen. 1992. "The Comparison between Ad Valorem and Specific Taxation under Imperfect Competition." *Journal of Public Economics* 49(3):351–61.
- . 2006. "Product Quality and the Optimal Structure of Commodity Taxes." *Journal of Public Economic Theory* 8(4):547–54.
- Delipalla, S., and O. O'Donnell. 2001. "Estimating Tax Incidence, Market Power and Market Conduct: The European Cigarette Industry." *International Journal of Industrial Organization* 19(6):885–908.
- Euromonitor. 2015. "Global Tobacco: Key findings, Part 1: Cigarettes—The Ongoing Quest for Value." *Euromonitor International*, July.
- European Commission. 2004. *Tobacco or Health in the European Union: Past, Present and Future*. Luxembourg: Office for Official Publications of the European Communities.

Confronting Illicit Tobacco Trade: A Global Review of Country Experiences

- . 2013. "Stepping Up the Fight against Cigarette Smuggling and Other Forms of Illicit Trade in Tobacco Products—A Comprehensive EU Strategy." Communication from the Commission to the Council and the European Parliament, COM(2013) 324, Brussels, June.
- Gruber, J., and B. Koszegi. 2001. "Is Addiction Rational? Theory and Evidence." *Quarterly Journal of Economics* 116(4):1261–1303.
- . 2008. *A Modern Economic View of Tobacco Taxation*. Paris: International Union Against Tuberculosis and Lung Disease.
- Hanson, A., and R. S. Sullivan. 2008. "The Incidence of Tobacco Taxation: Evidence from Geographic Micro-level Data." Research Paper Series 08-30, Andrew Young School of Policy Studies, Georgia State University, Atlanta.
- Hu., T.W., Z. Mao, J. Shi, and W. Chen. 2008. *Tobacco Taxation and Its Potential Impact in China*. Paris: International Union Against Tuberculosis and Lung Disease.
- Hu, T. W., X. Xu, and T. E. Keeler. 1998. "Earmarked Tobacco Taxes: Lessons Learned." In *The Economics of Tobacco Control: Towards an Optimal Policy Mix*, edited by I. Abedian, R. van der Merwe, N. Wilkins, and P. Jha, 102–18. Cape Town: Applied Fiscal Research Centre, University of Cape Town.
- Imperial Tobacco Canada. 2009. *What's Wrong with This Picture?* Montreal: Imperial Tobacco Canada.
- International Tax and Investment Center (ITIC). 2013. *The Illicit Trade in Tobacco Products and How to Tackle It*. 2nd ed. Washington, DC: International Tax and Investment Center.
- Jha, P., and F. Chaloupka. 1999. *Curbing the Epidemic: Governments and the Economics of Tobacco Control*. Washington, DC: World Bank.
- John, S. 2008. "History and Culture of Bidis in India: Production, Employment, Marketing and Regulations." In *Bidi Smoking and Public Health*, edited by P. C. Gupta and S. Asma, 1–12. New Delhi: Ministry of Health and Family Welfare. Government of India.
- Johnson, T. R. 1978. "Additional Evidence on the Effects of Alternative Taxes on Cigarette Prices." *Journal of Political Economy* 86(2):325–28.
- Joossens, L. 2011. "Pricing Policies and Control of Tobacco in Europe (PPACTE), Work Package 5, Deliverable 5.2: Illicit Tobacco Trade in Europe: Issues and Solutions." August.
- Keen, M. 1998. "The Balance between Specific and Ad Valorem Taxation." *Fiscal Studies* 19(1):1–37.
- Kemball, B. 2009. "Tobacco in Canada: An Inconvenient Truth." Speech to the Canadian Club of Montreal, June 1.
- Laffer, A. B. 2014. *Handbook of Tobacco Taxation: Theory and Practice*. San Francisco: Laffer Center at the Pacific Research Institute.
- How to Design and Enforce Tobacco Excises? International Monetary Fund | November 2016
- Lightwood, J., D. Collins, H. Lapsley, and T. E. Novotny. 2000. "Estimating the Costs of Tobacco Use." In *Tobacco Control in Developing Countries*, edited by P. Jha and F. Chaloupka. Washington, DC: World Bank.
- Manning, W. G., E. B. Keeler, J. P. Newhouse, E. M. Sloss, and J. Wasserman. 1989. "The Taxes of Sin: Do Smokers and Drinkers Pay Their Way?" *Journal of the American Medical Association* 261:1604–09.
- Marsden, W. 2009. *Canada's Boom in Smuggled Cigarettes: Indian Tobacco Factories, Organized Crime Control a Billion-Dollar Black Market*. Washington, DC: Center for Public Integrity.

- Merriman, D. 2001. "Tool 7, Smuggling: Understand, Measure and Combat Tobacco Smuggling. Economics of Tobacco Toolkit, World Bank, Washington, DC.
- Rasmussen, S. R., E. Prescott, T. I. A. Sørensen, and J. Sogaard. 2004. "The Total Lifetime Costs of Smoking." *European Journal of Public Health* 14(1):95–100.
- Royal Canadian Mounted Police. 2008. "2008 Contraband Tobacco Enforcement Strategy." Ottawa.
- Royal College of Physicians. 1962. *Smoking and Health*. London: Pitman Medical.
- Salti, N., J. Chaaban, and N. Naamani. 2014. "The Economics of Tobacco in Lebanon: An Estimation of the Social Cost of Tobacco Consumption." *Substance Use & Misuse* 49(6):735–42.
- Skeath, S. E., and G. A. Trandel. 1994. "A Pareto Comparison of Ad Valorem and Unit Taxes in Noncompetitive Environments." *Journal of Public Economics* 53(1):53–71.
- Stern, N. 1987. "The Effects of Taxation, Price Control and Government Contracts in Oligopoly and Monopolistic Competition." *Journal of Public Economics* 32(2):133–58.
- Sunley, E. 2007. "Tobacco Excise Taxation in Asia: Recent Trends and Developments." Paper presented at the Fourth Meeting of the Asia Tax Forum, Hanoi, Vietnam.
- United States Department of Health, Education and Welfare. 1964. *Smoking and Health: Report of the Advisory Committee to the Surgeon General of the Public Health Service*. Washington: Public Health Service, United States Department of Health, Education and Welfare.
- United States Department of Health and Human Services. 2014. *The Health Consequences of Smoking—50 Years of Progress: A Report of the Surgeon General*. Atlanta, GA: United States Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health.
- Verguet, S., C. L. Gauvreau, S. Mishra, M. MacLennan, S. M. Murphy, E. D. Brouwer, R. A. Nugent, K. Zhao, J. Prabhat, and D. T. Jamison. 2015. "The Consequences of Tobacco Tax on Household Health and Finances in Rich and Poor Smokers in China: An Extended Cost-Effectiveness Analysis". *The Lancet: Global Health* 3(4):e206–e216.
- Warner, K. E., F. J. Chaloupka, P. J. Cook, W. G. Manning, J. P. Newhouse, T. E. Novotny, T. C. Schelling, and J. Townsend. 1995. "Criteria for Determining an Optimal Cigarette Tax: The Economist's Perspective." *Tobacco Control* 4(4):380–86.
- Whitman, G. 2006. "Against the New Paternalism: Internalities and the Economics of Self-Control." Policy Analysis 563, Cato Institute, Washington, DC.
- World Health Organization (WHO). 2008. *WHO Report on the Global Tobacco Epidemic, 2008: The MPOWER Package*. Geneva.
- . 2010. *WHO Technical Manual on Tobacco Tax Administration*. Geneva.
- . 2016. "Fiscal Space, Public Financial Management and Health Financing: Sustaining Progress towards UHC. Implementation of the Collaborative Agenda. 26–28 April 2016, Montreux, Switzerland." WHO/HIS/HGF/HFWorkingPaper/16.2; Health Financing Working Paper No. 2, World Health Organization, Geneva. <http://apps.who.int/iris/bitstream/10665/250127/1/WHO-HIS-HGF-HFWorkingPaper-16.2.pdf>.
- Yach, D., and H. Wipfli. 2006. "A Century of Smoke." *Annals of Tropical Medicine and Parasitology* 100(5–6):465–79.

CONCLUSION

Conclusion

I. Overview

The preceding chapters of this book have presented a series of case studies addressing illicit trade in tobacco products in over 30 countries, including strategies and measures to address it. The country case studies describe the impact of tax administration (including customs) and, in most cases, of price and tax differences on illicit trade. Collectively, these case studies provide a strong platform for evaluating good and, in some cases, bad practices in addressing illicit trade in tobacco products. The chapters address both tax evasion (i.e., illicit tobacco trade) and tax avoidance (i.e., legal loopholes to avoid tobacco taxes). These studies demonstrate a wide variety in the salience of illicit tobacco trade, country strategies, capacities, and degrees of success in confronting this challenge.

This concluding chapter summarizes good practices and recommendations that emerge from the country cases. It also draws on guidance from the WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products (the Protocol), from the IMF Chapter in this volume, and from the recent World Bank report, *Tobacco Tax Reform: At the Crossroads of Health and Development*. The essence of these good practices and recommendations, as discussed below, can be summarized in the following three points:

- » To reduce illicit trade in tobacco products, it is both crucial and feasible for all countries to strengthen tax (including customs) administration and enforcement. There is growing experience and agreement on the package of steps needed to do so, the main elements of which are described in the Protocol.
- » Tobacco taxes play only a minor role in illicit trade, although several country cases found that the tobacco industry used exaggerated estimates of illicit trade to argue against

tobacco tax increases. Significantly, in every case study where there was a significant tax or price increase, there was a resultant increase in government revenue and (where data was available) a decrease in smoking prevalence. As a result, countries should not hesitate to increase tobacco taxes and improve their tax structures, even while at an early stage of efforts to improve tax administration. Even at relatively high levels of tobacco illicit trade, the overwhelming majority of smokers will still be buying on the official market and paying full taxes, while some smokers will quit (or non-smokers will not initiate smoking) as a result of a tobacco tax reform.

- » The strengthening of tax administration and tobacco tax reform – significant and sustained increases and restructuring of tobacco taxes – should be viewed as complements rather than substitutes. They reinforce each other in helping countries to reduce preventable morbidity and mortality and in increasing public revenues.

II. The importance of reducing illicit trade in tobacco products

The case studies make it clear that reducing illicit trade in tobacco products is important whether viewed from the perspective of public health, public finance, the rule of law, governance, or equity. As previously noted, illicit trade in tobacco products contributes to numerous health, economic, and governance challenges, of which the following are most salient:

- » **Illicit tobacco kills.** The fundamental reason to confront illicit trade in tobacco products involves its public health impact. All tobacco products are dangerous to human health, including those produced and sold in strict legality. However, illicit tobacco harms individual and population health in additional ways. From a public health perspective, illicit trade weakens the effect of tobacco excise taxes on tobacco consumption - and consequently on preventable morbidity and mortality - by increasing the affordability, attractiveness, and/or availability of tobacco products.
- » **Youth and the poor are most impacted.** Illicit cigarettes generally sell for considerably less than their tax-paid equivalents, as evidenced by the case studies presented in this book. They inflict the greatest harm to the most price-sensitive population group, reducing prices to and so encouraging consumption by, in particular, young people and those with low incomes. The availability of inexpensive illicit cigarettes increases the likelihood of young people developing addiction (particularly where illicit imports "glamorize" smoking through aspirational brands). It also encourages the poorest quintiles of the population to continue smoking, rather than choose to quit, even when tobacco taxes and the price of legal cigarettes rise. The poor tend to have higher tobacco consumption levels and consequently are disproportionately impacted by tobacco-related diseases and premature deaths, placing them at higher risk of being pushed into extreme poverty due to costs of treatment and/or loss of income when an

income-earning smoker develops a tobacco-related disease. As a result, illicit trade in tobacco products exacerbates equity gaps.

- » **Confronting illicit trade in tobacco products supports improved governance.** Tobacco illicit trade, by definition, reduces revenues that would otherwise be paid to government that could be invested in tobacco control and other priority programs that benefit the population. It also negatively impacts public welfare in other ways. For instance, illicit trade in tobacco is not only inconsistent with the rule of law, but often depends on and can contribute to weakened governance (e.g., through corruption and the presence of organized criminal networks). In contrast, confronting this issue can yield broader benefits for governance - tools and capacities developed to address illicit trade in tobacco products can strengthen overall tax administration, compliance, and enforcement (including for other products subject to excise taxes, such as alcohol and fuel). This subject is addressed in the Kenya, Georgia, and Ecuador chapters of this report. Controlling illicit trade in tobacco products and enhanced overall governance are mutually reinforcing.
- » **Uncontrolled illicit trade in tobacco provides opportunities for the tobacco industry to misinform public opinion and unduly influence public policy.** As emphasized in this report's country case studies and other recent analyses¹, the tobacco industry routinely uses inflated estimates of the impact of tobacco taxes on illicit trade to campaign against tobacco tax increases and misinform public opinion. By accurately measuring and better controlling illicit trade in tobacco, governments reduce industry's ability to distort policy priorities supporting improved public health, tax administration, and governance. For example, as emphasized in the Colombia chapter, an initial study to quantify the true volume of illicit cigarette trade in the country (notably, the first of its kind not to be sponsored by tobacco companies) was essential to galvanizing support for increased tobacco taxation.

III. Strategic steps to reduce illicit trade in tobacco products

How are countries effectively confronting tobacco illicit trade? The following strategic steps emerge from the case studies, with respect to key lessons from countries that are successfully addressing illicit trade in tobacco products.

- » **Diagnose the different forms of illicit trade in tobacco products:** The cases studies show that illicit trade overwhelmingly involves cigarettes, rather than other tobacco products. Cigarette illicit trade takes variety of forms, varying in type and severity by country: smuggling across borders; declaring products as for export (and thus not subject to domestic tax) and then selling them on the domestic market; using fake tax stamps; selling undeclared production (e.g. an undisclosed third production shift); producing counterfeits of legitimate brands; producing low-cost unbranded cigarettes destined for illicit markets (so called "illicit whites"); using Free Zones to leak cigarettes to the domestic market; and

selling tobacco products via Internet, phone, or mail². Each form of tax evasion has somewhat different implications for needed improvements in tax administration and enforcement.

- » **Understand the causes and drivers of illicit trade in tobacco products:** The case studies confirm findings from the literature that tobacco illicit trade stems from a wide range of causes. These include weaknesses in governance and the regulatory framework, corruption, insufficient capacity of enforcement and judiciary systems, the existence of informal distribution and of organized crime networks, having a border with another country suffering from similar problems; and expected profitability of tobacco illicit trade. Tobacco taxes are one of the factors affecting expected profitability, along with costs of procurement, distribution and the chances and consequences of getting caught – which is largely dependent on tax administration. However, the sub-regional case study on South Africa, Lesotho and Botswana shows that price differences had little to no detectable impact on illicit cross-border trade of tobacco products. In fact, countries or sub-regions with relatively low tobacco prices such as Malaysia or the Caribbean tend to have higher, rather than lower, shares of illicit trade.

The country cases strongly confirm that the most important determinant in illicit trade of tobacco products is tax administration. Countries as different in levels of economic and institutional development as the United Kingdom (UK), Kenya, and Georgia have all successfully improved the effectiveness of their tobacco tax administration and, by doing so, reduced tobacco illicit trade while increasing tobacco tax rates and tobacco tax revenues. Addressing illicit trade and raising tobacco taxes should be viewed as mutually reinforcing and complementary actions. Even at relatively high levels of illicit trade, the overwhelming majority of consumers purchase on the official tax-paid market. Some of that overwhelming majority of smokers will be reducing their consumption or quitting following a tax increase, while wealthier and less price sensitive smokers will be contributing to increased government revenues.

- » **Strengthen country data, analysis, planning, and implementation oversight:** Consistent with Articles 7 and 9 of the Protocol, the UK, Australia, and Ireland case studies visibly demonstrate the importance of reliable data. The process should start with mapping of the supply and demand for tobacco products; what is known about illicit trade in tobacco products; the modus operandi of actors involved in or facilitating illicit trade; the capacity, commitment, and accountability (including corruption) of government agencies; and resultant effectiveness of tax/customs administration. Anti-illicit trade strategies need to be informed and when needed adjusted based on the ongoing data collection - as the UK, Kenya, and Australia (with its Black Economy Taskforce), have done. Actors involved in the illicit trade of tobacco products are continuously assessing their sales and profits and adapting their tactics accordingly. Consequently, agencies responsible for controlling/preventing tobacco illicit trade must take a similarly adaptable, rigorous, and focused approach.

In addition, having access to high quality local market data, including smoking prevalence and intensity, is essential. Countries that regularly generate their own reliable estimates (e.g., UK, Australia, Ireland) use them also to fine-tune their strategies. Unfortunately, independent estimates of the size of illicit markets are scarce, particularly in low- and middle-income countries, and industry estimates (as discussed below) are unreliable. As a result, it is important that countries develop independent estimates of tobacco illicit trade using good-practice methods. These methods, described in a 2015 Guide³, if applied correctly and adjusted for the local circumstances, can generate reliable estimates of the size of illicit markets relatively quickly and at reasonable costs. Developing such independent estimates requires strengthening country capacity, which could be augmented by technical assistance available, including from multilateral donors and other development partners.

Importantly, not having data regarding the size of the illicit market is not an excuse for inaction. The absence of such a reliable estimate has not stopped Kenya, Georgia, or the Philippines, for example, from moving ahead in controlling illicit trade in tobacco products. In all countries, it is important to evaluate the measures already in place and determine what works, what does not, and why. Country strategies to reduce illicit trade in tobacco products should establish policies, legislation, and regulations appropriate for specific country contexts.

It is critical to note that having a strong strategy on paper is important but not sufficient, unless such plans can be operationalized. This includes the strengthening of capacity, incentives, and accountability needed for effective implementation.⁴ The case studies of Bangladesh, the Southern African Customs Union (SACU), and the UK, at quite different levels of development, all emphasize the importance of capacity development. Similarly, Colombia adopted an Anti-Smuggling Act that both provides the legal framework for controlling illicit trade and the tools for implementing extended law enforcement activities in border areas. Likewise, the Kenya case study highlights the fact that deterring tobacco illicit trade requires not just setting, but enforcing criminal penalties, including incarceration and severe financial penalties for correspondingly serious offenses.

- » **Avoid reliance on the tobacco industry:** The role of the tobacco industry poses a challenge to countries seeking to address illicit trade, since the tobacco industry is often linked to illicit trade in tobacco products, either directly or indirectly.⁵ The UK and Ireland case studies emphasize the need to fulfill obligations under Article 5.3 of the FCTC to prevent the tobacco industry from influencing public policy.⁶ One approach, as described in the UK case study, is to publicly expose the industry involvement in illicit trade. As the literature indicates, tobacco industry documents provide compelling evidence that the supply of international brands via illegal channels has been an important component of their market entry strategy in Africa, Latin America and in Asian countries.^{7,8} As the experience of SACU, Chile, the Organization of Eastern Caribbean States (OECS) and South Africa illustrates, the industry's economic power provides them substantial influence in many countries. In Colombia, for example, the main regulatory authority is required to report to the tobacco

industry, allowing it to influence budget allocations and decisions related to controlling tobacco illicit trade in violation of Article 5.3 of the FCTC.

The case studies, including Colombia, Australia, Georgia, and Malaysia, also confirm prior findings that the tobacco industry regularly overstates levels and changes in tobacco illicit trade to oppose tobacco tax reforms. For example, in Colombia, an impartial estimate of the market share of illicit trade was only 7 percent, while the tobacco industry estimated that share at 18 percent.⁹ In Australia, an industry-funded study estimated the illicit market at 14 percent¹⁰ of the total market, while the Australian Taxation Office calculated that share to be only 5.6 percent.¹¹ This issue of exaggerating the illicit market share applies whether the tobacco industry is reporting data to governments or to firms that aggregate and publish data.

The Georgia and Uruguay case studies show that when the government responds to industry pressure and reduces taxes due to fears regarding tobacco illicit trade, the result is a decline in revenues and an increase in consumption, while the true drivers of illicit trade in tobacco products remain unaddressed. Canada had a similar, well-documented, experience in the 1990s, when the government reduced tobacco tax in response to tobacco illicit trade concerns¹². This tax reduction led to lower cigarette prices, higher smoking rates, especially among youth,¹³ and lower tax revenue. After assessing the impact of its 1994 tobacco tax cut on prevalence and revenues, the Canadian government restored taxes to their pre-1994 level.¹⁴ In addition, it sued the tobacco industry for manipulating illicit trade to influence the lowering of the cigarette tax rate.^{15, 16}

- » **Build inclusive, political coalitions against illicit trade in tobacco products:** Strong and successfully implemented country strategies require enlisting support and finding champions at top levels of ministries and governments, as demonstrated in Georgia, the Philippines and the UK. Another crucial element of gaining political support is to build alliances with key stakeholders in civil society, including NGOs, think tanks, and the media, as emphasized in the Kenya and the UK case studies.

NGOs in Georgia, Turkey, Columbia, and Bangladesh also have played major roles in support of addressing tobacco illicit trade and in implementing tobacco tax reforms, including exposing efforts by the tobacco industry to counter tobacco control programs. In Bangladesh, for example, young people have torn down billboards that were illegally advertising tobacco. The Philippines and Kenya introduced apps for the public to verify the authenticity of cigarette packs, while the UK ran a public awareness campaign explaining how purchasing illegal cigarettes harms the country and local communities. Involving the public in addressing illicit trade both supports enforcement and reduces the demand for illegal products. Issues of political economy also affect enforcement – the Mexico and Kenya case studies highlight the importance of the electoral cycle and the overall national security context on the effectiveness of tax administration and enforcement.

- » **Work across sectoral silos:** The Colombia, Chile and Kenya case studies identified lack of integration across sectors at the national and subnational levels as the major obstacle in controlling illicit trade of tobacco products. These analyses, in conjunction with the Bangladesh, Australia and Mexico case studies, emphasize that success in adopting and implementing strong programs to combat illicit trade and implement tobacco tax reform requires active and coordinated support from numerous ministries/government agencies. Coordination is particularly important in integrating tobacco illicit trade control into strategies for tobacco tax reform and overall tobacco control programs.

Bangladesh, for example, closely coordinates its tobacco control efforts through five ministries at both the national and the district levels: Health (the lead agency in the FCTC and overall tobacco control); Finance (responsible for tax policy and administration); Home Affairs (responsible for police and border control); Agriculture (regarding tobacco cultivation); and the Cabinet Office (to provide high level political support). As detailed in the Bangladesh case study, its national taskforce also includes, among others, the Ministry of Commerce (on regulating trade and licensing); the Ministry of Justice (on enforcing the law and prosecuting offenders); and the Ministry of Education (on convincing vulnerable young people not to initiate smoking behavior /develop an addiction to tobacco).

- » **Address illicit trade as an integral part of tobacco tax reform and overall tobacco control:** Country cases, including those of the Philippines, the UK and Ireland, clearly demonstrate the complementary nature of addressing tobacco illicit trade and implementing tobacco tax reform. The key elements of tobacco tax reform have recently been summarized in the World Bank publication *Tobacco Tax Reform: At the Crossroads of Health and Development*¹⁷ and are summarized below:

- › **Go big, go fast.** Tax strategies should focus on health gains first, then on fiscal benefits. This means going for big tobacco excise tax rate increases starting early in the process.
- › **Attack affordability (i.e., if tobacco taxes increase tobacco prices faster than inflation and growth in per capita income).** Tobacco taxes only reduce tobacco consumption if they reduce cigarette affordability.
- › **Change expectations.** Communication with the public is also critical. Governments must make sure consumers know that cigarette prices will keep going up.
- › **Tax by quantity.** Tobacco tax rates should be simplified and based on the quantity of cigarettes, not their price.
- › **“Soft earmarks” can win support.** Although earmarking tax revenues through legislation is criticized by fiscal experts as contributing to rigidities, fragmentation, and eventual distortions in public expenditure, “soft” earmarking of funds (for example, linking increased taxes to increased health spending) has helped generate grassroots support for the tax hikes.

- › **Regional collaboration can boost results.** Momentum for ambitious tobacco tax reform can be enhanced, and cross-border threats like cigarette smuggling minimized, when countries work together in a regional structure.
- › **Build broad alliances.** Country leaders face sharp resistance to tax rate increases and other tobacco control measures from the tobacco industry. Countering these pressures requires reliable data and economic analysis, multi-sectoral policy development, and strong partnerships among key stakeholders at the local, national, and international levels.

The pace and phasing of these tax reform principles will, of course, depend on specific country circumstances. Following these principles of tobacco tax reform, combined with addressing tax avoidance and tax evasion, will improve public health, increase tax revenues and support economic growth. The largest beneficiaries of health and income gains will be former smokers and their families, as well as those who might otherwise have initiated smoking.¹⁸

More broadly, confronting illicit trade in tobacco products should be an integral part of a country's overall approach to tobacco control, which includes the steps called for in WHO's "MPOWER" strategy (banning smoking in public places, banning advertising and promotion of tobacco products, offering help to those who want to quit, as well as, of course, tobacco tax reform). The UK and Ireland case studies illustrate the importance of integrating tax and non-tax MPOWER steps in responding to tobacco illicit trade.

- » **Encourage and draw on regional and global cooperation/partnerships:** As recommended in the Protocol (Articles 20 – 31) and the FCTC, countries also should support and draw on regional and sub-regional, as well as global, partnership arrangements to address illicit trade and to implement tobacco tax reform. This can help, for example, in reducing substantial disparities in tobacco taxes in neighboring countries by pulling countries up to a common higher tax level. It also can improve coordination of cross-border and regional efforts to reduce tobacco illicit trade. As shown in the European Union (EU) case study, the EU sets the gold standard in using regional agreements to establish high minimum standards for tobacco taxes and to address illicit trade in tobacco products. Its regulations have an impact not only on EU member states, but also on candidate countries and on countries with Association Agreements such as Georgia. Georgia, for example, has worked closely with Turkey to stop the use of its territory for transit of untaxed cigarettes. In addition, Georgia has a memorandum of understanding with the UK Customs office to share intelligence regarding large-scale smuggling operations.

However, it should be noted that not all regional agreements are uniformly positive. The case study of the OECS countries and Trinidad and Tobago, for example, shows a negative informal 'neighborhood' effect, where all countries have low tobacco taxes (except for Barbados), lag behind the implementation of the MPOWER recommendations on tax reforms, and have implemented very few measures to control tobacco illicit trade. Also,

the Senegal case study points to the damaging impact on tobacco tax reform of the maximum tobacco tax rate established by the West African Economic and Monetary Union (WAEMU). In contrast, West Africa's other regional economic grouping, the Economic Community of West African States (ECOWAS), has recently drastically reformed its tobacco tax directives by changing its "maximum" tax rule to a "minimum" one, so that, like the EU, it does not restrain countries from implementing higher tax rates.

At the global level, the most effective way a country can benefit from and contribute to promoting international collaboration is to join the Protocol, discussed below. Only four of the countries covered by case studies have done so, as of yet - Ecuador, Senegal, the UK and Uruguay. Ratifying the Protocol has advantages that go beyond information sharing and coordination of enforcement efforts, including access to technical assistance in implementing the Protocol and establishing track and trace systems.

- » **Draw on the Protocol and Guidelines for implementing the FCTC:** Authorities seeking to strengthen tax administration can utilize two important sources of good practice that derive from Section 15 of the FCTC, "Illicit Trade in Tobacco Products." The first is the WHO's FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (or the Protocol). It is a new treaty derived from the FCTC that has been ratified by 46 countries and the European Union and that entered into force on September 25, 2018, as detailed in the chapter of this book. The case studies consistently refer to the Protocol, recommending adhering to its principles and citing specific Articles, even where countries have not yet ratified it. As an international treaty, the Protocol also can help generate domestic political support for implementing its measures. Additionally, countries that have ratified the Protocol will have access to resources to help them assess their illicit markets and develop their strategies to address illicit trade in tobacco products. The Protocol outlines three main approaches to reduce and prevent tobacco illicit trade: (i) Controlling the supply chain of tobacco products (Articles 6-13); (ii) Addressing unlawful conduct and criminal offenses through enforcement (Articles 14-19); and (iii) Promoting international cooperation through information sharing, mutual administrative and legal assistance, and extradition (Articles 20-31).

The second key source of policy guidance and good practice is constituted by the Guidelines for Implementation of Article 6, on *Price and Tax Measures* of the FCTC (issued in 2014). These guidelines also cover Article 15, on *Illicit Trade in Tobacco Products*. One of its guiding principles is the need for efficient and effective administration of tobacco tax systems, including addressing illicit trade in tobacco products. Section 4 of the Guidelines, which focuses specifically on tax administration, is closely aligned with the articles of the Protocol. It addresses a common practice of tax avoidance called "forestalling" (i.e., stocking up tax stamps or tax-paid excess inventories in the distribution system in advance of a tax increase). Forestalling has been reported in several case studies (including Georgia and the Philippines). Section 6 of the Guidelines is devoted to tax-free/duty-free sales - topics raised, for example, in Uruguay, the Philippines, and Chile case studies as a potential

source of tax evasion or avoidance. Section 7 of the Guidelines emphasizes and provides guidance on international cooperation.

Box 1 summarizes the above strategic steps to reduce illicit trade in tobacco products.

BOX 1: SUMMARY OF STRATEGIC STEPS TO REDUCE ILLICIT TRADE IN TOBACCO PRODUCTS

- » Diagnose the different forms of illicit trade in tobacco products
- » Understand the causes and drivers of illicit trade in tobacco products
- » Strengthen country data, analysis, planning, and implementation processes
- » Avoid reliance on the tobacco industry
- » Build inclusive, political coalitions against illicit trade in tobacco products
- » Work across sectoral silos
- » Address illicit trade as an integral part of tobacco tax reform and overall tobacco control
- » Encourage and draw on regional and global cooperation/partnerships
- » Draw on the Protocol and Guidelines for implementing the FCTC

IV. Specific actions to confront illicit trade in tobacco products

The discussion above provided broad, strategic directions for enhancing progress in controlling/preventing illicit trade in tobacco products. *However, what specific actions can decision makers prioritize to rapidly achieve gains?* Findings from the country case studies suggest the following specific actions (which are consistent with the IMF guidance presented in Chapter 22).

- » *Require licensing for the full tobacco supply chain, as required by Article 6 of the Protocol.* At present there is licensing at least for all manufacturers, importers, exporters, and distributors in almost all country cases. What is needed is for each country to assess its capacity to require licensing for rest of the supply chain, particularly retail. As noted in the Canada case study, the best example of using licensing to control the supply chain is in the province of Quebec, where the entire supply chain is licensed including tobacco growers, transporters, manufacturers, those who store raw tobacco and/or final products, importers, wholesalers, retailers, as well as those in possession of manufacturing equipment. Tobacco importers are licensed in Malaysia, and the Philippines requires suppliers of raw materials to the production process, including those providing tobacco papers and filter components,

to be licensed. The Australia case study highlights the importance of licensing tobacco manufacturing equipment to prevent the use of second-hand equipment for unlicensed and untaxed production. The UK has recently implemented a similar measure.

- » *Require use of secure excise tax stamps and other product markings to facilitate enforcement and tax collection, as required by Article 8 of Protocol.* These markings should possess multiple layers of security (as implemented in Kenya, Georgia, and the Philippines, for example); they should not be removable (not the case in Indonesia where the stamps are being reused illegally); and they should be destroyed when the pack is opened (also to prevent reuse). The absence of secure excise marking in SACU countries, Chile or Mexico weakens the ability of the tax authorities to collect taxes.
- » *Establish effective track-and-trace systems to follow tobacco products through the supply chain from production or import to sale to consumers (Article 8 of the Protocol).* Secure excise stamps are crucial but not sufficient to prevent tax evasion if there is no downstream verification that cigarettes have tax stamps and that they are authentic. Georgia, Kenya, and the Philippines, for example, already possess tight monitoring of production and import using unique IDs and excise stamps. These efforts could be readily developed into full-fledged track-and-trace systems throughout the supply chain with relatively small investments. A track-and-trace system would help address, for example, the challenge posed by under-declared domestic cigarette production or production declared for export but then sold on the domestic market.

The Mexican and Chilean case studies identify the absence of a track-and-trace system as the major obstacle to controlling illicit trade in tobacco products, as does the SACU study. The Ecuador case study, documented how its Internal Revenue Service implemented a tax track-and-trace system — “SIMAR” for domestically produced cigarettes, alcoholic beverages, and beer. As the first track-and-trace to comply with the Protocol to Eliminate Illicit Trade in Tobacco Products, SIMAR has become a benchmark for other countries in the region as they begin to tackle these issues.

- » *Establish effective enforcement teams equipped with automated reporting devices, to reduce human discretion in tobacco tax administration (Articles 8 and 19 of the Protocol).* This feature played a major role in improving the level of enforcement in Kenya and Georgia. However, the Kenya case also underlines the importance of enforcement agents with the power to carry out inspections at any time and at any point in the supply chain, to seize illicit products on the spot, and to bring immediate charges against offenders.
- » *Obtain detection equipment and use it effectively at customs posts (Articles 14 and 19 of the Protocol).* Most countries already have access to detection equipment, although not necessarily in adequate quantity. Potential governance challenges, with respect to the use of this equipment, can be further reduced by separating the roles of generating and interpreting scans (as noted in the Kenya case study).

- » *Develop a risk profile to target inspections (Articles 10, 14 and 19 of the Protocol).* The Chile case highlights the use of a risk analysis tool for targeting suspicious cargos and to generate customs alerts.
- » *Set relatively low duty-free allowances (Article 13 of the Protocol and Article 6.2 of the FCTC) for tobacco product purchases,* both in terms of amounts (e.g. only two packs, as in Australia) and frequency (e.g. only once every 30 days as in Georgia). Chile shows how the lack of restrictions on frequency led to substantial but legal small-scale tax avoidance.
- » *Regulate or ban trade in tobacco products in free trade and other special economic zones (Article 12 of the Protocol).* The Chile case study illustrates how the relative freedom from regulation in these zones can make them gateways for domestic sale of untaxed tobacco products. In contrast, Colombia and Malaysia both established a strict regulatory framework for free trade zones to prevent this challenge.
- » *Set and enforce significant financial penalties and penal provisions for illicit trade in tobacco products (Articles 15, 16 and 17 of the Protocol).* Seizures, financial penalties, and other punishment severe enough to be a deterrent (unlike some of those reported in the Kenya case study) are important. Criminal prosecutions are particularly important as deterrents. The UK case study, for example, reported that in its successful efforts to sharply reduce illicit trade, there were an average of about 250 criminal convictions per year from 2014-2016. Colombian officials also realized the importance of punishment as a deterrent when Colombia substantially boosted penalties for those involved in smuggling.
- » *Provide for secure and environmentally friendly destruction of seized cigarettes, carried out by the regulatory authorities and not by the tobacco industry (Article 18 of the Protocol).* In Mexico, customs officials destroy seized cigarettes, while in the Philippines approval and presence of a Bureau of Internal Revenue representative is required. In contrast to this guidance, in South Africa an industry-representative body is responsible for the destruction of illicit goods.
- » *Educate the public on the impact of tobacco illicit trade.* Getting the public involved supports enforcement and reduces the demand for illegal products. As noted in the case studies, the Philippines and Kenya introduced apps for the public to verify the authenticity of cigarette packs, while the UK ran a public awareness campaign explaining how purchasing illegal cigarettes harms the country and local communities.

The specific actions noted above do not cover Articles 7 (due diligence), 9 (record keeping) and 15 (liability) of the Protocol, since the country case studies generally did not call attention to these Articles. However, the Australia chapter stresses the importance of due diligence and record keeping, and the Canada chapter addressed record keeping. Since these Articles relate to the obligations of the industry, they are highly relevant to the implementation of the FCTC and the Protocol, in order to help create a strict regulatory environment for the tobacco industry and to protect public policies from commercial and other vested

interests of the tobacco industry (in accordance with national law as specified in Article 5.3 of the FCTC).

Box 2 summarizes the above strategic steps to reduce illicit trade in tobacco products.

BOX 2: SUMMARY OF SPECIFIC ACTIONS TO CONFRONT ILLICIT TRADE IN TOBACCO PRODUCTS

- » Require licensing for the full tobacco supply chain, as required by Article 6 of the Protocol.
- » Require use of secure excise tax stamps and other product markings to facilitate enforcement and tax collection, as required by Article 8 of Protocol.
- » Establish effective track-and-trace systems to follow tobacco products through the supply chain from production or import to sale to consumers (Article 8 of the Protocol).
- » Establish effective enforcement teams equipped with automated reporting devices, to reduce human discretion in tobacco tax administration (Articles 8 and 19 of the Protocol).
- » Obtain detection equipment and use it effectively at customs posts (Articles 14 and 19 of the Protocol).
- » Develop a risk profile to target inspections (Articles 10, 14 and 19 of the Protocol).
- » Set relatively low duty-free allowances (Article 13 of the Protocol and Article 6.2 of the FCTC) for tobacco product purchases, both in terms of amounts and frequency.
- » Regulate or ban trade in tobacco products in free trade and other special economic zones (Article 12 of the Protocol).
- » Set and enforce significant financial penalties and penal provisions for illicit trade in tobacco products (Articles 15, 16 and 17 of the Protocol).
- » Provide for secure and environmentally friendly destruction of seized cigarettes, carried out by the regulatory authorities and not by the tobacco industry (Article 18 of the Protocol).
- » Educate the public on the impact of tobacco illicit trade.

V. Final remarks

Complementing and supporting the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, the case studies presented in this book illustrate how countries have confronted illicit trade in tobacco products, in addition to summarizing the progress achieved, and the lessons learned. The case studies presented in this work demonstrate the importance - and feasibility - of addressing illicit trade in tobacco products as an integral part of tobacco tax reform and comprehensive tobacco control.

Endnotes

¹ Gallagher AWA, Evans-Reeves KA, Hatchard JL, et al. Tobacco industry data on illicit tobacco trade: a systematic review of existing assessments. *Tobacco Control* Published Online First: 22 August 2018. doi: 10.1136/tobaccocontrol-2018-054295

² Addressed by Article 11 of the Illicit Trade Protocol.

³ Hana Ross. *Understanding and measuring tax avoidance and evasion: A methodological guide*. Washington DC 2015. DOI: 10.13140/RG.2.1.3420.0486

⁴ On the importance of incentives and accountability as well as capacity in improving institutional effectiveness, see *World Development Report 2017, Governance and the Law*, World Bank, 2017.

⁵ Gilmore AB, Gallagher AWA, Rowell A. Tobacco industry's elaborate attempts to control a global track and trace system and fundamentally undermine the Illicit Trade Protocol. *Tobacco Control*. 2018

⁶ Framework Convention on Tobacco Control, WHO, 2003

⁷ Collin J, Legresley E, MacKenzie R et al. (2004). Complicity in contraband: British American Tobacco and cigarette smuggling in Asia. *Tob Control*, 13 Suppl 2;ii104–ii111.doi:10.1136/tc.2004.009357 PMID:15564212.

⁸ For a summary of the role of the tobacco industry see two recent WHO reviews, both based on internal tobacco documents: <http://www.who.int/tobacco/media/en/TobaccoExplained.pdf>; and http://www.who.int/tobacco/communications/TL_manual_content.pdf

⁹ Maldonado, Norman et al. (2018a). "Measuring illicit cigarette trade in Colombia". *Tobacco Control*.

¹⁰ KPMG, *Illicit Tobacco in Australia*. 2018

¹¹ Australian Taxation Office (2018) Tobacco tax gap.

¹² Eric Breton, Lucie Richard, France Gagnon, Marie Jacques And Pierre Bergero. Fighting a Tobacco-Tax Rollback: A Political Analysis of the 1994 Cigarette Contraband Crisis in Canada. *Journal of Public Health Policy* (2006) 27, 77–99.

¹³ Zhang B, Cohen J, Ferrence R, et al. The impact of tobacco tax cuts on smoking initiation among Canadian young adults. *Am J Prev Med* 2006;30(6).

¹⁴ Royal Canadian Mounted Police. Contraband tobacco enforcement strategy. 2008.

¹⁵ Kelton and Givel. Public Policy Implications of Tobacco Industry Smuggling through Native American Reservations into Canada. *International Journal of Health Services*. Vol 38, Issue 3, pp. 471 – 487. 2008

¹⁶ Daudelin J, Soiffer S, Willows J. Border integrity, illicit tobacco, and Canada's security. Macdonald-Laurier Institute; March 2013.

¹⁷ *Tobacco Tax Reform: At the Crossroads of Health and Development*, World Bank 2017

¹⁸ Ibid

ⁱ WHO Framework Convention on Tobacco Control Press Release, June 28, 2018.

<https://www.who.int/fctc/mediacentre/press-release/protocol-entering-into-force/en/>

ⁱⁱ World Health Organization Press Release, July 19, 2017.

<https://www.who.int/en/news-room/detail/19-07-2017-who-report-finds-dramatic-increase-in-life-saving-tobacco-control-policies-in-last-decade>

ⁱⁱⁱ Combatting illicit trade in tobacco products: Commissioner Andriukaitis' Statement on the EU's adoption of an EU-wide track and trace system. European Commission Press Release, December 15, 2017.

http://europa.eu/rapid/press-release_STATEMENT-17-5269_en.htm

^{iv} How to design and enforce tobacco excises? International Monetary Fund, October 2016

<https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2016/12/31/How-to-Design-and-Enforce-Tobacco-Excises-44352>

^v World Bank Group: "Global Tobacco Control: A Development Priority for the World Bank Group", Preface of WHO Global Tobacco Report 2015.

http://www.who.int/tobacco/global_report/2015/timevansandworldbankforeword.pdf?ua=1

“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”ⁱ

– Dr. Vera Luiza da Costa e Silva
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”ⁱⁱ

– Dr. Tedros Adhanom Ghebreyesus, Director-General
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”ⁱⁱⁱ

– Commissioner Vytenis Andriukaitis
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”^{vi}

– Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”^v

–Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)
Health, Nutrition and Population Global Practice / World Bank Group

