

# ILLICIT TRADE IN TOBACCO

A SUMMARY OF THE EVIDENCE  
AND COUNTRY RESPONSES



**World Health  
Organization**

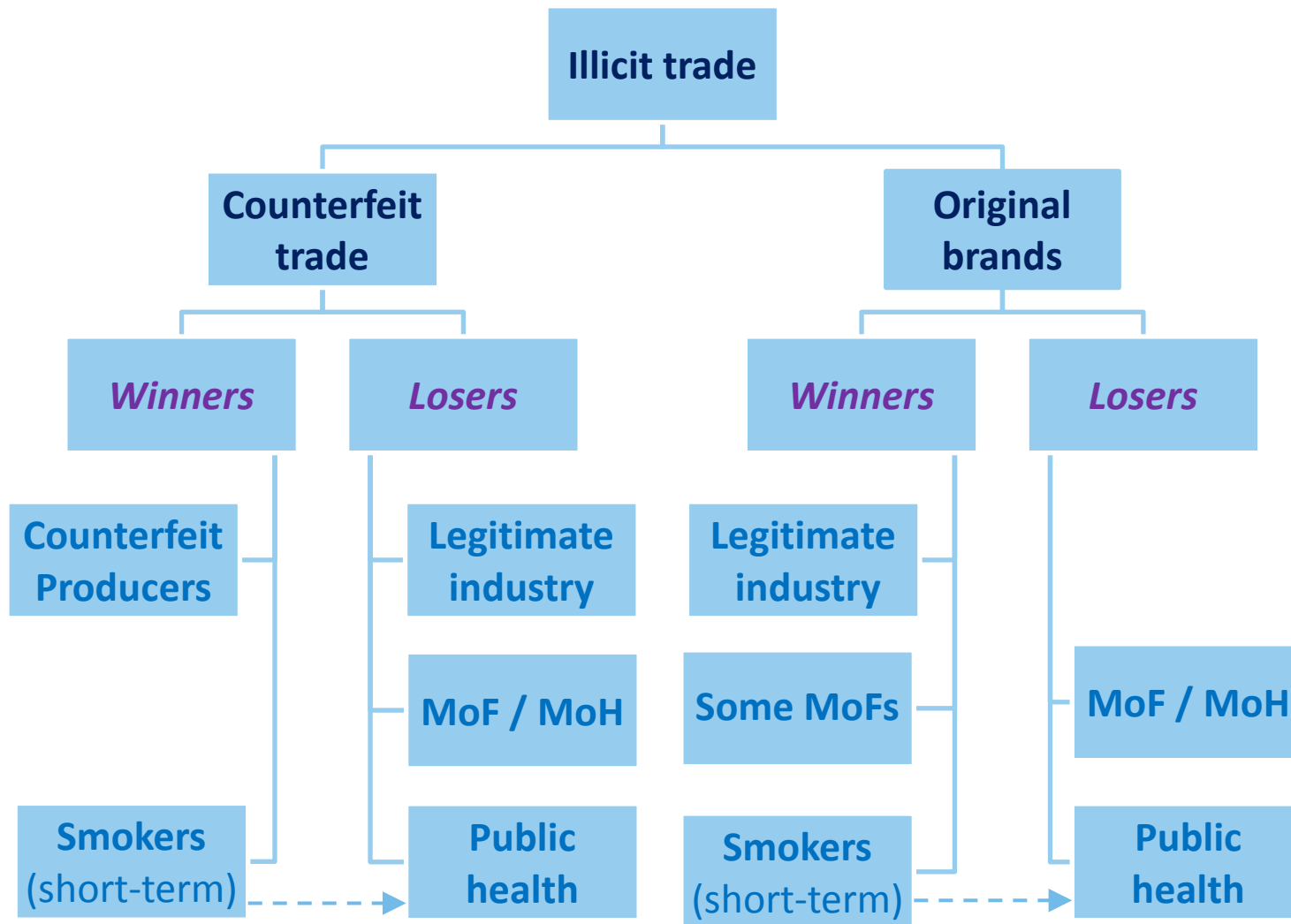
# Introduction

- This presentation summarizes the evidence on illicit trade in tobacco products and measures that countries and the international community are introducing to address the problem.
- It addresses four main questions:
  - ❖ What is it?
  - ❖ How can it be measured?
  - ❖ What are the causes?
  - ❖ What are the control measures?

# What is illicit trade?

- **Illicit manufacture:** cigarettes produced in legal or covert facilities and not declared to the tax authorities.
  - ❖ Counterfeits of established international brands
  - ❖ Non-duty paid production for local consumption
  - ❖ Duty and non-duty paid production for smuggling out.
- **Illicit importation:** cigarettes produced/brought in one jurisdiction then illegally transported to another to avoid applicable taxes.
  - ❖ Bootlegging of legally purchased cigarettes by individuals for personal use
  - ❖ Small-scale smuggling of legally purchased cigarettes by groups for re-sale.
  - ❖ Large-scale smuggling involving the illegal transportation, diversion and re-sale of legally produced and counterfeit brands. Generally avoids taxes by diverting the product while still in the distribution chain (e.g. in transit).

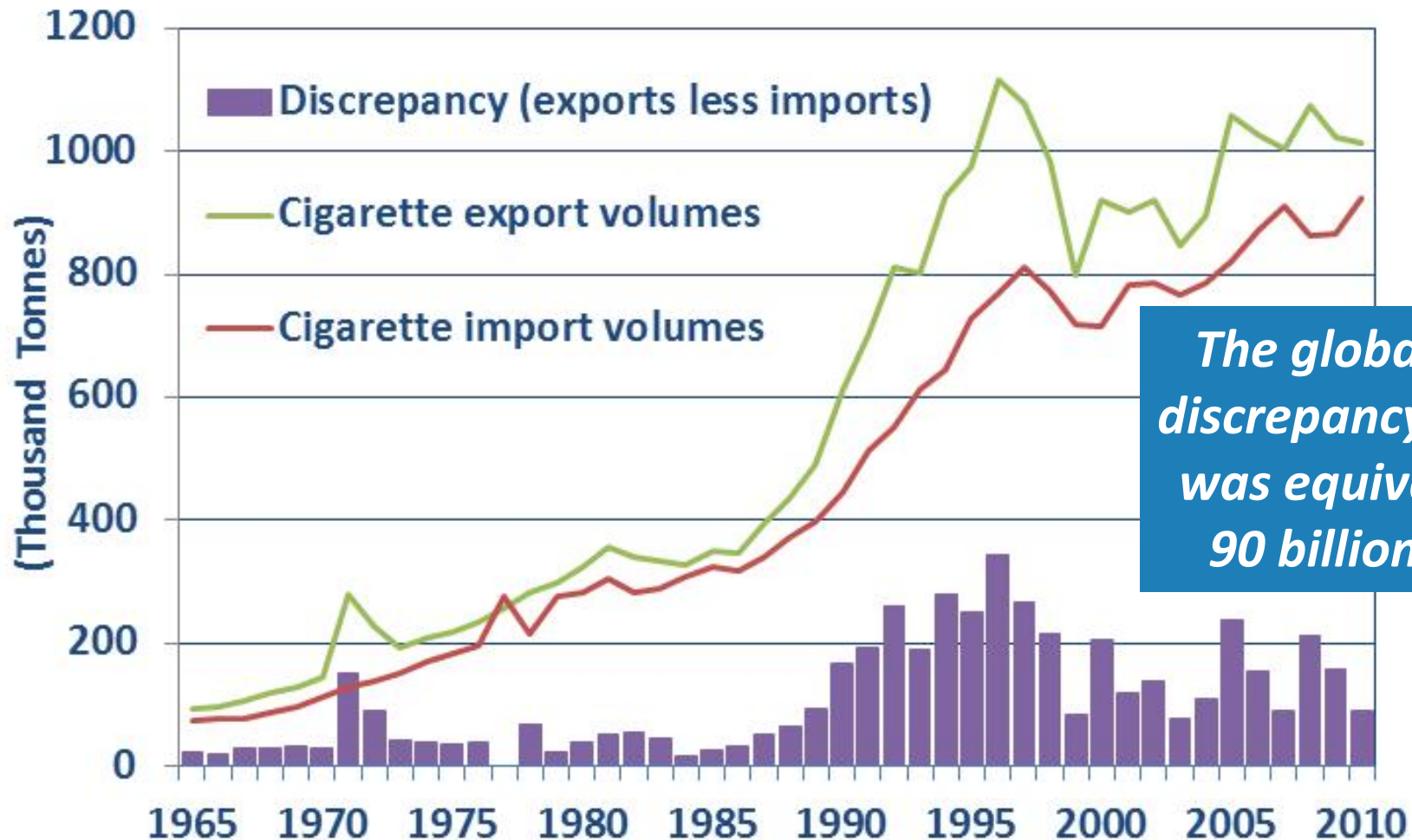
# Who wins and who loses?



# How can it be measured?

1. **Global trade data:** gap between exports and imports measures under-reporting of imports to avoid taxes. The measure does not include unrecorded exports or illicit local production.
2. **Local expert opinion:** ask customs officials or industry insiders. A common measurement approach in low and middle-income countries, but expert opinions can be highly biased and subjective.
3. **Market observation:** Consumer surveys and observation of littered cigarette packs. Note consumers often underreport due to fear of confiscation.
4. **Supply & demand:** gap between tax-paid sales and total consumption as estimated from consumer prevalence surveys such as the Global Adults Tobacco Survey.

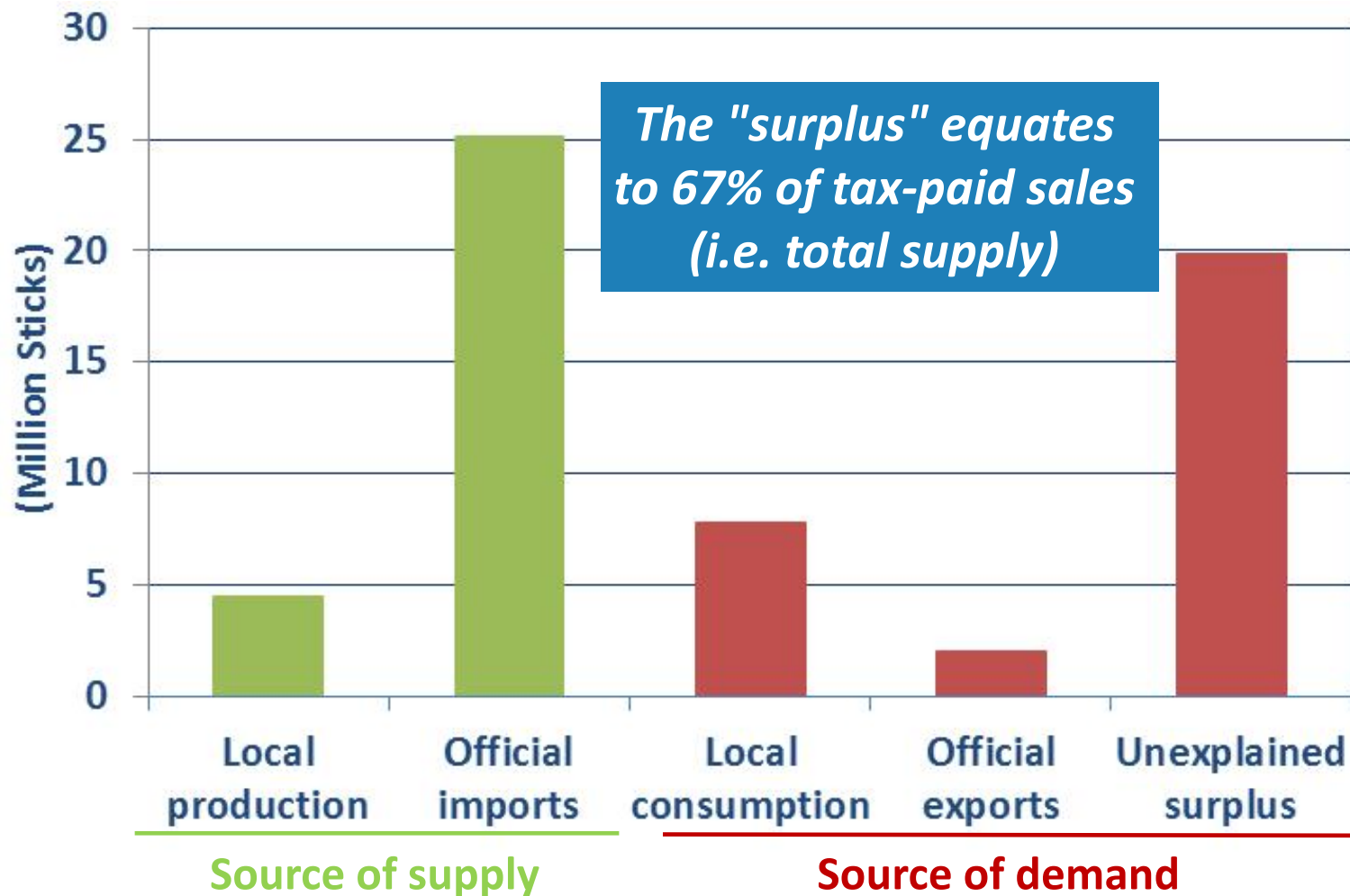
# Global trade discrepancy



Source: <http://faostat.fao.org>

# Tax-paid sales versus consumption

## Example: Cambodian cigarette supply and demand in 2011



# Illicit trade affects most regions

<b>Euromonitor estimates</b>	<b>Retail Sales volume (Billion Sticks)</b>	<b>Illicit Trade Share (% retail sales)</b>	<b>Illicit trade volume (Billion Sticks)</b>
Asia and the Pacific	3,474	8.4%	291
Eastern Europe	701	8.4%	59
Latin America	252	16.7%	42
Middle East & Africa	405	10.6%	43
North America	343	7.9%	27
Western Europe	562	8.7%	49
<b>World</b>	<b>5,152</b>	<b>9.0%</b>	<b>462</b>

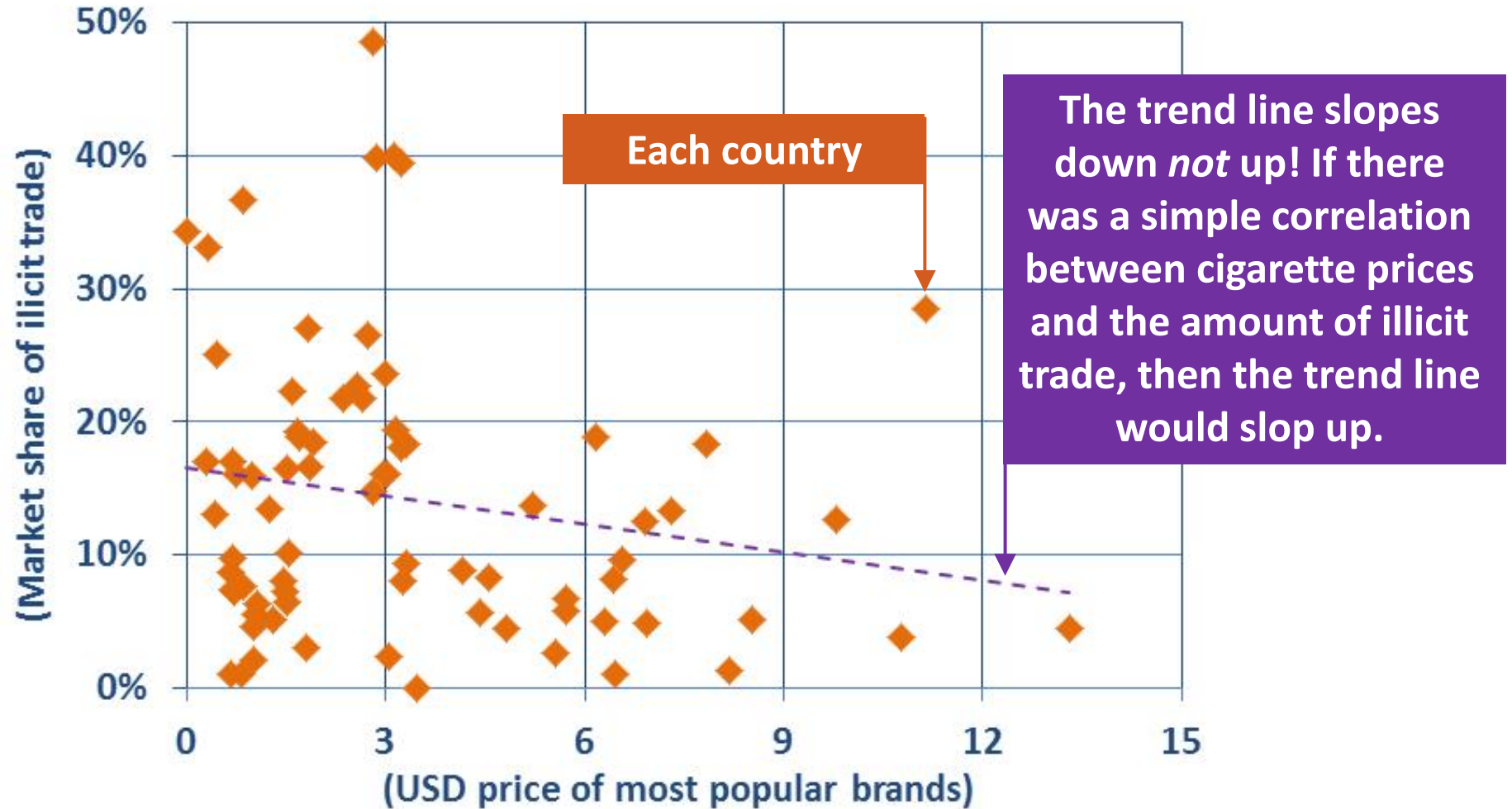


# What causes illicit trade?

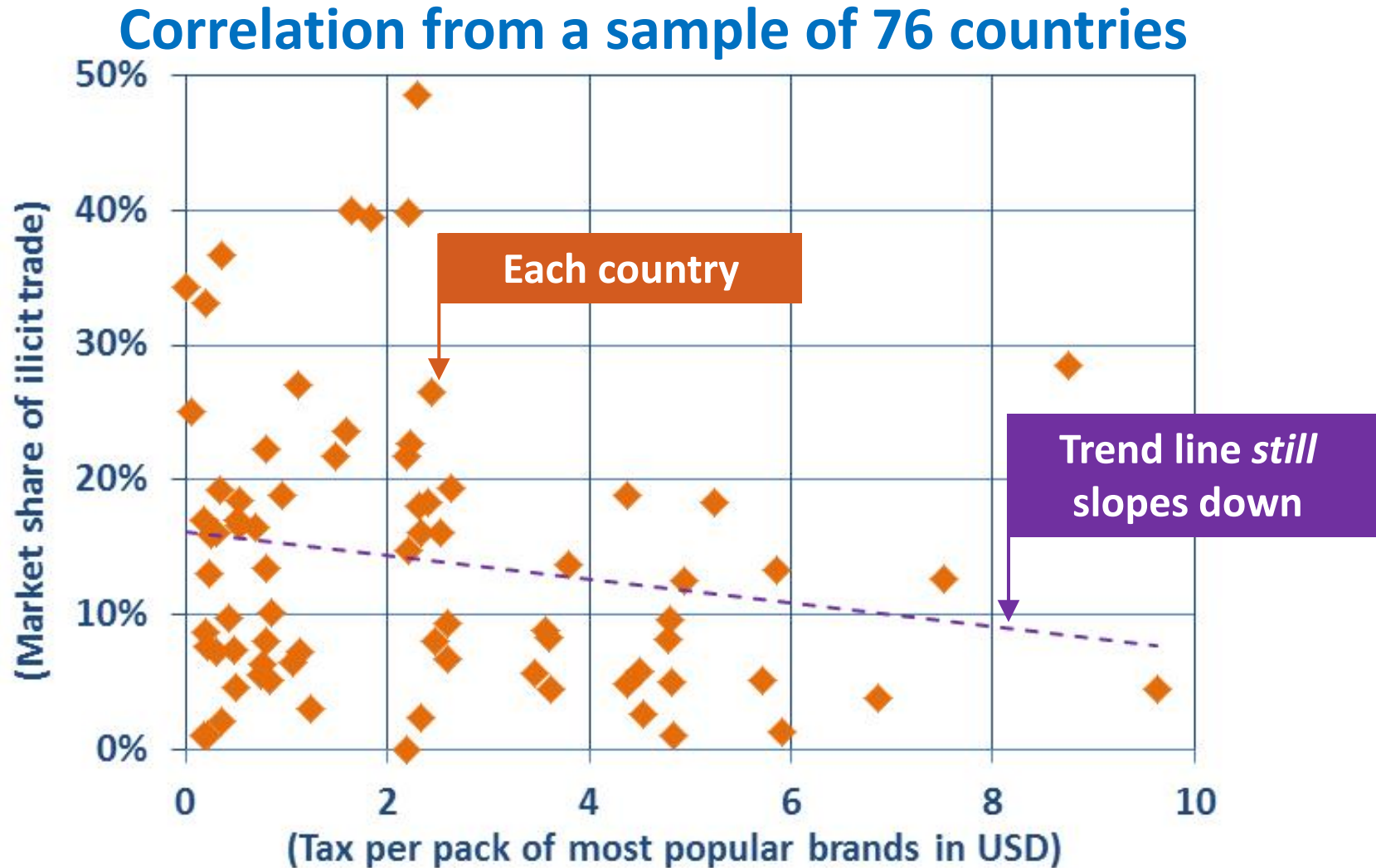
- The industry blames differences in tax rates between countries and uses this (everywhere) as a argument against higher taxes.
- The evidence does show that price and tax differences can motivate bootlegging by individuals, especially in border or transit areas.
- But highly organized, large-scale smuggling is typically the main threat to the Government's tax base and to public health.
- The link between price and tax differences and large-scale illicit trade is weak, rather the evidence shows that other "enabling factors" are more important...

# Cigarette prices and smuggling

Correlation from a sample of 76 countries

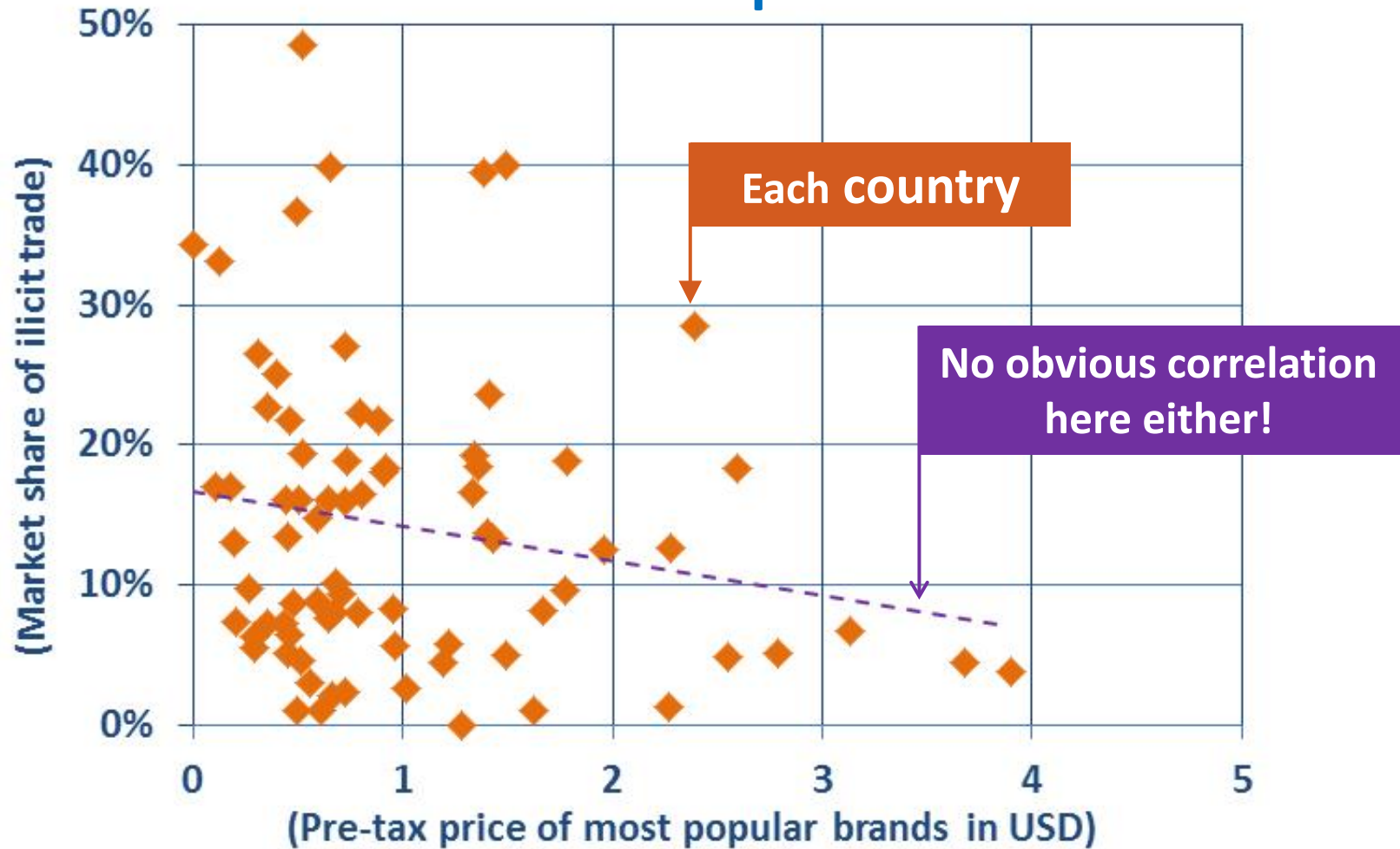


# Cigarette taxes and smuggling



# Pre-tax prices and smuggling

Correlation from a sample of 76 countries

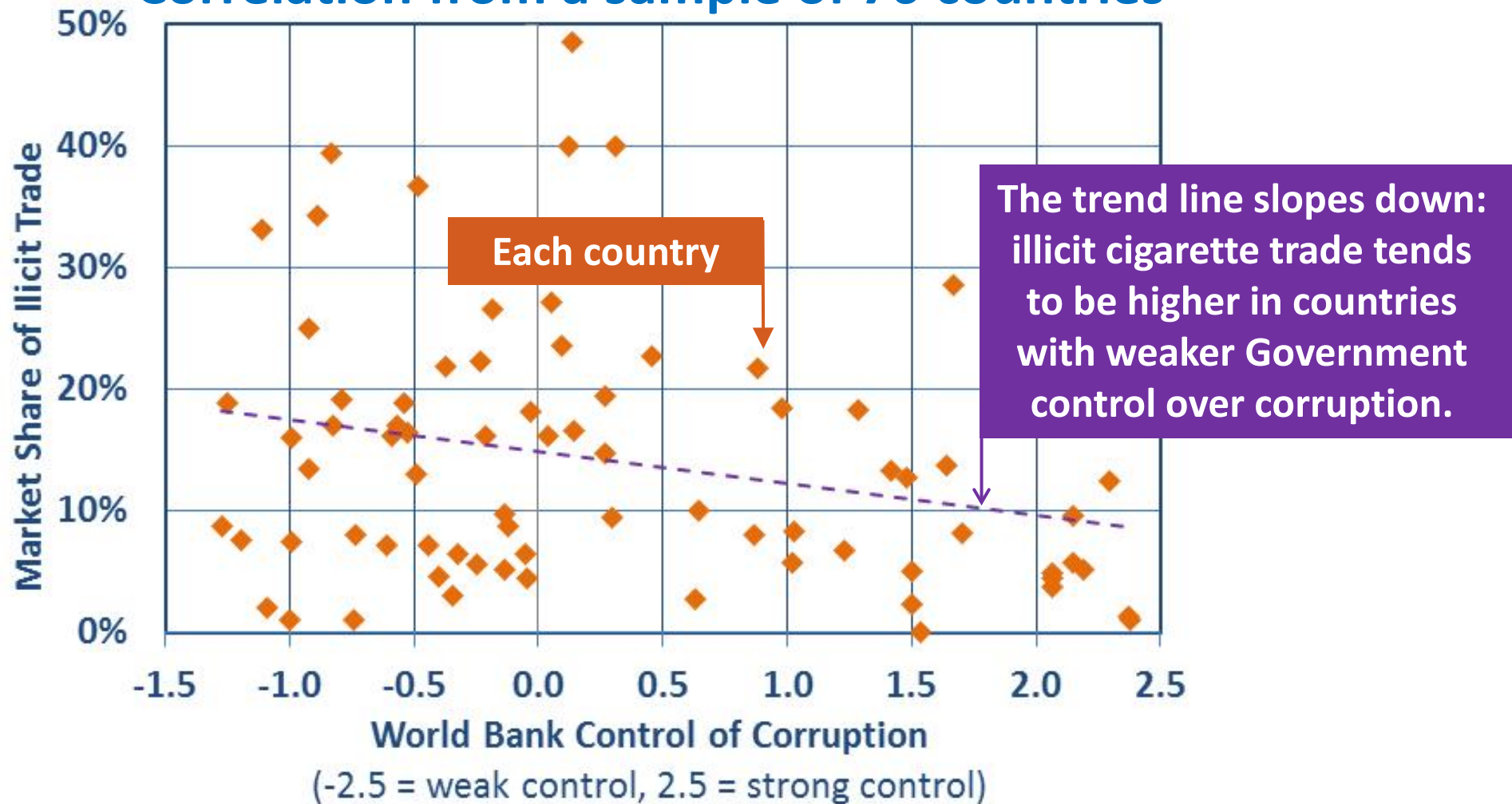


# What are the enabling factors?

- Although price differences can be an incentive for illicit trade especially for small-scale bootlegging, the evidence shows that other **enabling factors** are of equal or greater importance:
  - ❖ Weak governance/lack of high-level commitment.
  - ❖ Ineffective customs and excise administration.
  - ❖ Corruption and complicity of cigarette manufacturers.
  - ❖ Presence of informal sectors/distribution channels.
  - ❖ Population perceptions and social economic status.

# Corruption and smuggling

Correlation from a sample of 76 countries





# Factors effecting administration

- The ability of customs and excise administrations to effectively tackle illicit trade many countries is hampered by:
  - ❖ A lack of technology, tools and manpower required to monitor production, trade and distribution.
  - ❖ Poor communication and collaboration between jurisdictions and with international bodies (e.g. World Customs Org).
  - ❖ Weak judicial systems and low penalties for infringement.
  - ❖ A lack of commitment by high-level officials.
  - ❖ Corruption or "industry capture" of customs/excise officers.

# Seizures are only a partial picture

Seizure statistics mostly reflect strength of customs activity rather than the size of the illicit trade problem

	Illicit trade volume (a) (Million Sticks)	Customs Seizures (b) (Million sticks)	Seizures as a % of all Illicit Trade (% total volumes)
Asia & the Pacific	291,600	281	0.1%
Europe	107,800	2,502	2.3%
Americas	69,200	42	0.1%
Middle East & Africa	42,900	354	0.8%
<b>World</b>	<b>461,600</b>	<b>3,180</b>	<b>0.7%</b>

(a) Euromonitor estimates. (b) World Customs Annual Report 2011-2012



# Is the industry also complicit?

- In 2000, the European Commission (EC) and ten Member States took several companies to court in the United States under the Racketeer Influenced & Corrupt Organizations (RICO) legislation.
- The EC agreed to drop their case against PMI in return for an Agreement and a similar agreement was reached with JTI in 2007. Under these agreements, the tobacco companies agreed to:
  - ✓ Pay the EC (PMI agreed to pay 1 Billion USDs over 12 years while JTI agreed to pay 400 million USDs over 15 years).
  - ✓ Make additional payments if their cigarettes continue to be seized.
  - ✓ Control smuggling of their brands through measures such as controlling the distribution system and the contractors they use.
  - ✓ Limit their sales to volumes commensurate with legitimate demand.

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**Many countries are increasing tax rates on cigarettes and earning higher tax revenues, despite the presence and/or threat of illicit trade...**

**...and an increasing number of them are protecting their tax revenues by introducing strong measures to control activities and monitor production**

# Types of control measures

Least  
effective

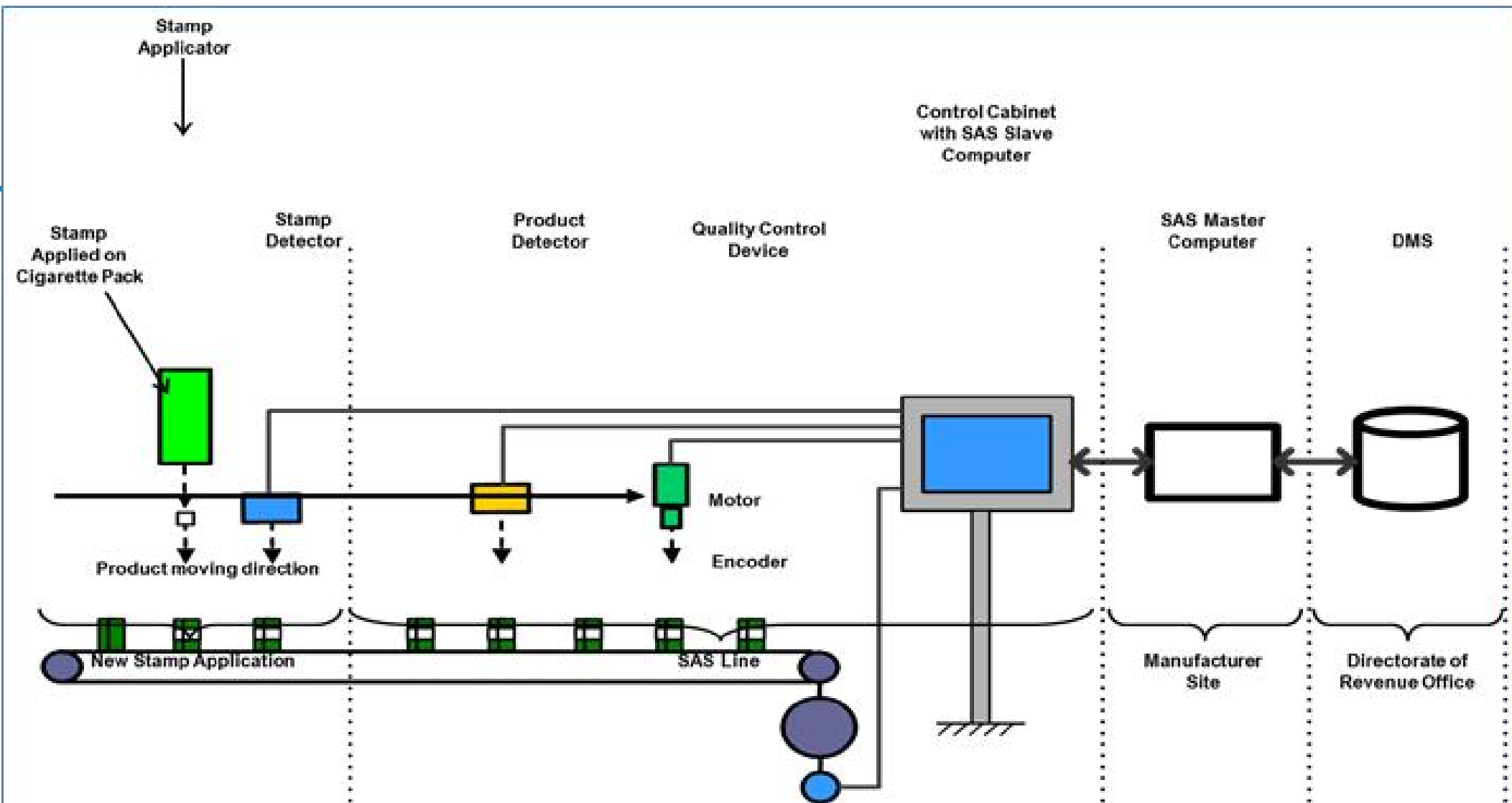
- **Industry self-assessment:** relying on declarations of production by the manufacturers is highly vulnerable to tax evasion.
- **Physical control:** MOF officials monitor/clear production on-site. Still vulnerable to tax evasion and industry capture of officials.

Partly  
effective

- **Tax stamps (without monitoring):** Stamps ordered from the 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.

Most  
effective

- **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.



Turkey introduced an automated system in 2007. It uses electronically-coded tax banderoles that are affixed to locally-produced packs during production. The stamped packs go through scanners that provide real time information directly to the MoF about brand production

# Other recent country examples

- **Kenya:** implemented a pilot electronic cargo tracking system in 2011 to ensure exports actually exit Kenya. The pilot project found an increase in sales of up to 30% of duty paid tobacco in Western border areas.
- **Bangladesh:** finance Minister established a "*tobacco Tax Cell*" in 2011 within the Ministry to increase monitoring of domestic producers.
- **Brazil:** introduced an automated cigarette production monitoring system in 2007. This led to a reduction in tax evasion of 100 Million USD in 2008.
- **Italy/Spain:** joint customs activity, stronger anti-smuggling legislation and high penalties caused the market share of illicit trade to fall from as high as 15% in 1990s to <6% by 2012.

# A new Protocol to Eliminate Illicit Trade in Tobacco Products

- After 4 years of negotiations, the Protocol was adopted at the fifth session of the Conference of the Parties (COP) to the WHO Framework Convention on Tobacco Control on 12 November 2012 in Seoul, South Korea.
- The Protocol aims to eliminate all forms of illicit trade in tobacco by requiring Parties to take measures to control the supply chain and to cooperate internationally on a range of matters.
- As a key measure, the Parties committed to establishing a global tracking & tracing system to reduce illicit trade.
- 12 Parties signed the Protocol during the ceremony and the treaty will enter into force after the 40th Party has ratified it.



# Conclusions

- The characteristics of the illicit tobacco market can be vary depending on **country conditions**. It can include a mix of illegal manufacturing, illicit importation, and smuggling-out.
- The link between tax differences and large scale illicit trade is weak, rather enabling factors such as **weak administration** are important.
- Many countries are increasing tax rates on cigarettes and earning higher tax revenues, despite the presence of illicit trade.
- Countries are beginning to protect their tax revenues by introducing strong measures to control activities and monitor production.
- The new **Protocol** in aims to eliminate all forms of illicit tobacco trade by requiring Parties to take measures to control the supply chain and to cooperate internationally on a range of matters.

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**THANK YOU**

<http://www.who.int/tobacco/en/index.html>

