



THE TOBACCO BLACK MARKET

A Spanish policeman inspects cigarettes seized during an anti-smuggling operation

ITSA reports on how tobacco products are used for illicit means and why control measures are vital for international security

Estimates for the size of the illicit tobacco market worldwide vary but run into the billions of packs per year. As with many crimes, it's difficult to be precise about the magnitude of this illicit market, so proxy measurement methods abound. Such methods include data from seizures, collection of empty cigarette packs, secret shopper operations and public surveys and questionnaires. What is clear, as with all criminal activity practiced on a global scale, is that the illicit tobacco activity is big, widespread and comes with serious consequences – and is certainly not the victimless crime that some might maintain.

In a statement in 2018, the Director-General of the World Health Organisation Tedros Adhanom Ghebreyesus declared: “The illicit trade of tobacco products creates a shadowy market that not only destroys health, but also fuels organised crime and deprives governments of tax revenues”. He argued for stronger global measures highlighting “if the global illicit trade was eliminated overnight, governments would see an immediate gain of at least \$31 billion in revenue; and more than 160,000 lives could be saved per year”.

In highlighting the cost to human health, Doctor Ghebreyesus was underlining a very special aspect of the phenomenon. Although the main driver for the crime might be monetary, the consequences of it are much

further reaching: tobacco is almost unique as a legal product which when correctly consumed is potentially deadly for the consumer. Indeed, the WHO maintains that tobacco kills up to half its users, not counting those affected by secondary exposure.

It is this very nature of the product which gives it special status and makes it a special type of problem. The product is legal, but governments have a responsibility toward their citizens to protect them from the ill effects of consuming it. And they bear the health costs when they fail to do so. Multiple policy approaches are adopted, with more or less energy depending on the country. WHO and independent academic studies promote a holistic policy approach, but highlight in particular the importance of reducing consumption through price increases brought about by imposing taxes, especially for vulnerable groups most at risk such as young people: “A tax increase that increases tobacco prices by 10 percent decreases tobacco consumption by about 4 percent in high-income countries and about 5 percent in low and middle-income countries”.

So, we have a product which, for sound reasons, is normally only legally available at a price many times greater than its production cost. This creates scope for criminal profit. Commonly there is a two-sided effect: on the one hand criminal enterprises defraud the states of taxes lawfully due and needed to mitigate the harm to public health engendered by the product, and on the

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other consumers acquire product at less than the defined price, thus not curbing their consumption.

This crime is so widespread not only because it is profitable, but because the risk-reward ratio is often so favourable. Unlike other serious crimes such as drug smuggling, people trafficking *etc.*, the actors involved in tobacco fraud calculate that not only is there a low chance of being caught, but if they are the penalties will be relatively light. Too often they are right. The focus by enforcement agencies on higher profile issues, complex cross border supply chains, exempt tax zones (eg US Native American lands), the rise of internet sales and lack of functioning international cooperation mechanisms have allowed this criminal activity to proliferate.

Who are these actors and how do they operate? They range from low-level petty criminals to large-scale organised groups. Their crimes deprive governments of revenue, while feeding corruption and undermining good governance and the rule of law. And there is also an impact to national security: terrorist organisation groups have oft spotted the opportunity to fund themselves this way (the forays of the IRA into illicitly traded cigarettes are very well documented). More recently Moktar Belmokhtar, alias Mr Marlboro, has become famous for trading in this product to finance his terrorist operations.

There are numerous variations in the way in which tobacco product fraud occurs, as well as a rich vocabulary to describe these variations: parallel trade, contraband, massive contraband, anti-smuggling, over-supply, under-reporting *et al.* Interestingly, as the authors of the *Tobacco*

Atlas point out, counterfeiting is not the dominant problem that some might think: “Most cigarettes traded illicitly are products of legitimate tobacco manufacturers that profit from selling these cigarettes to smugglers and use illicit trade as a counter argument against tobacco control policies”. The *Tobacco Atlas* estimates that 98 percent of illicit cigarettes traded globally are products of legitimate tobacco manufacturers, backing up the figure with reference to the number of legal cases worldwide against manufacturers and the fines and compensation payments paid by them over the years.

TRACKING AND TRACING

Concern by both the international health community and others in government (notably tax authorities), has led to serious debate about what action to take. But this community has faced serious resistance from the tobacco industry itself, which is dominated by four global companies. The adoption in 2012 of the WHO Framework Convention on Tobacco Control (FCTC 2005) Protocol to eliminate the illicit trade in tobacco products came only after many years of negotiation and interference and it was six more years before it actually came into force in 2018, having achieved the required minimum number of ratifying states. The first international treaty of its type, the Protocol sets out a range of measures to try to combat illicit trade – including protection and sanctions, legal assistance and cooperation, information sharing, and control of duty-free sales. Importantly, the Protocol extensively covers supply chain control measures such as licensing and due diligence, and Article 8 of the Protocol determines that an international Tracking and Tracing regime is to be in place within five years of the treaty coming into force. Tracking and Tracing (T&T) is a technology with the potential to tackle the pernicious cross-border aspects of the problem and the inherent gaps between different jurisdictions and legal and administrative frameworks. It's all too easy to make investigation (never mind prosecution) nigh-on impossible by routing trade flows through different intermediate countries, with multiple real or apparent changes of ownership.

An effective secured T&T regime works by assigning a unique individual identity, like a passport, to each item such as a pack of cigarettes during the manufacturing process. Once assigned, the identity is stored in a secured database and updated every time there is a significant event, such as change of ownership or payment of tax due and supports authentication throughout the supply chain. This produces a comprehensive product history. It means that if the pack is found in a place or state that is irregular, its provenance can be fully traced back and the responsible party held accountable.

Given the prevalence of fraud, it is crucial that the identity is unique and once assigned is fully secured both digitally and physically to prevent duplicating or copying. An effective way of doing this is by associating it with a high security tax stamp. The best modern tax stamps are designed with different levels of security – visible, semi-covert, fully covert or even forensic. These different levels are aimed at supporting all interested stakeholders – from consumers themselves to retailers to government inspectors – while making it as difficult as possible to copy. Security features can be similar to those used on modern bank notes.

T&T can successfully tackle fraud within a single country and the World Bank has recently highlighted numerous real-life cases, that have been developed over the last 10 years, which demonstrate convincingly that this is the case. But the impact is multiplied when the approach extends across borders, and this is the ambition of the Protocol. Its approach is based on a defined set of data requirements for all tobacco products, starting with cigarettes – from manufacturer through to point of sale. Appropriate interoperability allowing secure exchange of key data between countries is an essential facet.

A QUESTION OF RESOURCES

But the WHO, which has only recently begun its technical consideration of standards is, like many international organisations, starved of resources and, for all its deep knowledge on health issues, is also short on expertise in what is a highly technical domain. The tobacco industry itself, by contrast, has no lack of resources and has been investing preemptively over the last decade to put in place a self-control regime. This goes against clearly expressed provisions of the FCTC itself and the Protocol which, based on a weighty body of evidence, makes clear that it does not trust the tobacco industry to self-regulate. Indeed, it has ruled that Member States must not delegate the duties assigned to them to the industry or its allies. Governments thus need technical solutions provided by independent bodies and companies, tasked by and reporting only to governments and not the tobacco industry itself.

Sounds clear? In a further twist in the tale, enter stage right the EU. The EU finally updated its Tobacco Products Directive in 2014 to take account of the provisions of the FCTC of 2005, and incorporated, late in the day, additional measures to take account of the Protocol. Intrigue was already in the air as witnessed by convoluted allegations against the then Commissioner for Health John Dalli and his consequential forced

departure. As detailed discussion of the technically more complex parts of the Protocol concerning T&T progressed, the influence of the tobacco industry became increasingly apparent to the small number of those with the technical knowledge to understand the implications. The EU design – which finally emerged breaks down into separate parts a system which needs to function in a unified way end-to-end and, in contradiction with the Protocol it was supposed to be faithfully transposing – has assigned key roles to the tobacco industry itself. This clear misalignment with a more senior international treaty is the subject of an on-going legal challenge filed by the International Tax Stamp Association to the EUCJ.

If this were not enough to raise concerns, the European Commission is strongly promoting its model to WHO member states. The implications for nations even less able to resist the pressure of tobacco multinationals, such as

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developing countries, are worrying. These countries are often struggling with corruption and scarce resources. The last thing they need is to relinquish control to an industry which has been described by academics as “the fox in the hen house”.

The illicit tobacco trade needs to be tackled as the serious and organised crime that it is. The approach adopted needs to take account of the special nature of the product and the multiple harm which it, legal or illegal, causes to citizens and societies. Prohibition may arguably not work, but strong controls and enforcement can. Governments need to stick to their guns, avoid the red herring agendas of manufacturers and seek the support of expert providers whose focus is on providing the best possible solutions, which are genuinely fit for purpose ●

ITSA is a global association founded in 2015 that brings together leading providers of tax stamps and integrated track and trace solutions. The mission of ITSA is to promote a better understanding of how these solutions can be used by governments to secure excise revenues and protect product supply chains from illicit trade.

The T&T regime assigns a unique identity to each pack of cigarettes so it can be traced back to where it originated from

