

# All Party Parliamentary Group on Smoking and Health

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Inquiry into the illicit trade in tobacco products

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# Written Evidence to the Inquiry

(Online at [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev))

1. Mr Howard Reed, Update to the Cost Benefit Analysis for the UK of the Illicit Trade Protocol
2. North of England Tackling Illicit Tobacco for Better Health Programme
3. Mr Luk Joossens
4. Professor Anna Gilmore
5. Mr Austin Rowan (summary of oral evidence)
6. Mr Andy Leggett (summary of oral evidence)
7. Tobacco Manufacturers Association
8. Dr Mohammed Jawad
9. South East London Illegal Tobacco Cluster
10. Trading Standards Institute Tobacco Focus Group



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## Inquiry into the illicit trade in tobacco products

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# About the All Party Parliamentary Group on Smoking and Health

The All Party Parliamentary Group (APPG) on Smoking and Health is a cross-party group of MPs and Peers which was founded in 1976 and is currently chaired by Stephen Williams MP. Its agreed purpose is to monitor and discuss the health and social effects of smoking; to review potential changes in existing legislation to reduce levels of smoking; to assess the latest medical techniques to assist in smoking cessation; and to act as a resource for the group's members on all issues relating to smoking and public health. The Secretariat of the group is provided by Action on Smoking and Health, which is funded by the British Heart Foundation and Cancer Research UK for carrying out this work.

## About the Inquiry

The All Party Parliamentary Group on Smoking and Health launched this Inquiry because of important recent developments in tackling the illicit trade in tobacco products, including the successful conclusion of international negotiations through the World Health Organisation of a subsidiary treaty, the Illicit Trade Protocol. The Group also wished to examine the argument that high taxation and other tobacco control policies, including the introduction of standardised packaging for tobacco products, which is now being considered by the UK government, will lead to an increase in illicit trade.

The APPG put out a call for evidence and held three oral evidence sessions, on 6th December 2012, 13th December 2012, and 10th January 2013. Witnesses appearing at the evidence sessions were:

- On 6th December, Mr Howard Reed, Landman Economics; and the following representatives of the North of England Tackling Illicit Tobacco for Better Health Programme: Ms Andrea Crossfield (Director of Tobacco Free Futures), Mr Richard Ferry (Tobacco Control Projects Manager, NE Trading Standards Association), Ms Ailsa Rutter (Director of FRESH North East) and Assistant Chief Constable Terry Sweeney (Greater Manchester Police).
- On 13th December, Mr Luk Joossens, Advocacy Officer of the European Cancer Leagues and an international expert on the illicit tobacco trade, and Professor Anna Gilmore of the University of Bath and UKCTCS.
- On 10th January, Mr Austin Rowan, Adviser to the European Union Anti-Fraud Office (OLAF) and lead negotiator for the European Union in the negotiations on the Illicit Trade Protocol; and Mr Andy Leggett, Deputy Director of HM Revenue and Customs.

Written evidence was also received, and is available online at [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev). The Tobacco Manufacturers Association and the Tobacco Retailers Alliance were invited to give oral evidence to the Inquiry, but declined to do so. The TMA submitted written evidence.



# Foreword

Tackling the illicit trade in cigarettes and other tobacco products is an important priority. The UK has high tobacco taxes, for very good reasons: increasing the price of tobacco products is known to be the single most effective means of encouraging smokers to quit. They are also a vital source of revenue for the Treasury, raising more than £12 billion a year. Illicit tobacco causes damage both to its consumers and to the wider society. It makes tobacco more available to poorer people and to children. It helps to widen health inequalities. It funds and supports organised crime.

High prices for legitimate products can create an incentive for smugglers and counterfeiters unless effective action to tackle the trade is taken. This problem is made much worse if, as in the past, some legitimate manufacturers are themselves implicated in producing and exporting goods in volumes far in excess of any demand in their target markets, knowing that a significant number may be diverted into illicit channels. By 2000, HM Revenue and Customs estimated that as many as 1 in 5 cigarettes smoked in the UK, and as much as 60% of all hand rolled tobacco, were illicit, costing over £3 billion a year in lost tax revenue. Illicit trade involves organised criminal gangs, often also engaged in other criminal activity such as people trafficking and smuggling of illegal drugs, and in many countries the illicit tobacco trade has also been implicated in the funding of terrorism and civil conflict.

Since 2000, the UK has succeeded in making substantial progress in the fight against illicit trade. In particular, HM Revenue and Customs and the UK Border Agency have agreed and implemented a detailed strategy to tackle tobacco tax evasion, and the UK government provided substantial additional resources for this purpose during the last spending review. Internationally the European Union has concluded legally enforceable agreements with the big four tobacco manufacturers to tackle illicit trade, and Parties to the Framework Convention on Tobacco Control, including the UK, have reached agreement on a subsidiary treaty on illicit trade, the Illicit Trade Protocol. Across the UK, there are successful examples of regionally co-ordinated action against illicit trade, involving the health sector, local government and police, and aimed at reducing both supply and demand for illicit tobacco. By 2010/11, HMRC estimate that the proportion of illicit cigarettes in the UK market had fallen to less than one in ten, and the proportion of illicit hand rolled tobacco to 38%.

The tobacco industry uses the problem of illicit trade as an argument against tax rises and other tobacco control policies. The latest effort to deploy this argument has been in their attempt to dissuade the UK Government from proceeding with proposals to require cigarettes to be sold in standardised packaging (often misleadingly described as “plain packs”), preventing the industry from using pack design to recruit new smokers.

As the evidence to this Inquiry demonstrates, there is no good reason to accept this argument. In fact, legitimate packs of cigarettes carry both covert and overt security marking, including numbers and anti-counterfeit marks, which would still be present on standardised packaging. The Illicit Trade Protocol mandates Parties to ensure the introduction of a robust “tracking and tracing” system for tobacco products, and the big four manufacturers have already announced that they have a preferred system to meet the requirements of the Protocol, a coded numbering system which again could be introduced on standardised packs just as simply as on existing branded packs.



Rather than bow to self-interested and at times seemingly disingenuous industry lobbying, the UK government and its partners at international and local level need to build on their success in recent years to strengthen their work on illicit trade. The evidence shows quite clearly that high taxes and strong regulation of the industry, required to deal with the public health disaster created by tobacco consumption, need not lead to increases in illicit trade. Instead, what is required is co-ordinated planning, robust international, national and regional partnerships, good funding for enforcement, and a renewed determination to tackle the problem.

Finally, my colleagues in the All Party Group and I are extremely grateful to the expert witnesses to the Inquiry for finding time to give us oral evidence, and to those organisations and individuals who submitted written evidence. They have provided us with invaluable information and advice, and their contribution to our work has been essential.

Stephen Williams MP for Bristol West  
Chair, All Party Parliamentary Group on Smoking and Health  
March 2013



# Executive Summary

Illicit tobacco causes harm by: increasing the availability of tobacco to the most deprived socioeconomic groups leading to widening health inequalities; increasing the availability of tobacco to children; and developing links with organised criminal activity in communities.

UK taxes on tobacco products are high by international standards. They raise more than £12 billion for the exchequer every year. They are also the principal component in tobacco prices to the consumer, and raising prices is known to be the most important single lever to reduce smoking and other tobacco consumption.

High prices for legitimate products can create an incentive for smugglers and counterfeiters. However, to make a simple connection between raising prices and increasing illicit trade, as the tobacco industry routinely does, is grossly misleading. The difference between the cost of production or bulk purchase of illicit products and the price realised when they are sold is not the only factor in determining the level of illicit trade. Other factors include the difficulty and costs of entering the target market, the level of law enforcement activity and the presence or absence of corruption in the system, the likelihood of detection and the scale of penalties imposed. This is why the evidence on international levels of the illicit tobacco trade clearly shows it to be highest in low income countries, with relatively low tobacco prices, which generally lack resources for law enforcement and may suffer from serious corruption in Government and public agencies.

The UK has in the past suffered from high levels of illicit trade. This was exacerbated by the actions of the major tobacco multinationals, which knowingly produced and exported cigarettes in volumes much greater than the known demand in their stated target markets. Much of this excess production was then smuggled back into the UK. By 2000, HM Revenue and Customs estimated that 20% of cigarettes and 60% of hand rolled tobacco consumed were illicit, and this cost the Treasury about £3 billion a year in lost taxes. Evidence to our Inquiry showed how smuggling and illicit manufacturing are activities undertaken by organised criminal networks, and in some cases by groups involved in paramilitary violence and terrorism.<sup>1,2</sup> Rightly, therefore, successive governments have regarded action on illicit trade as a high priority, and increasingly they have been joined in this work by partners at a regional and local level.

HM Revenue and Customs and the UK Border Agency have agreed and implemented a detailed strategy to tackle tobacco tax evasion, and the UK Government provided substantial additional resources for this purpose during the last spending review. Internationally, the European Union has concluded legally enforceable agreements with the big four tobacco manufacturers to tackle illicit trade and included measures against illicit trade in the draft Tobacco Products Directive currently under consultation. Parties to the World Health Organisation Framework Convention on Tobacco Control, including the UK, have now reached agreement on a subsidiary treaty on illicit trade, the Illicit Trade Protocol, which includes detailed provisions for a global tracking and tracing system for tobacco products.

The result of this increasingly co-ordinated action has been a sharp fall in the measured levels of illicit trade, despite continuing rises in tobacco taxation. By 2010/11, HMRC's mid-range estimate of the proportion of illicit cigarettes in the UK market had fallen to 9%, and the proportion of illicit hand rolled tobacco to 38%.

1 In August 2012, HM Revenue and Customs published its list of the UK's twenty most wanted individuals in relation to tax fraud, eight of whose activities allegedly included tobacco smuggling. See: Hope C. HMRC publishes mugshots of 20 most wanted tax fugitives for first time. *The Telegraph*. 16 August 2012. <http://www.telegraph.co.uk/finance/personalfinance/consumertips/tax/9478101/HMRC-publishes-mugshots-of-20-most-wanted-tax-fugitives.html> (Accessed 5 February 2013)

2 Mokhtar Belmokhtar, the Islamist militant allegedly behind the attack in January 2013 on an Algerian oil refinery is also reported to operate a cigarette-smuggling ring in the Sahel. See: Porzucki N. Algerian Militant Mokhtar Belmokhtar, 'Mr. Marlboro,' Jihadist or Thug? *PRI's The World*. 22 January 2013. <http://www.theworld.org/2013/01/algeria-mokhtar-belmokhtar/> (Accessed 5 February 2013)



The tobacco industry routinely uses the problem of illicit trade as a lobbying lever against tax rises and other tobacco control policies. In particular, this argument is being deployed in an attempt to dissuade the UK government from implementing its proposal to require cigarettes to be sold in standardised packaging. The purpose of this measure is to prevent the industry from using pack design to recruit new smokers, which would be achieved partly by making the product less attractive, and also by preventing deliberate price segmentation by the industry, using branded cheap cigarettes to attract new consumers and branded luxury cigarettes to extract the maximum value from existing consumers.

There is however no good evidence for the assertion that standardised packaging will lead to an increase in illicit trade. Evidence to our Inquiry showed that existing packaging can be cheaply and readily copied by illicit manufacturers. It also showed that external packaging is not what is used by enforcement authorities in determining whether tobacco products are illicit. Licit packs of cigarettes and hand rolling tobacco (HRT) already carry both covert and overt security markings. These include coded numbers and anti-counterfeit marks, which would still be present on standardised packaging.

The Illicit Trade Protocol also mandates Parties to ensure the introduction of a robust “tracking and tracing” system for tobacco products within five years of the Protocol coming into force. The big four tobacco multinationals have already announced that they have a preferred system to meet the requirements of the Protocol, called “Codentify”, a coded numbering system which again could be introduced on standardised packs just as simply as on existing branded packs. In lobbying on the Protocol, the industry presents Codentify as an important solution to the illicit trade problem. Yet at the same time, in lobbying on standardised packaging, the industry claims that such packs could not provide product identification or security. These arguments are simply inconsistent.

There are reasons for caution before the UK government decides to accept “Codentify” as the preferred tracking and tracing solution. For example, it remains to be demonstrated that this system allows proper aggregation between all levels of packaging (from pack up to master case), and therefore that it enables proper tracking through the distribution chain. It also needs to be demonstrated that use of the system will not compromise the integrity and confidentiality of enforcement action. Nonetheless, a robust tracking and tracing system is both technically possible and highly desirable, regardless of the design of tobacco packaging.

Evidence to our Inquiry also shows the importance of the development of local and regional partnerships in fighting illicit trade. Such partnerships need to include HMRC, police, trading standards and health professionals to be fully effective. As the North of England partnership has demonstrated, such partnerships can be highly effective not only in helping to co-ordinate action to disrupt the supply of illicit tobacco, but also in reducing public demand for the product. One important lesson appears to be that it is a mistake to emphasise the health consequences of consuming illicit tobacco, since both illicit and licit tobacco are exceptionally damaging to health. Research by the North of England Programme shows that the low price and easy availability of illicit tobacco in many communities keeps people smoking and smoking more. The unregulated market makes it easier for children and young people to obtain tobacco, undermining under-age sales enforcement.

It is clear that targeted public spending to reduce illicit trade is highly cost effective with a gross return on investment of 10 to 1. This is why the UK government took the important and welcome decision to protect the HMRC and Border Agency’s budgets for tackling illicit trade in the latest public spending review. The government needs to continue this approach in the next spending round, and to consider improving central funding for regional partnerships and ensuring that local government has sufficient funds to maintain effective enforcement work by trading standards officers.





# Recommendations

## National

1. The government should sign and ratify the Illicit Trade Protocol as soon as possible, and begin consideration of how its provisions will be brought into effect in the UK market.
2. The government needs to begin consideration of how the tracking and tracing provisions of the Protocol will be implemented in the UK. In particular it needs to consider whether the “Codentify” system promoted by the major tobacco manufacturers meets the terms of Article 8 of the Protocol; whether it allows for effective tracking and tracing throughout the supply chain; and whether it could compromise the integrity and independence of enforcement action by public agencies.
3. The government should ensure that as far as possible the costs of implementing the provisions of the Protocol are borne by the tobacco industry, in line with Article 36.7 of the Protocol.
4. The government should take a lead in the European Union in supporting effective action against illicit trade, for example by urging the EU anti-fraud office OLAF to continue to give this work a high priority and in particular to investigate and take timely and effective action where there is evidence that the EU legal agreements with the major manufacturers have been broken. It should support the draft EU Tobacco Products Directive recommendations on tracking and tracing, with some appropriate amendments:
  - the “unique identifier” should ensure a simple link between all levels of packaging (from pack level, through carton to master case);
  - the “third party” chosen for data storage should be chosen by Member State governments rather than the industry; and
  - the proposed “auditor” of the system should be chosen by and answerable to the Commission.
5. The government should not accept the tobacco industry position that tax rises and other tobacco control measures will necessarily lead to an increase in illicit trade. It should introduce a tobacco tax escalator at 5% above inflation and support legislation to introduce plain standardised packaging of tobacco products.
6. Public spending at a national level on action against the illicit tobacco trade is highly cost effective, and should be protected in the next public spending round.<sup>3</sup>
7. The government also needs to consider, in decisions on local authority financial support, how to ensure that enforcement work, by trading standards officers and others at a local and regional level, that protects national tax revenues is adequately funded in a period of overall grant reductions.
8. The government should set and publish a quantified objective to reduce the market share of illicit cigarettes, which we suggest should be from 10% in 2009-10 to 3% by 2015-16. This would take the market share of illicit cigarettes back to the levels of the early 1990s. We also recommend that there should be a published objective to reduce the market share of illicit HRT, and we suggest that this should be from 46% in 2009-10 to 28% by 2015-16.
9. HMRC should work with the Trading Standards Institute, and other representative local government bodies as appropriate, to help develop a joint strategy on regional and local partnership work on illicit trade, to ensure that this is pursued more systematically across the country. As part of this work, HMRC should share data with trading standards services about levels of seizures, enforcement outcomes and levels of duty recovered.

<sup>3</sup> The cost effectiveness of tobacco control measures generally was explored in a previous APPG report: All Party Parliamentary Group on Smoking and Health. *Inquiry into the effectiveness and cost-effectiveness of tobacco control*. 2010. <http://www.ash.org.uk/APPGoct2010>. (Accessed 13 February 2013).



10. The UK government should consider following the example of the Scottish government by introducing a simple registration scheme for retailers wishing to sell tobacco products and an offence of selling tobacco while unregistered. This creates an additional low cost mechanism to deal with illicit tobacco sellers. Given that the business of legitimate retailers is damaged by the illicit trade in tobacco products, this should be a net positive benefit to the retail sector.
11. Data relating to the tobacco market and the illicit trade should be published on HMRC's website as part of an annual tobacco report which includes all the relevant information on tobacco in one place. This report should include information both on the make up of the licit and the illicit market, including seizures broken down by mode and type of product, prosecution statistics, and data on confiscation and fines. The government should also consider whether it would be possible to collect and publish the average size of seizures in cases that come before the UK courts, as well as the average sentence, so the two can be compared.
12. The government, in partnership with local authorities and their representative bodies, should consider whether a specific strategy is required to deal with the illicit trade in smokeless and shisha tobacco, which appears currently to be at a high level.
13. HMRC/UK Border Agency and OLAF should continue to develop their co-operation to increase their impact and improve cost-effectiveness in tackling the illicit trade to the benefit of taxpayers in the UK as well as the rest of Europe.

## Regional and Local

1. Local authorities should develop comprehensive tobacco control strategies, led by the Director of Public Health, including action plans to tackle illicit tobacco. The strategy should include objectives with results reported to Health and Wellbeing Boards. Local authorities in England will assume responsibility for public health budgets on 1st April 2013.
2. Key agencies in work on illicit trade should look to develop regional partnerships between local authorities (including public health, trading standards, environmental health, licensing, and education), police, fire and rescue, HMRC and local health services, building on successful models already established. Such partnerships should actively engage Councillors as well as officers.
3. The government should consider how to provide appropriate financial support to regional partnerships working on illicit trade, and in particular to support effective action to reduce demand for illicit products as well as to interdict supply. Nationally, local government bodies should assist in the co-ordination of public messages and marketing campaigns around illicit tobacco.
4. The government should consider whether trading standards officers require additional powers to take effective action against the illicit tobacco trade. The sentencing guidelines issued to magistrates for relevant offences should be reviewed, for example to ensure that fines for such offences are set at a level that provides an effective deterrent.
5. All local authorities should be encouraged to continue to complete and return the annual Tobacco Control Survey currently managed by the Local Government Association, and to share the results with HMRC as well as the Department of Health. This survey gathers data on a range of different indicators including data relating to under age sales and other enforcement activity.
6. Partnership working to improve knowledge and awareness of illicit tobacco and sharing of intelligence from a wider range of partners in order to develop effective enforcement activity, including: police officers in custody suites; street cleaning teams; schools; and stop smoking service advisors.
7. The use of illicit tobacco increases the risk of fires due to smoking since counterfeit cigarettes and cheap/illicit whites are likely not to conform to the reduced ignition propensity (RIP) safety standard. Therefore, regional partnerships should highlight the increased risk of house fires due to illicit tobacco and raise awareness of illicit tobacco among the fire service and coroners.



# Introduction

1. The production and distribution of illicit tobacco products is a large scale enterprise, often involving large and internationally structured criminal organisations. These organisations are also likely to be committing other offences, for example illegal drug trafficking, people trafficking and money laundering. In some cases, cigarette smuggling may help to fund paramilitary and terrorist groups.<sup>4</sup> Tackling organised crime of this kind requires effective and co-ordinated action throughout the supply chain and at every level - global, European, national, regional and local.
2. In relation to tobacco products, “illicit trade” can cover a wide range of activities. Key categories include:
  - a. **Smuggling.** This covers the unlawful movement of tobacco products from one jurisdiction to another, without applicable tax being paid. Therefore, smuggling may involve the movement of otherwise lawfully manufactured tobacco products, as for example when cigarettes are “diverted” from their stated target market to another. A special category of tobacco smuggling involves *cheap/illicit whites*: cigarettes are lawfully produced in one country, with tax often paid in that country but intended for smuggling into countries with higher tax rates where there is no lawful market for them.
  - b. **Counterfeiting.** This covers the illegal manufacturing of an apparently lawful and well-known product, with trademarks used without the owners’ consent. As might be expected, tax is rarely, if ever, paid on such products.
  - c. **Bootlegging.** This covers cases where tobacco products are legally bought in one country and then transported to another with a higher tax rate, in amounts beyond those reasonable for personal use.
  - d. **Illegal Manufacturing.** This covers cases where tobacco products are manufactured without declaration to the relevant authorities. In some cases, they may be manufactured in approved factories, unbooked and/or out of normal hours, in others they will be manufactured in unlawful covert operations.
3. The remainder of this report is divided as follows:
  - Paragraphs 4 to 9 give a brief outline of the tobacco market internationally and in the UK
  - Paragraphs 10 to 18 outline the relationship between tobacco taxation and consumption
  - Paragraphs 19 to 45 set out the nature and extent of illicit trade in tobacco at an international, national and regional level
  - Paragraphs 46 to 52 review the history of complicity in illicit trade by some large tobacco manufacturers themselves
  - Paragraphs 53 to 66 show how the tobacco industry has used the argument that illicit trade could rise to oppose tax rises and other tobacco control policies
  - Paragraphs 67 to 72 review relations between governments and public agencies and the tobacco industry, in view of the provisions of Article 5.3 of the Framework Convention on Tobacco Control
  - Paragraphs 73 to 79 review the evidence on whether the introduction of standardised (“plain”) packaging for cigarettes and tobacco products could lead to a rise in illicit trade
  - Paragraphs 80 to 104 review international action and agreements on illicit trade, including key provisions of the Illicit Trade Protocol, and the European Union legal agreements with the major tobacco manufacturers
  - Paragraphs 105 to 109 outline action taken at UK level to reduce illicit trade

<sup>4</sup> Doward J. How cigarette smuggling fuels Africa’s Islamist violence. *The Observer*. 27 January 2013. <http://www.guardian.co.uk/world/2013/jan/27/cigarette-smuggling-mokhtar-belmokhtar-terrorism?INTCMP=SRCH> (Accessed 5 February 2013). For evidence of paramilitary involvement (both loyalist and republican) in cigarette smuggling in North Ireland, see: House of Commons Northern Ireland Select Committee. *Fuel laundering and smuggling in Northern Ireland*. 20 March 2012. <http://www.publications.parliament.uk/pa/cm201012/cmselect/cmniaf/1504/150406.htm> (Accessed 5 February 2013).



- Paragraphs 110 to 136 outline action on illicit trade taken by regional partnerships in the UK, and the possible impact of local authority spending reductions
- Paragraphs 137 to 140 review the case for a licensing system for tobacco retailers
- Paragraphs 141 to 155 look in detail at the Illicit Trade Protocol's provisions on the tracking and tracing of tobacco products, at the provisions on tracking and tracing in the proposed EU Tobacco Products Directive and at the tobacco manufacturers' preferred system for implementing these provisions
- Paragraphs 156 to 167 consider the illicit trade in shisha and chewing tobacco and the impact of illicit trade on the reduced ignition propensity (fire safer) standard for cigarettes

Written evidence submitted to the Inquiry, and a summary of oral evidence from representatives of the EU anti fraud office OLAF and HM Revenue and Customs, is published online at [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev).

## The Tobacco Market

4. Internationally, four multinational companies dominate cigarette and tobacco sales: (in order) Philip Morris International (PMI); British American Tobacco (BAT); Imperial Tobacco (ITL); and Japan Tobacco International (JTI). The UK market is dominated by just two companies, ITL and Gallaher (now part of the JTI group), each having approximately a 40% market share. In 2010, PMI had a UK market share of 9%, and BAT had a UK market share of 8%.<sup>5</sup>
5. In 2010, the global tobacco market is estimated to have been worth about £450 billion.<sup>6</sup> In 2010, the UK tax paid tobacco market was worth about £17.7 billion, and some market analysts have estimated that this figure could rise to £19.0 billion by 2015. The UK market is dominated by cigarettes, which in 2010 represented 86.6% of the overall value of sales, followed by hand rolled tobacco (HRT), which represented 11.5%. Cigars, pipe tobacco and other niche tobacco products represented 1.9% of the market.<sup>7</sup>
6. The tobacco industry is the most profitable consumer business in the world, with BAT and ITL being two of the largest companies listed on the London stock market. The tobacco companies continue to make large profits in the UK market. Between 2006 and 2011, ITL, the tobacco manufacturer with the largest UK market share, increased its UK operating margins from 62% to 67%. Over the same period, the number of cigarettes consumed in the UK fell from about 51 billion to 45 billion.<sup>8</sup>
7. Research by Professor Anna Gilmore, economist Mr Howard Reed (both witnesses to our Inquiry) and others, suggests that "the industry may, perhaps unsurprisingly, be attempting to maximise both short term and long term profitability. This could be achieved through increasing prices on high end brands in order to maximise profits at the expense of volume declines, while attempting to maintain smoking rates (at least in some sectors of the population) and entice the young to take up the habit by keeping low end brands cheap."<sup>9</sup>
8. Research in Nottingham in 2010 showed that in 117 small retailers surveyed "44% of cigarette packs and 40% of RYO (Roll-Your-Own) tobacco pouches, almost exclusively lower priced brands, were displayed with a price mark, implying a promotional price offer. 80% of 20-pack cigarette brand or brand variants on sale were priced below the EU-defined Most Popular Price Category (MPPC) for the UK in 2010; 45% were priced below the Weighted Average Price (WAP), which replaced the MPPC in 2011."<sup>10</sup>

5 Gilmore A, Branston JR, and 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: 423-430

6 British American Tobacco. *Annual Report* 2011. [http://www.bat.com/group/sites/uk\\_\\_3mnfen.nsf/vwPagesWebLive/DO52AK34/\\$FILE/medMD85SECK.pdf?openelement](http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO52AK34/$FILE/medMD85SECK.pdf?openelement). (Accessed 14 February 2013)

7 Key Note. *Cigarettes & Tobacco Market Report 2011*. <http://www.keynote.co.uk/market-intelligence/view/product/10494/> (Accessed 4 February 2013).

8 Thompson C. Tobacco tax smokescreen evaporates. *Financial Times*. 7 December 2012.

9 Tavakoly B, Taylor G, Reed H, Gilmore AB. How tobacco industry pricing strategies undermine public health: the example of the British market. 15th World Conference on Tobacco or Health paper. 20-24 March 2012, Singapore.

10 Spanopoulos D, Ratschen E, McNeill A, Britton J. Retail Price and Point of Sale Display of Tobacco in the UK: A Descriptive Study of Small Retailers. *PLoS One*. 2012; 7(1): e29871. doi:10.1371/journal.pone.0029871. (Accessed 4 February 2013)



9. This strategy is threatened by current and proposed regulatory measures, in particular the ban on point of sale displays in retailers (which came into effect for large retailers in England in April 2012, and will come into effect for small retailers in England in April 2015), and the proposed introduction of “plain” (more accurately “standardised”) packaging, which the UK Government is now considering. In paragraphs 73 to 79 below we consider the tobacco industry’s public position that standardised packaging would lead to an increase in illicit trade and suggest, first, that this is an argument of convenience for the industry, and secondly that the likely motivation for their opposition is the threat to their marketing strategy.

## Tax, Price and Consumption

10. The World Tobacco Atlas (produced by the American Cancer Society and World Lung Foundation with support from the World Health Organisation) ranks UK tobacco taxation as amongst the highest in the world.<sup>11</sup> Tax revenue from tobacco in 2011/12 amounted to £12.1 billion: £9.5 billion in excise duty and £2.6 billion in VAT. On a typical pack of 20 cigarettes, the total tax of £5.83 accounted for 78% of the recommended retail price (RRP). On some of the least expensive brands total tax accounts for up to 88% of the RRP.<sup>12</sup> In the 2012 Budget, the Government increased tobacco excise duty by 5% above the rate of inflation. This raised the cost of a mid-price pack of 20 cigarettes by about 37 pence.
11. Use of taxation to increase tobacco prices is known to be the single most effective policy lever to encourage smokers to quit. Article 6 of the Framework Convention on Tobacco Control, to which the UK is a Party, states that: “the Parties recognize that price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons”.
12. There is extensive research literature estimating the price elasticity of demand for tobacco products (price elasticity being defined as the percentage change in quantity demanded in response to a one percent change in price). One well known study from 1996 found average price elasticity in the UK to be -0.5, in other words a 1% price rise for tobacco products would lead to a 0.5% reduction in total consumption.<sup>13</sup> A World Bank report from 2000 gave an estimate for price elasticity in high income countries as -0.4.<sup>14</sup> However, there is evidence that price elasticity is higher among disadvantaged groups, for example a 1994 study estimated price elasticity in socioeconomic group V at -1.0 for men and -0.88 for women.<sup>15</sup> Research in 2011 for HMRC gave an even higher elasticity estimate for the UK as a whole, of -1.05.<sup>16</sup>
13. The consensus from recent published research is that the prevalence elasticity (defined as the percentage change in the total number of tobacco users in response to a one percent change in price) is around one-half to three-quarters of the price elasticity.<sup>17,18</sup> Based on recent research for HMRC which gives an elasticity estimate for the UK of -1.05, this suggests that the prevalence elasticity is between -0.52 and -0.79.
14. Between 1992 and 2011, the average price of cigarettes in the United Kingdom increased more than 200%, while total tax on tobacco remained at or above 75% of overall price. During the same period, cigarette sales declined 51% and Government revenue increased 44%. Adult smoking prevalence

11 Erikson M, Mackay J, Ross H. *World Tobacco Atlas Fourth Edition* chapter 29. American Cancer Society 2012 [http://www.tobaccoatlas.org/uploads/Images/PDFs/Tobacco\\_Atlas\\_2ndPrint.pdf](http://www.tobaccoatlas.org/uploads/Images/PDFs/Tobacco_Atlas_2ndPrint.pdf). (Accessed 5 February 2013)

12 Tobacco Manufacturers Association. *Taxation*. <http://www.the-tma.org.uk/policy-legislation/taxation>. (Accessed 5 February 2013)

13 Townsend J. Price and consumption of tobacco. *Br Med Bull* 1996; 52: 132-142.

14 Jha P, Chaloupka FJ. The economics of global tobacco control. *BMJ* 2000;321:358.

15 Townsend J, Roderick P, Cooper J. Cigarette smoking by socioeconomic group, sex, and age: effects of price, income, and health publicity. *BMJ* 1994;309:923. <http://www.bmj.com/content/309/6959/923>. (Accessed 4 February 2013).

16 Czubek M, Johal S. *Econometric analysis of cigarette consumption in the UK*. HMRC Working Paper No 9 (2011)

17 U.S. Department of Health and Human Services. *The Health Consequences of Smoking: A Report of the Surgeon General*. Atlanta, GA. 2004. [http://www.cdc.gov/tobacco/data\\_statistics/sgr/2004/index.htm](http://www.cdc.gov/tobacco/data_statistics/sgr/2004/index.htm) (Accessed 8 February 2013).

18 Reed H. *The effects of increasing tobacco taxation: A cost benefit and public finances analysis*. ASH, 2010. [http://ash.org.uk/files/documents/ASH\\_722.pdf](http://ash.org.uk/files/documents/ASH_722.pdf) (Accessed 7 February 2013).

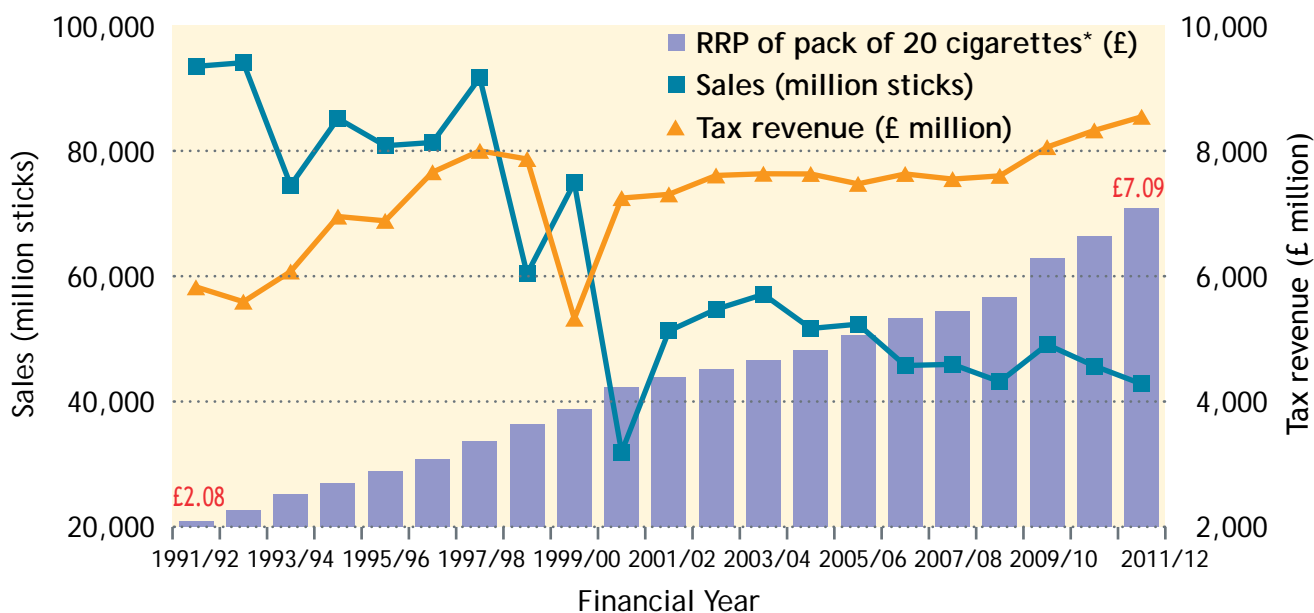


dropped from 27% in 1994 to 20% in 2010. The relationship between cigarette price, sales and tax revenue in the UK is illustrated in figure 1.

Table 1. Timeline of recent tobacco tax increases in the United Kingdom <sup>19</sup>

Years	Tobacco excise increase
1993 - 1997	3% above inflation
1998 - 2000	5% above inflation
2001 - 2008	with inflation
2009	equivalent to 5% increase in real terms
2010	1% above inflation, with a commitment to minimum 2% above inflation increases for next four years
2011	2% above inflation
2012	5% above inflation

Figure 1: Cigarette Prices, Sales and Government Revenue in the UK (1991/92 - 2011/12) <sup>20</sup>



\*Recommended retail price (RRP) of a typical pack of 20 cigarettes in the Most Popular Price Category on 1st January in each financial year.

[Note: In this figure sales of cigarettes are based on volume of products released onto the UK market. Tax revenue was low in 1999/00 because there was no forestalling in the financial year 1999/00. Forestalling occurs when manufacturers release a greater volume of tobacco products

<sup>19</sup> ASH Fact Sheet no 16: *The Economics of Tobacco*. August 2012. [http://www.ash.org.uk/files/documents/ASH\\_121.pdf](http://www.ash.org.uk/files/documents/ASH_121.pdf). (Accessed 4 February 2013).  
<sup>20</sup> Figure produced using sales and tax revenue data from HMRC Tobacco Bulletin, December 2012. <https://www.uktradeinfo.com/Statistics/Pages/TaxAndDutyBulletins.aspx>  
 RRP from Tobacco Manufacturers' Association. UK cigarette prices. <http://www.the-tma.org.uk/tma-publications-research/facts-figures/uk-cigarette-prices/> (Accessed 8 February 2013).



onto the UK market in the months immediately preceding the Budget so that they can pay duty at the pre-budget rate. This is normally followed by lower than usual releases of tobacco products in the month or so after the Budget. In December 1998, tax revenue was high following the November 1998 Budget and associated forestalling prior to the Budget. The next Budget took place in March 1999 but as stocks were still available from the November forestalling, no further forestalling took place. The subsequent Budget took place in March 2000 and the associated forestalling prior to the Budget increased April 2000 tax revenue.]

15. In the UK market, there is evidence of a recent shift in consumption patterns towards hand-rolling tobacco and cheaper brands. Research by Professor Anna Gilmore et al of the University of Bath, based on General Household Survey data, showed that while the smoking prevalence rate across the UK dropped from 26.8% in 2001 to 20.8% in 2008, this decline was seen only among smokers of filter cigarettes, while the proportion smoking hand-rolled tobacco remained static. In consequence, the share of all smokers who consume HRT has increased since 1990. The proportion of smokers mainly using HRT has increased from 25% of men and 8% of women in 1998 to 39% of men and 23% of women in 2009.<sup>21</sup>
16. For cigarettes, the largest market share, around half the market, is still held by economy brands. However, this share has fallen recently due to an increased market share taken by ultra low price brands, which the tobacco multinationals began to launch from around mid-2005 onwards. The market share of both premium and mid-price brands has fallen from 2001 onwards, although mid-price brands are far fewer in number and have never been a major part of the market. Between 2006 and 2009, the price of most ultra low price brands either remained stable or fell in real terms.<sup>22</sup>
17. According to Euromonitor International the volume of sales of smoking tobacco (HRT and pipe tobacco) increased from 3,615.8 tons in 2006 to 5,074.7 tons in 2010.<sup>23</sup> This growth in legitimate sales is likely to be at least in part a result of the declining volume of illicit trade in HRT.
18. If illicit tobacco is widely available some smokers will shift to buying and consuming illicit products rather than reducing consumption or quitting in response to tax and price rises. Therefore illicit trade threatens both government revenues and a key component of public health policy.

<sup>21</sup> Office for National Statistics. *General Lifestyle Survey Overview: A report on the 2010 General Lifestyle Survey*. 2012.

<sup>22</sup> Gilmore AB, Tavokoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines the public health impacts of tobacco tax policy: the example of the British cigarette market. *Addiction* (in press)

<sup>23</sup> Euromonitor report. *Tobacco in the United Kingdom*. August 2011



# The Extent and Nature of Illicit Trade

## International

19. By definition, the global illicit trade in tobacco products is hard to measure with accuracy.
20. However, a 2009 study estimated that 11.6% of the global cigarette market was illicit.<sup>24</sup> This is equivalent to 657 billion cigarettes a year, and means a loss of tax revenues of about \$40.5 billion. The table below, taken from the study, shows that in 2007 the proportion of consumption that was illicit was higher in low income than in high income countries - despite the fact that the price of legal cigarettes was lower in such countries.

Table 2: Relation between Legal Price and Illicit Trade in 2007

World Bank Income Group	Average Legal Price (\$)	Average Percentage of Illicit Consumption (%)
Low Income	1.13	16.8
Middle Income	1.89	11.8
High Income	4.91	9.8

21. This finding may appear surprising, but shows that the difference between the cost of manufacture of illicit tobacco products and the price at which they can be sold in specific markets is not the sole, or even primary, driver of illicit trade. Other relevant factors include the ease with which products can be smuggled into the target country, the law enforcement resources in a country available to fight illicit trade, the extent to which there is an integrated strategy on enforcement in that country, and the level of corruption. The UK scores very well on the Transparency International corruption perception index - in 2012, it was ranked 17th out of 176 countries (high ranking meaning low levels of perceived corruption).<sup>25</sup>
22. The following table shows estimates of the illicit trade in cigarettes in 2007 from the Joossens et al study, ranking the top ten countries in terms of billions of illicit cigarettes (including the European Union as one jurisdiction for this purpose).

Table 3: Ten countries with the greatest illicit trade in 2007<sup>24</sup>

Ranking	Country	Illicit Trade (billions of cigarettes)	Percentage of cigarette market that was illicit (%)*
1	China	214	8-10
2	Russian Federation	76	23.0
3	United States	62	13-25**
4	European Union	58	8-9
5	Brazil	38	35.0
6	Philippines	19	19.4
7	India	18	14.0
8	Indonesia	14	5-6
9	Pakistan	13	17.0
10	Turkey	12	10.5

\* estimates based on data from 2007 or as close to 2007 as possible

\*\* Percentage of consumers that purchased lower-priced cigarettes from 1992-2002

<sup>24</sup> 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

<sup>25</sup> Transparency International. *Corruption Perceptions Index 2012*. <http://cpi.transparency.org/cpi2012/results>. (Accessed 4 February 2013)





23. A 2006 World Health Organisation report estimated that in 2030 there will be around 8.3 million deaths around the world from tobacco consumption: 6.8 million in low and middle income countries and 1.5 in high income countries.<sup>26</sup> Using this estimate and assuming a global price elasticity estimate of -0.4 (see paragraphs 12 and 13), Joossens et al produced the following table, showing that eliminating illicit trade altogether might be expected to save around 164,000 lives a year by 2030.

Table 4: Global Illicit Trade: Cost in Revenue and Lives

Global Illicit Trade: Cost in Revenue and Lives	Global	High Income Countries	Low and Middle Income Countries
<b>Current Situation</b>			
Total illicit cigarette market (% of consumption)	11.6%	9.8%	12.1%
Total illicit cigarette market (cigarettes per year)	657bn	124bn	533bn
Total revenue lost to Governments	\$40.5bn	\$17.6bn	\$22.9bn
Estimated deaths in 2030	8.3m	1.5m	6.8m
<b>If Illicit Trade Were Eliminated</b>			
Immediate gain in revenue	\$31.3bn	\$13.0bn	\$18.3bn
Lives saved in 2030 and subsequently per year	164,000	32,000	132,000

24. The commitment of governments across the world to fight the illicit trade in tobacco products is shown by the successful negotiations for an Illicit Trade Protocol. The Protocol is the first subsidiary treaty to be negotiated under the World Health Organisation (WHO) Framework Convention on Tobacco Control (FCTC).<sup>27</sup>

## UK National

25. HM Revenue and Customs have estimated that in 2000 about 1 in 5 cigarettes smoked in the UK were smuggled, costing over £3 billion a year in lost tax revenue.<sup>28</sup> The proportion of HRT that was smuggled in 2000 was as high as 60%. Illicit trade in the UK has since been substantially reduced, although it remains a serious problem. HMRC data suggests that by 2010/11 the illicit market in cigarettes accounted for around 9% of the UK market, and in HRT around 38% of the market.
26. Figure 2, overleaf, supplied to our Inquiry by HMRC, shows that the UK has high cigarette prices relative to the rest of Europe. It also shows that many of the key smuggling routes into the UK (and the rest of the European Union) come from or through countries in Eastern Europe. On average, it is estimated that an illicit standard size (forty foot length) container of cigarettes entering the European Union would cost the Member States about €2 million in lost import duties, export duties and VAT.<sup>29</sup> A container of 10,000,000 cigarettes might be bought without taxes “in transit” for less than €200,000, so the potential profits from smuggling are large.

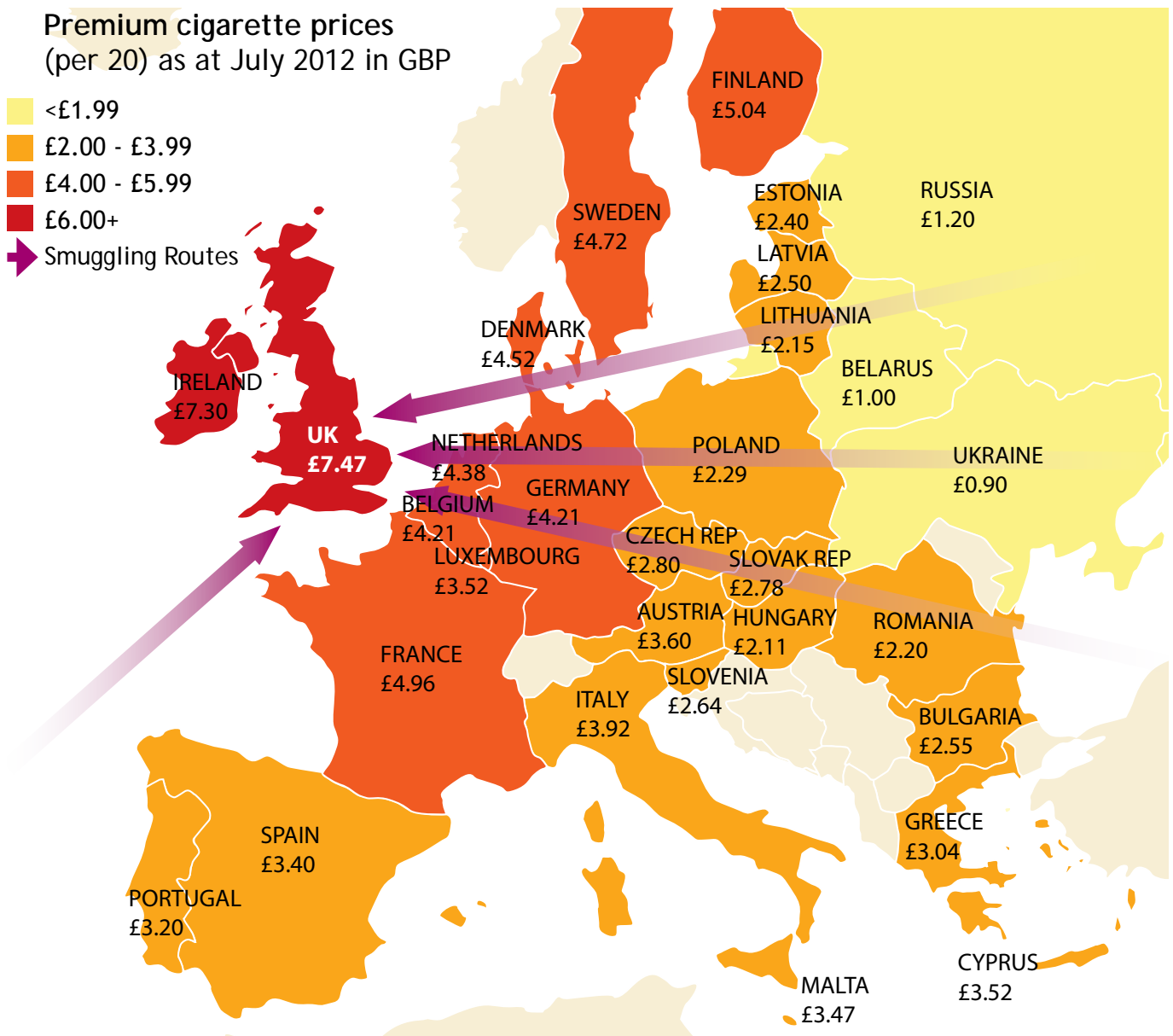
<sup>26</sup> Mathers CD, Loncar D. Projections of Global Mortality and Burden of Disease from 2002 to 2030. *PLoS Med* 2006; 3(11): e442. doi:10.1371/journal.pmed.0030442. (Accessed 4 February 2013)

<sup>27</sup> World Health Organisation. *WHO Framework Convention on Tobacco Control*. 2003. [http://www.who.int/tobacco/framework/WHO\\_FCTC\\_english.pdf](http://www.who.int/tobacco/framework/WHO_FCTC_english.pdf) (Accessed 4 February 2013)

<sup>28</sup> HM Revenue and Customs, UK Border Agency. *Tackling Tobacco Smuggling - building on our success*. 2011 paragraph 3.2

<sup>29</sup> Rowan A. (OLAF) Combating illicit trade through structured cooperation at a European and World level. *Presented at the APPG Inquiry into the Illicit Trade in Tobacco Products*. London. 10th January 2013

Figure 2: Cigarette Prices and Smuggling Routes: July 2012 <sup>30</sup>



27. However, the attractiveness of the UK market to smugglers is not simply a function of price differentials. It is also affected by the difficulty of getting illicit product into the UK without seizure, the risks of being caught breaking the law in this way, the sanctions likely to be applied, and the difficulty of selling illicit product without detection. These can be considered as additional costs to smugglers, and a key purpose of action against illicit trade by government and public agencies is to increase these costs and hence reduce the incentive to smuggle.
28. In general, high income countries have better resourced and more effective customs and law enforcement agencies and lower levels of illicit trade than low income countries, despite their higher average price of licit tobacco.<sup>31</sup>
29. Effective enforcement action in the UK, summarised in paragraphs 105 to 109 below, helps to explain why the illicit share of the UK tobacco market has fallen since its likely peak in 2000/1, when HMRC estimated the proportion of cigarettes in the UK market that were illicit at 21%, resulting in £2.7

<sup>30</sup> Leggett A. (HMRC) Inquiry into tackling illicit trade in tobacco products. Presented at the APPG Inquiry into the Illicit Trade in Tobacco Products. London. 10th January 2013.

<sup>31</sup> 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



billion in lost tax revenue, and the proportion of HRT that was illicit at 63%, resulting in £790 million in lost tax revenue.<sup>32</sup>

Table 5a: Cigarettes: Illicit Market and Associated Revenue Losses<sup>33</sup>

	2006/7	2007/8	2008/9	2009/10	2010/11
<b>Illicit Market Share (%)</b>					
Upper estimate	19%	19%	19%	17%	16%
Mid point estimate	15%	14%	13%	11%	9%
Lower estimate	11%	8%	7%	6%	2%
<b>Revenue Losses (£m)</b>					
Upper estimate	2,400	2,400	2,400	2,300	2,100
Mid point estimate	1,900	1,700	1,600	1,500	1,200
<i>of which ...</i>					
VAT	400	300	300	300	200
Duty	1,500	1,400	1,300	1,200	1,000
Lower estimate	1,300	1,000	800	600	300

Table 5b: HRT: Illicit Market and Associated Revenue Losses

	2006/7	2007/8	2008/9	2009/10	2010/11
<b>Illicit Market Share (%)</b>					
Upper estimate	60%	55%	54%	47%	44%
Mid point estimate	55%	50%	50%	42%	38%
Lower estimate	50%	45%	46%	37%	33%
<b>Revenue Losses (£m)</b>					
Upper estimate	920	810	930	810	810
Mid point estimate	780	690	800	680	660
<i>of which ...</i>					
VAT	180	160	170	140	150
Duty	610	530	630	540	510
Lower estimate	650	570	680	550	520

30. Targeted public spending to reduce illicit trade is highly cost effective. The Government currently spends around £94 million a year tackling smuggling. It has been estimated that the decline in the illicit market share has resulted in additional revenue to the Exchequer (VAT plus excise tax) of approximately £1 billion a year compared to a situation in which the illicit market shares for tobacco products remained at their 2000/1 levels. This is a conservative assessment given that in 2000 the illicit market was on a steep upward trajectory. At an annual cost of under £100 million this is a gross return on investment of 10 to 1.<sup>34</sup>

32 HMRC. *New Responses to New Challenges: Reinforcing the Tackling Tobacco Smuggling Strategy*. March 2006.

33 HMRC. *Measuring tax gaps 2012: Tax gap estimates for 2010-11*. 18th October 2012.

34 Johnson P. *Cost Benefit Analysis of the FCTC Protocol on Illicit Trade in Tobacco Products*. [http://www.ash.org.uk/files/documents/ASH\\_709.pdf](http://www.ash.org.uk/files/documents/ASH_709.pdf). (Accessed 4 February 2013). Reed H update on this analysis as evidence to this Inquiry. [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev)



31. There have been changes over time in the proportion of illicit cigarettes seized in the UK between genuine UK brands, non-UK brands and cheap/illicit whites, and counterfeit. As the table below shows, in 2002/3 almost a third of all seizures were of genuine UK brands, diverted into illicit channels. By 2009/10, this had fallen to 6%.

Table 6: Cigarettes: Composition of Large Seizures in UK <sup>35</sup>

	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10
Genuine UK Brands	31%	28%	31%	18%	17%	13%	7%	6%
Genuine non-UK Brands or Illicit Whites	28%	18%	20%	31%	13%	36%	44%	46%
Counterfeit	41%	54%	46%	51%	70%	51%	49%	49%

32. In her evidence to our Inquiry, Professor Anna Gilmore suggested that these seizure figures may overestimate the proportion of illicit tobacco that is counterfeit. Since HMRC quite properly acts when it receives information supplied by the major tobacco firms, it would not be surprising if that skewed the seizure data towards counterfeit, which is of course the principal concern of the industry. This hypothesis is lent some support by the results of regional surveys, summarised in the next section, and by data from the KPMG annual report “Project Star”, financed by Philip Morris International. Its latest report, containing 2011 data, was published on 19th June 2012. The report estimates that across the EU in 2011 75% of “counterfeit and contraband” cigarettes were non-PMI products, 4% were counterfeit PMI products, and 21% were PMI contraband (i.e. genuine PMI products which were not being sold in their stated target market).<sup>36</sup>
33. Other general social factors relevant to the decline in illicit trade may include a continuing apparent fall in crime levels across the UK.<sup>37</sup>

## UK Regional and Local

34. Since 2009 a market research company has been commissioned to conduct several regional surveys on illicit tobacco in the UK. The North of England Tackling Illicit Tobacco for Better Health Programme commissioned a survey in the North of England (in the North West, North East and Yorkshire & Humberside regions) in 2009. This was repeated in 2011 in the North West (NW) and North East (NE) following instigation of the “Get Some Answers” (GSA) social marketing campaign, which was run in the NW and NE in June/July 2010 and January/February 2011.
35. Key findings from surveys in the North of England and South West (SW) of England are shown in table 7.<sup>38,39</sup> The table shows the responses from adults aged 16 and over from the NW and NE only in 2009, excluding Yorkshire and Humberside, so that the findings can be compared to the North of England survey in 2011.

35 HMRC. *Presentation to Anti-Illicit Tobacco Seminar*. 31 January 2011. <http://web1.wisetigerhosting.co.uk/~thetma/wp-content/uploads/2011/03/HMRC.pdf>. (Accessed 5 February 2013)

36 KPMG. *Project Star 2011 Results*. 2012. page 35. [http://www.pmi.com/eng/tobacco\\_regulation/illicit\\_trade/documents/project%20star%202011%20results.pdf](http://www.pmi.com/eng/tobacco_regulation/illicit_trade/documents/project%20star%202011%20results.pdf). (Accessed 14 February 2013)

37 The British Crime Survey for 2010/11 shows recorded crime at its lowest level since 1981. See: Chaplin R, Flatley J, Smith K. (eds.) *Crime in England and Wales 2010/11: Findings from the British Crime Survey and police recorded crime*. (2nd Edition). Home Office Statistical Bulletin 10/11. 2011.

38 NEMS market research. *North of England Illicit Tobacco Survey*. 2011. [http://www.illicittobaccnorth.org/FileUploads/Illicit\\_tobacco\\_programme\\_public\\_opinion\\_report\\_2011.pdf](http://www.illicittobaccnorth.org/FileUploads/Illicit_tobacco_programme_public_opinion_report_2011.pdf). (Accessed 4 February 2013)

39 NEMS market research. *South West Regional Illicit Tobacco Survey*. 2010.



Table 7 : Findings from Regional Illicit Tobacco Surveys

Region	North of England (North West and North East)	North of England (North West and North East)	South West
Date of survey	June - July 2009	March - April 2011	March - May 2010
Respondents	4,105 adults aged 16 and over	4,111 adults aged 16 and over	2,092 adults aged 16 and over
Current smoking prevalence	24%	22%	28%
Proportion of smokers who have bought duty free from abroad or had someone bring back duty free for them in the last 12 months	48%	37%	42%
Proportion of smokers buying illicit tobacco (IT)	20%	18%	20%
Proportion of all tobacco purchased that is illicit, among IT buyers	36%	33%	52%
Total market share of IT (% of all tobacco consumed that is illicit)	9.4%	8.8%	11%
Volume of all IT purchased by main source (%)			
- Friend, colleague or family member	77%	73%	74%
- Shop	6%	14%	1%
- Pub/ club	11%	11%	9%
- Fag/ tab house	4%	3%	12%
- Street hawker	2%	0%	1%
- Car boot sale	-	-	1%
Proportion of IT buyers buying different types of IT:			
- UK brand cheaply priced (not thought to be counterfeit)	68%	63%	57%
- foreign brands not normally found in the UK (cheap whites)	22%	35%	36%
- counterfeit	26%	26%	20%
Proportion of smokers who are comfortable with IT	19%	15%	28%
Proportion of people agreeing that IT is a danger to children (because they can buy it easily and cheaply)	87%	88%	76%
Proportion of people likely to report someone selling IT	26%	29%	32%
Proportion of people likely to report someone selling IT to children	75%	75%	75%
Proportion of IT buyers that said IT makes it possible for them to smoke when they could not afford to otherwise	61%	60%	69%



36. The surveys showed that in the North of England in 2009 and the South West in 2010, 20% of smokers bought illicit tobacco, falling to 18% in the North of England in 2011. The majority of illicit tobacco was purchased from a known source such as a friend, colleague or family member (77% of the total volume of illicit tobacco in North of England in 2009, 74% in the South West). There has been a marked increase in the volume of illicit tobacco purchased from shops in the North of England, from 6% in 2009 to 14% in 2011. A higher proportion of illicit tobacco was bought from private addresses in the South West (12%) in 2010 compared to the North of England.
37. The proportion of illicit tobacco buyers that reported buying UK brands that were cheaply priced but not thought to be counterfeit was 63% in the North of England in 2011 and 57% in the South West in 2010. This suggests that, if smokers are correct in their assessment, a high proportion of illicit tobacco consists of legitimately produced tobacco sold in the UK without UK duty being paid. HMRC figures based on seizures of illicit tobacco may therefore underestimate the proportion of illicit tobacco that is legitimately produced, compared to cheap/illicit whites and counterfeit tobacco.
38. There has been an increase in the proportion of illicit tobacco buyers in the North of England that reported buying foreign brands not normally found in the UK (cheap/illicit whites), from 22% in 2009 to 35% in 2011. There has been no change in the proportion buying cheap tobacco that the purchaser believed to be counterfeit in the North of England from 2009 to 2011.
39. Over 75% of people interviewed in the three surveys agreed that cheap illicit cigarettes are a danger to children because they can buy them easily and cheaply. This is reflected by the much higher percentage of people that said they were likely to report someone selling illicit tobacco if they were selling it to children (75% compared to 29% in North of England in 2011).
40. It was notable that a high proportion of illicit tobacco buyers said that illicit tobacco makes it possible for them to smoke when they could not afford to otherwise (60% in North of England in 2011, 69% in the South West in 2010). This highlights the importance of reducing the demand for and availability of illicit tobacco in order to reduce smoking prevalence. Heavier smokers buy a greater proportion of the tobacco they consume from illicit sources (34% for those smoking more than 20 cigarettes a day versus 11% in those smoking 10 or less a day).
41. The 2011 North of England survey also interviewed 358 young people aged 14-15 years. The most common source that they reported having bought illicit tobacco from was friends (59%), followed by so called “fag houses” - sales from private houses - (34%) and shops (25%). There was a marked increase in the proportion of 14-15 year old illicit tobacco buyers that had ever bought from fag houses, from 15% in 2009 to 34% in 2011.
42. Interviews with more than 3,000 adults in London, conducted by NEMS market research for the London Health Improvement Board between June and July 2012, showed that about one third of smokers in the survey had been offered illicit tobacco to buy. A quarter of that group had not tried it, and fewer than half of those who had tried it became buyers. Around a tenth of illicit tobacco volume was purchased from close friends and family, about a fifth from acquaintances, and more than a third was acquired from strangers. Illicit tobacco was most likely to be purchased in a pub or club (45% of buyers had ever bought there) while a quarter of buyers had purchased illicit tobacco in a shop. One in five buyers had bought from a hawker on the street. The average price paid for a single pack of 20 illicit cigarettes was £4.13, and the average price of a sleeve (200 cigarettes) was £28.40.<sup>40</sup>

<sup>40</sup> Siggins G, Murray P. *London Health Improvement Board Illicit Tobacco Research Study 2012*. NEMS market research. [http://www.lhib.org.uk/attachments/article/112/Illegal%20tobacco%20in%20London%20study%20report%20\(26%20Sept%202012\).pdf](http://www.lhib.org.uk/attachments/article/112/Illegal%20tobacco%20in%20London%20study%20report%20(26%20Sept%202012).pdf) (Accessed 5 February 2013)



43. Research conducted in South East London between June and November 2012 showed that approximately 60% of the 1,700 smokers surveyed indicated that they had been offered illicit tobacco in the last year, and that 40% reported that they had bought illicit tobacco at least once in the last year.<sup>41</sup> This implies that illicit tobacco is widely available and that there is a very high level of tolerance for the trade within these communities. The survey also suggests that about half of the illicit tobacco purchased was counterfeit, and that illicit tobacco was generally sold at slightly less than half the price of legitimate brands.
44. The most common routes through which illicit tobacco was purchased by end users were sales in private homes (“fag houses”), street sales, sales in pubs and social clubs, and sales through shops (the least common of the four categories)
45. In other qualitative research conducted in London in 2011, smokers reported that they would not be able to afford to buy licit tobacco, therefore they would need to cut down or quit if they were unable to buy illicit tobacco.<sup>42</sup> This highlights the need to reduce demand for illicit tobacco by changing the attitudes of smokers towards illicit tobacco through the use of social marketing campaigns.

<sup>41</sup> Results of an unpublished survey sponsored by trading standards and public health teams in the London Boroughs of Bexley, Bromley, Greenwich, Lambeth, Lewisham and Southwark, written evidence to Inquiry from the South East London Illegal Tobacco Cluster. [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev)

<sup>42</sup> Iringe-Koko B, McNeill A, Beard E, McEwen A. *Attitudes, views and purchasing behaviour of smokers who regularly purchase illicit tobacco in a metropolitan city in England*. Not yet published.



# Illicit Trade and the Tobacco Industry

## Involvement of Tobacco Multinationals

46. There is extensive evidence of previous complicity in illicit trade by tobacco multinationals.<sup>43</sup> For example, over many years cigarettes were routinely supplied to national markets in amounts far in excess of any conceivable domestic demand.
47. The extent of this complicity was investigated in 2002 by the House of Commons Public Accounts Committee. Products smoked in significant quantities only in Britain, such as Regals and Superkings, were being exported to jurisdictions where there was no end market and smuggled back to the UK. In a celebrated exchange with ITL Chief Executive Gareth Davis and other witnesses, George Osborne MP, then a member of the PAC, said: “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 ... and not in the expectation they would be smuggled? You must know - you only have to read a newspaper every day, a member of the public could tell you - these are places which are linked to organised crime.”<sup>44</sup>
48. Documents released as part of the US Master Settlement with the tobacco industry also show wide knowledge and active collaboration by some manufacturers with illicit trade. Cigarette company documents do not use the term “smuggling”, preferring euphemisms such as “duty not paid” (DNP), “general trade” (GT), and “transit”. For example, the BAT Corporate Plan for the mid 1990s states that: “In 1993, it is estimated that nearly 6% of sales of the total world cigarette sales of 5.4 trillion were DNP [Duty Not Paid] sales ... A key issue for BAT is to ensure that the Group’s system-wide objectives and performance are given the necessary priority through the active and effective management of such business.”<sup>45</sup>
49. Seizure data in the UK and information from the EU anti-fraud office OLAF suggests that the proportion of illicit trade that is diverted legitimate product has declined in recent years. However, there is evidence of continuing involvement in illicit trade by major manufacturers.
50. In July 2008 and April 2010 in Canada, five tobacco companies pleaded guilty and admitted “aiding persons to sell or be in possession of tobacco products manufactured in Canada that were not packaged and were not stamped in conformity with the Excise Act”. They included Imperial Tobacco Canada (wholly owned by BAT), JTI (which now owns Gallaher), Rothman’s Benson and Hedges (wholly owned by PMI since 2008) and RJ Reynolds (which sold RJR-Macdonald, Inc., its former Canadian affiliate, to JTI in 1999). Northern Brands International Inc., a subsidiary of R.J. Reynolds Tobacco Holdings, Inc, pleaded guilty to a conspiracy offence under the Criminal Code.
51. In 2009, the International Consortium of Investigative Journalists (ICIJ) reported that PMI, JTI, ITL and BAT produced and imported 30 billion cigarettes in Ukraine beyond what the country can consume, fuelling a \$2 billion black market that reached across the EU. Speaking to the ICIJ, Dmytro Redko, JTI’s Director of Corporate Affairs in the Ukraine, said that “objectively, we know that our brands produced in Ukraine are found in Europe. We do our best to prevent such shipments, although we can’t halt them completely. That is the function of the [Ukraine] Government.”<sup>46</sup> ICIJ

43 See for example: LeGresley E et al, *Tobacco Control*, 2008. 17(5): p. 339-346; Nakkash, R. and Lee D. *Tobacco Control* 2008. 17: p. 324-31; Joossens L, Raw M. *BMJ* 1995; 310:1393-97; Joossens L, Raw M. *Tobacco Control* 1998; 7: 66-71. Rowell A. Britain is centre of European cigarette smuggling racket. *Independent on Sunday*. Sunday December 9 2001. Also International Consortium of Investigative Journalists, various reports. (Accessed 4 February 2013)

44 House of Commons Public Accounts Committee. *Tobacco Smuggling*: Third Report of Session 2002-3.

45 Tobacco Industry Legacy Archive. Bates document no. 2078185634/5651

46 Lavrov V. *Big Tobacco’s Overproduction Fuels \$2 Billion Black Market*. Organised Crime and Corruption Reporting Project. [https://reportingproject.net/underground/index.php?option=com\\_content&view=article&id=8:ukraineslost-cigarettes-flood-europe&catid=3:stories&Itemid=21](https://reportingproject.net/underground/index.php?option=com_content&view=article&id=8:ukraineslost-cigarettes-flood-europe&catid=3:stories&Itemid=21). (Accessed 4 February 2013)





have also reported sources pointing to the major manufacturers' continued complicity in cigarette smuggling to and through Bulgaria between 2000 and 2010.<sup>47</sup>

52. In 2012, the Organised Crime and Corruption Reporting Project (OCCRP)<sup>48</sup> published a major investigative report based on internal JTI documents and interviews with former employees. The OCCRP report has led to an ongoing investigation by OLAF into possible breaches of the EU/JTI agreement. The report raises concerns that:
- JTI investigators and quality control officers in Russia and the Baltic states informed the company of extensive smuggling by distributors, particularly of its St. George Brand, but no action was taken, according to internal memos filed by investigators in Russia and by JTI's former "brand integrity chief".
  - During 2012, as Syrian president Bashar al-Assad and his regime continued to make war against his own population, JTI's Middle East business partner IBCS "poured cigarettes into duty free shops, according to invoices obtained by OCCRP". The profits went to a company whose owner has been named by the European Union as providing "funding to the regime allowing violence against demonstrators".
  - JTI investigators reported that an Israeli distributor was smuggling large quantities of cigarettes into Iraq and Belgium, but OCCRP report that the company took no action. OCCRP also report that internal company documents show that contractors working for JTI paid officials in Iraq, Kurdistan and Iran to get information on smuggling routes.

## A Lobbying Lever for the Tobacco Industry

53. The tobacco industry and its lobbyists regularly claim that both tax increases and any proposed new tobacco regulatory measures will lead to an increase in illicit trade.
54. For example, the March 2010 Budget raised tobacco duty by inflation plus 1% and the March 2011 budget raised tobacco duty by inflation plus 2%. As always, tobacco industry lobbyists complained that tax rises would drive up illicit trade. After the March 2010 Budget, the Tobacco Manufacturers Association (TMA) predicted that because the Government had "imposed the largest tax increase on tobacco products in ten years" it would "only provide further stimulus to those who seek to profit from the illicit trade in tobacco."<sup>49</sup> After the March 2011 Budget, the TMA complained that the "government has today increased tobacco duties by 2% above inflation which clearly demonstrates a complete lack of joined-up-thinking as taxation is the acknowledged driver of the illicit tobacco trade."<sup>50</sup>
55. More recently, even the TMA has accepted that the consumption of illicit tobacco in the UK is falling, although it claims - without good evidence - that this "reduction is largely due to the impact of the recession (fall in travel/weak Pound) on cross border shopping".<sup>51</sup>
56. However, major tobacco manufacturers continue to use their own statistics to try to show the level of illicit trade is rising. Since 2006, PMI have funded KPMG to conduct "Project Star", an annual review of illicit trade in every EU Member State. "Project Star" estimates the level of illicit trade partly by using "empty packs surveys". A PMI presentation in Spring 2012, to the Institute of Trade Mark Attorneys, used data from empty packs surveys to claim a rise in illicit trade in the UK in the last quarter of 2011.<sup>52</sup>

47 Skavida V et al. Change in tobacco excise policy in Bulgaria: the role of tobacco industry lobbying and smuggling. *Tobacco Control* doi:10.1136/tobaccocontrol-2012-050600 <http://tobaccocontrol.bmj.com/content/early/2012/11/09/tobaccocontrol-2012-050600.full.pdf+html>. (Accessed 4 February 2012)

48 Organised Crime and Corruption Reporting Project. *Big Trouble at Big Tobacco*. [https://reportingproject.net/troubles\\_with\\_big\\_tobacco](https://reportingproject.net/troubles_with_big_tobacco). (Accessed 4 February 2013)

49 Double tobacco tax hike will delight the smugglers. *Tobacco Manufacturers Association* press release, March 24 2010 <http://www.the-tma.org.uk/2010/03/double-tobacco-tax-hike-will-delight-the-smugglers>. (Accessed 4 February 2013)

50 The Government risks undermining its own Tackling Tobacco smuggling strategy. *Tobacco Manufacturers Association* press release, March 23 2011. <http://www.the-tma.org.uk/2011/03/tma-response-to-the-budget-%E2%80%93-the-government-risks-undermining-its-own-tackling-tobacco-smuggling-strategy>. (Accessed 4 February 2013)

51 Tobacco Manufacturers Association. *UK Tobacco Market Summary*. (Accessed 4 February 2013)

52 Philip Morris International. Tobacco Regulation and Illicit Trade. Presented at International Trade Mark Attorneys' conference. London March 22 2012 [http://www.pmi.com/eng/tobacco\\_regulation/illicit\\_trade/documents/project%20star%202011%20results.pdf](http://www.pmi.com/eng/tobacco_regulation/illicit_trade/documents/project%20star%202011%20results.pdf) (Accessed 4 February 2013)



57. The “Project Star” report published 2012 also states that: “the UK Tobacco Manufacturers Association (TMA) estimate [of illicit trade] is of non-UK duty paid cigarette consumption. This methodology is based on consumption and prevalence levels as well as empty pack collection samples. These empty pack collections are carried out in various locations including sports events”. The TMA estimate of the extent of the illicit tobacco trade in 2010 was 19%, compared with a Project Star estimate in 2010 of 13.2% and HMRC mid point estimate of 11% in 2009/10.<sup>53</sup>
58. Empty pack surveys may be methodologically dubious because results will be heavily affected by the choice of venues for sample collections - for example, poorer communities have a higher than average level of smoking prevalence, and are likely to have higher than average rates of illicit tobacco use. Surveys conducted at sports stadia are also likely to have higher levels of illicit tobacco. Higher levels of non-UK duty paid tobacco are likely to be found at international sporting events where visiting fans have travelled from abroad.
59. PMI has also funded a series of reports from Università Cattolica del Sacro Cuore in Milan (“Transcrime”) which look at the potential impact of proposed regulation on the illicit trade.<sup>54</sup> These reports generally repeat industry assertions about illicit trade, including the proposition (see paragraphs 72 to 78 below) that the introduction of standardised (“plain”) packaging in the UK could lead to an increase in smuggling.
60. An academic review of Transcrime’s work in this area has concluded that it “does not add anything substantive to the existing evidence on the impact of regulation on the trade and, on the basis of the available data, arguably overstates the risks of regulation and taxation in shifting consumption from legitimate to illegitimate markets”.<sup>55</sup>
61. JTI recently published a report on illicit trade called “The Billion Pound Drop: the impact of tobacco smuggling and cross-border shopping in the UK”<sup>56</sup>, which presents a clear example of how the tobacco multinationals wish to use the existence of illicit trade to prevent tax rises and tougher regulation.
62. In his introduction to the report, Mr Martin Southgate, Managing Director of JTI in the UK, suggests that government efforts to fight illicit trade will “be wasted if taxes continue to rise and other poorly thought through policy measures come to pass”. He also complains that “there are some who say the tobacco companies should be excluded from the debate on cutting illicit trade, let alone working with others in solving the problem”.
63. However, the remainder of the report demonstrates why the tobacco multinationals’ statements on the issue should be treated with extreme caution:
  - In the charts on page five showing JTI’s estimates of non-duty paid tobacco consumption, HMRC’s upper bound estimates appear to have been used in every case, with no methodological explanation.
  - On page six, the report states that “in every other EU country, the taxes levied on tobacco products are lower than in the UK.” In fact Ireland has higher excise yield per 1000 cigarettes.<sup>57</sup>
  - On page nine, the report states that “HMRC estimates that in 2011/12, up to 19% of cigarette

53 KPMG. *Project Star 2011 Results*. 2012. page 264 [http://www.pmi.com/eng/tobacco\\_regulation/illicit\\_trade/documents/project%20star%202011%20results.pdf](http://www.pmi.com/eng/tobacco_regulation/illicit_trade/documents/project%20star%202011%20results.pdf). (Accessed 4 February 2013)

54 Transcrime. *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*. [http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-CP\\_of\\_the\\_EU\\_TPD.pdf](http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-CP_of_the_EU_TPD.pdf) [http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-Analysis\\_of\\_the\\_Draft\\_Protocol\\_to\\_eliminate\\_ITTP.pdf](http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-Analysis_of_the_Draft_Protocol_to_eliminate_ITTP.pdf)

*Plain Packaging and Illicit Trade in the UK: Study on the risks of illicit trade in tobacco products as unintended consequences of the introduction of plain packaging in the UK*. [http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-Plain\\_packaging\\_and\\_illicit\\_trade\\_in\\_the\\_UK.pdf](http://transcrime.cs.unin.it/tc/fso/pubblicazioni/AP/Transcrime-Plain_packaging_and_illicit_trade_in_the_UK.pdf). (Accessed 4 February 2013)

55 Fooks GJ, Peeters S, Evans-Reeves K. Illicit trade, tobacco industry-funded studies and policy influence in the EU and UK. *Tobacco Control* doi:10.1136/tobaccocontrol-2012-050788

56 Japan Tobacco International. *The Billion Pound Drop*. [http://www.jti.com/files/2413/5220/4070/The\\_Billion\\_Pound\\_Drop\\_website\\_version.pdf](http://www.jti.com/files/2413/5220/4070/The_Billion_Pound_Drop_website_version.pdf). (Accessed 4 February 2013)

57 European Commission Directorate-General Taxation and Customs Union. *Excise Duty Tables: Part III - Manufactured Tobacco* [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/excise\\_duties/tobacco\\_products/rates/excise\\_duties-part\\_iii\\_tobacco\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf). (Accessed 4 February 2013)



- and 50% of hand-rolling tobacco consumption in the UK was NUKDP” (non-UK duty paid). It is technically correct to say “up to”, since these figures appear to the upper bound estimates from HMRC tax gap publications. However, from this point on in the publication these numbers are used as if they are the mid-point estimates.
- On page eleven, the report states that “recently there have been indications that NUKDP has started to rise again”. On the contrary, the latest HMRC figures, given in tables 5a and 5b above, show a continuing fall.
  - On page twelve, the report quotes an “analysis” of HMRC reports on the extent of excise duty related fraud, conducted by the right wing pressure group “the Taxpayers Alliance”. It appears that the HMRC numbers since 2007 have simply been aggregated, rather than for example showing an average per year, presumably to give the largest possible figure.
  - On page sixteen, the report states that: “For 2011, we estimate that 50% of hand-rolling tobacco was NUKDP, broadly in line with HMRC’s estimate”. Again this is not the HMRC mid point estimate.
64. When asked to justify the use of upper bound estimates in the report, a JTI spokesperson said that HMRC had told JTI that the upper bound estimate was just as likely as the mid-point or the lower bound estimate, and so it was equally valid to use any of the three.<sup>58</sup> In fact HMRC report that: “the upper estimate of total consumption makes an assumption that consumption per smoker has been constant over time. An analysis of that assumption suggests that this does not hold. There is evidence that consumption per smoker has fallen since 1994-95, which means that the estimate produced is too high for later years, and certainly since 2000-01. Therefore the effect is likely to result in an estimate of total consumption that is too high and can be treated as an Upper Bound”.<sup>59</sup>
65. In general it is not appropriate to report upper bound estimates from econometric analysis as the most likely estimate of a statistic derived from data. The mid-point estimate is statistically the most likely estimate, given that in most cases the probability density function for an estimate from regression or similar econometric methods will follow a normal distribution or something similar to it. Therefore the upper and lower bound estimates are actually the least likely value for the statistic to take within the whole range of estimates.
66. Concerns arising from the drafting of “The Billion Pound Drop” and its special pleading about tobacco taxation and regulation give further support to the case for relations between government and public bodies and the tobacco industry over illicit trade to be conducted with great caution, and within the spirit of Article 5.3 of the FCTC, reviewed in the next section.

## Article 5.3: Interactions with the Tobacco Industry

67. Article 5.3 requires Parties, in setting and implementing their ‘public health policies with respect to tobacco control’, to ‘act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law’. WHO guidelines for implementation of article 5.3 recognise that fulfilment of the obligation to protect tobacco control policies from tobacco industry interests requires Parties to be accountable and transparent in their dealings with the industry; they should interact ‘only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products’, and should ensure that any necessary interactions are conducted transparently.
68. It is of course impossible for any government, or for international bodies with competence in this area, such as the European Union, to take effective action on illicit trade without considerable interaction with the tobacco industry, in particular to ensure the receipt of information required for effective enforcement action. As a result, there is a continuing danger of regulatory capture.

<sup>58</sup> Statement by JTI employee to Chief Executive of ASH on 3 December 2012.

<sup>59</sup> HMRC. *Measuring Tax Gaps Methodological Annex 2012*, paragraph E.16. <http://www.hmrc.gov.uk/statistics/tax-gaps.htm>. (Accessed 4 February 2013)



69. Even intelligence provided by the industry about illicit trade, although necessary for effective enforcement work, may over-emphasise the proportion of illicit trade that consists of counterfeit goods (which the manufacturers have a common interest with tax authorities in controlling) and under-emphasise the proportion that consists of legitimate products diverted into illicit channels (in which some manufacturers may be complicit). As a consequence allocation of enforcement resources may be distorted.
70. In his evidence to our Inquiry, Mr Leggett of HMRC stated that HMRC's interactions with the tobacco industry are conducted appropriately and in the knowledge of where government and industry interests diverge as well as where they may overlap. There is no evidence to suggest that this is not currently the case. In some other countries, however, there is good reason to think that relations between customs services and other law enforcement agencies and the tobacco industry may have become too close. For example, customs officers from a number of Latin American and African countries have indicated to members of the secretariat to the APPG that they perceive the tobacco multinationals as routinely providing customs officers with equipment, training, and advice on tackling illicit trade, on which customs services in poorer countries may have become reliant.<sup>60</sup>
71. The recent decision of INTERPOL to accept \$15 million from PMI to assist in the development of its global register of illicit products is also a matter of serious concern. Since INTERPOL is an intergovernmental organisation, it appears to raise issues in relation to Article 5.3 of the Framework Convention on Tobacco Control.
72. The extent of the historic involvement of the tobacco multinationals in illicit trade shows why they should not be allowed to influence or control the training of customs officials or provide funding of equipment and materials used in investigations. This should be the responsibility of HMRC and equivalent national and international agencies. Industry funding for law enforcement should be raised through tobacco taxation. Given that controlling the illicit tobacco trade requires international collaboration, it is important that HMRC help clarify this message among its international collaborators.

## Standardised ("Plain") Packaging

73. The tobacco industry and its funded surrogates have repeatedly claimed that the introduction of standardised packaging for cigarettes and other products would lead to an increase in illicit trade.
74. Philip Morris International states that standardised packs would create "significant incentives to counterfeiters and smugglers".<sup>61</sup> Japan Tobacco International claims (contrary to the available statistics) that the UK illicit tobacco market is "booming".<sup>62</sup> Imperial Tobacco, in an advert aimed at MPs, stated that plain packs are "good for criminals".<sup>63</sup> British American Tobacco claims that: "... a policy designed to make tobacco less accessible to youth could actually end up having the opposite effect – by increasing the black market and making the products cheaper and more accessible. Generic packaging would make it harder to prevent smuggled and counterfeit products entering a market, eroding Government tax revenue and disrupting efforts to tackle the illegal trade in tobacco products that plays a significant role in funding international crime and terrorism".<sup>64</sup>
75. The evidence for these claims is in fact poor, and there are three key reasons why the introduction of standardised packaging is not likely to make a significant difference to the volume of illicit trade.

<sup>60</sup> Private information from customs officers at conferences during negotiations on the Illicit Trade Protocol

<sup>61</sup> Philip Morris International. *Generic packaging* [http://www.pmi.com/eng/tobacco\\_regulation/regulating\\_tobacco/pages/generic\\_packaging.aspx](http://www.pmi.com/eng/tobacco_regulation/regulating_tobacco/pages/generic_packaging.aspx) . (Accessed 4 February 2013)

<sup>62</sup> Japan Tobacco International. *Media advertising on plain packaging*. September 2012 [http://www.jti.com/download\\_file/view/873/627/](http://www.jti.com/download_file/view/873/627/) (Accessed 4 February 2013)

<sup>63</sup> Imperial Tobacco. House Magazine advertisement. September 2012

<sup>64</sup> British American Tobacco. *Plain packaging of tobacco products*. [http://www.bat.com/group/sites/uk\\_\\_3mnfen.nsf/vwPagesWebLive/DO7J7DCZ?opendocument&SKN=1](http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO7J7DCZ?opendocument&SKN=1). (Accessed 4 February 2013)



76. First, as Mr Luk Joossens pointed out in his evidence to our Inquiry, the production costs of illicit cigarettes (including packaging) are very low.<sup>65</sup> In Paraguay costs can be as low as 5 US cents a pack. A Jin Ling pack in Kaliningrad or a Chinese counterfeit pack may cost about 20 cents a pack to produce. Philip Morris International acknowledges that production costs are low and estimates the cost for a Chinese counterfeit pack at about 15 pence.
77. Secondly, counterfeiters are also able to produce quality and apparently genuine packaging at low prices in a short time. The quality of counterfeit cigarette packs has substantially improved from the 1990s, making it difficult to distinguish counterfeit from genuine cigarette packs. In 2004, HM Customs and Excise reported that the outside pack was the least likely indicator of the carton being counterfeit.<sup>66</sup> Even the tax stamps with more sophisticated security features used in other parts of the EU are easy to counterfeit.
78. Thirdly, the existing security systems used on packs would continue to be used on standardised packaging. These include:
- a covert mark on each licit pack, which can be read by enforcement authorities using a simple scanner to determine whether or not a pack is counterfeit
  - other security marks that vary between manufacturers, for example the configuration of marks on filter paper
  - numerical codes printed on each pack, which will be developed and standardised through the introduction of the tracking and tracing system mandated under Article 8 of the Illicit Trade Protocol (discussed in paragraphs 141 to 155 of this report)<sup>67</sup>
79. In oral evidence to our Inquiry, police, trading standards and OLAF representatives agreed that by maintaining security markings already in place and with new identifiers included to meet the terms of the Illicit Trade Protocol, the introduction of standardised packaging, would be likely to have little or no significant impact on the level of illicit trade.

<sup>65</sup> Mr Joossens works for the Association of European Cancer Leagues, and is an international expert on illicit trade, who has advised the World Bank, European Commission, World Health Organisation, and the Bloomberg Initiative to Reduce Tobacco Use. See Joossens L. Report for Cancer Research UK. *Smuggling, the Tobacco Industry and Plain Packs*. [http://www.cancerresearchuk.org/prod\\_consump/groups/cr\\_common/@nre/@pol/documents/generalcontent/smuggling\\_fullreport.pdf](http://www.cancerresearchuk.org/prod_consump/groups/cr_common/@nre/@pol/documents/generalcontent/smuggling_fullreport.pdf). (Accessed 4 February 2013)

<sup>66</sup> HM Customs & Excise. *Counterfeit cigarettes* 2004.

<sup>67</sup> Details of existing security systems are private information from industry source



# Action against Illicit Trade

## International

### The Framework Convention and the Illicit Trade Protocol

80. The FCTC was adopted by the World Health Assembly on 21 May 2003 and entered into force on 27 February 2005. As of August 2012, there were 176 Parties to the treaty, including every major economy in the world with the exception of the United States. All countries in the European Union are Parties, as is the European Union collectively.
81. Article 15 of the FCTC reads as follows:<sup>68</sup>

#### “Illicit trade in tobacco products

1. The Parties recognize that the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting, and the development and implementation of related national law, in addition to sub-regional, regional and global agreements, are essential components of tobacco control.
2. Each Party shall adopt and implement effective legislative, executive, administrative or other measures to ensure that all unit packets and packages of tobacco products and any outside packaging of such products are marked to assist Parties in determining the origin of tobacco products, and in accordance with national law and relevant bilateral or multilateral agreements, assist Parties in determining the point of diversion and monitor, document and control the movement of tobacco products and their legal status. In addition, each Party shall:
  - a. require that unit packets and packages of tobacco products for retail and wholesale use that are sold on its domestic market carry the statement: “Sales only allowed in (insert name of the country, subnational, regional or federal unit)” or carry any other effective marking indicating the final destination or which would assist authorities in determining whether the product is legally for sale on the domestic market; and
  - b. consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade.
3. Each Party shall require that the packaging information or marking specified in paragraph 2 of this Article shall be presented in legible form and/or appear in its principal language or languages.
4. With a view to eliminating illicit trade in tobacco products, each Party shall:
  - a. monitor and collect data on cross-border trade in tobacco products, including illicit trade, and exchange information among customs, tax and other authorities, as appropriate, and in accordance with national law and relevant applicable bilateral or multilateral agreements;
  - b. enact or strengthen legislation, with appropriate penalties and remedies, against illicit trade in tobacco products, including counterfeit and contraband cigarettes;
  - c. take appropriate steps to ensure that all confiscated manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products are destroyed, using environmentally-friendly methods where feasible, or disposed of in accordance with national law;

<sup>68</sup> World Health Organisation. *Text of the Framework Convention on Tobacco Control and Illicit Trade Protocol*. (Accessed 4 February 2013)



- d. adopt and implement measures to monitor, document and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties within its jurisdiction; and
  - e. adopt measures as appropriate to enable the confiscation of proceeds derived from the illicit trade in tobacco products.
5. Information collected pursuant to subparagraphs 4(a) and 4(d) of this Article shall, as appropriate, be provided in aggregate form by the Parties in their periodic reports to the Conference of the Parties, in accordance with Article 21.
  6. The Parties shall, as appropriate and in accordance with national law, promote cooperation between national agencies, as well as relevant regional and international intergovernmental organizations as it relates to investigations, prosecutions and proceedings, with a view to eliminating illicit trade in tobacco products. Special emphasis shall be placed on cooperation at regional and subregional levels to combat illicit trade of tobacco products.
  7. Each Party shall endeavour to adopt and implement further measures including licensing, where appropriate, to control or regulate the production and distribution of tobacco products in order to prevent illicit trade.”
82. Under Article 15 of the FCTC, the Illicit Trade Protocol was negotiated at five Intergovernmental Negotiating Body meetings, the first between 11th and 16th February 2008 and the last between 29th March and 4th April 2012. It was adopted by the fifth FCTC Conference of the Parties, which took place between 12th and 17th November 2012.
  83. The central provisions of the Illicit Trade Protocol cover two broad areas:
    - a. supply chain controls to reduce the extent of illicit trade; and
    - b. measures to improve law enforcement and international co-operation in tackling illicit trade
  84. The key supply chain controls can be summarised as:
    - a. **Article 6: Licence, Equivalent Approval or Control System.** The Article obliges Parties to operate a licensing or equivalent system for “natural or legal persons” involved in the manufacture of tobacco products and manufacturing equipment, or in the import or export of tobacco products and manufacturing equipment. License applications must contain essential business information.

Parties must “endeavour to license, to the extent considered appropriate”, any natural or legal person involved in retailing, growing or transporting commercial quantities of tobacco, tobacco products and manufacturing equipment (there is an exemption for small growers). Within five years of the Protocol coming into force, a Meeting of the Parties should consider applying this licensing requirement to “key inputs” to tobacco manufacturing.<sup>69</sup> Licenses could be suspended or withdrawn for breaches of the supply chain controls in the Protocol.
    - b. **Article 7: Due Diligence.** The Article obliges Parties to conduct due diligence with respect to their customers and contractors. This includes obtaining information about their business dealings and monitoring their transactions, for example to check whether they appear to be engaging in transactions that exceed likely demand in the stated market (which may be a marker for product diversion and tax evasion). Subject to national law, Parties may operate a “blocked customer” system.

<sup>69</sup> An example of such a key input might be the acetate tow used in the production of cigarette filters.



- c. **Article 8: Tracking and Tracing.** The Article obliges Parties to establish a global tracking and tracing system within five years of the Protocol entering into force, “comprising national and/or regional tracking and tracing systems and a global information sharing focal point located at the Convention Secretariat of the WHO Framework Convention on Tobacco Control”. Within five years of the Protocol’s entry into force for cigarettes, and within ten years for other tobacco products, Parties must ensure that “unique, secure and non-removable identification markings ... such as codes or stamps, are affixed to or form part of all unit packets and packages and any outside packaging” .
  - d. **Article 9: Record-keeping.** The article obliges Parties to ensure that natural or legal persons involved in the tobacco supply chain must keep accurate records for at least four years of relevant transactions. “Such records must allow for the full accountability of materials used in the production of their tobacco products.” “As appropriate”, Parties may also require persons licensed under Article 6 to provide information to the competent authorities on market volumes, trends and forecasts, and quantities of tobacco products and manufacturing equipment held in stock or in tax and customs warehouses.
  - e. **Article 10: Security and Preventive Measures.** The Article obliges Parties “where appropriate” to “require that all neutral and legal persons subject to Article 6 take the necessary measures to prevent the diversion of tobacco products into illicit trade”, including reporting suspicious transactions such as cross-border transfers of cash.
  - f. **Article 11: Sale by Internet, Telecommunication or Any Other Evolving Technology.** The Article obliges Parties to ensure that sale of tobacco products via the internet or similar technology should be subject to the provisions of the Protocol.
  - g. **Article 12: Free Zones and International Transit.** The Article obliges Parties to “implement effective controls on all manufacturing of, and transactions in, tobacco and tobacco products, in free zones, by use of all relevant measures as provided in this Protocol”. It also obliges Parties to prohibit the “intermingling of tobacco products with non-tobacco products” in single containers or similar transportation units.
  - h. **Article 13: Duty Free Sales.** The Article obliges Parties to ensure that duty-free sales of tobacco products are covered by the provisions of the Protocol. Within five years of the Protocol’s entry into force, a Meeting of the Parties must consider whether further action is required to control duty free sales.
85. Articles 14 to 31 deal with investigations, enforcement and international capacity building and co-operation.
- a. **Article 14** sets out conduct in relation to illicit trade which Parties are obliged to ensure are offences under their domestic law and Article 15 requires Parties to ensure the liability of legal persons (including companies) for unlawful conduct under Article 14. Article 16 obliges Parties to ensure that the unlawful conduct specified in Article 14 is subject to “effective, proportionate and dissuasive criminal or non-criminal sanctions, including monetary sanctions”. Article 17 obliges Parties to consider appropriate seizure payments from persons engaged in illicit trade “proportionate to lost taxes and duties”, and Article 18 requires the destruction of seized tobacco products and manufacturing equipment, by environmentally friendly methods.
  - b. **Article 19** obliges Parties, subject to national law, to use controlled delivery and other special investigative techniques in fighting illicit trade, and to co-operate with other Parties to develop international capacity in this area and to conclude appropriate bilateral and multi-lateral agreements to facilitate international investigations.





- c. **Articles 20 to 22** oblige Parties, subject to national law, to record information relating to illicit trade and to share enforcement information with other Parties to assist in the detection and investigation of illicit trade.
  - d. **Articles 23 to 27** require Parties to co-operate with each other to produce training and technical assistance, to co-operate in the investigation and prosecution of offences, and to ensure effective international co-operation between law enforcement agencies.
  - e. **Articles 28 and 29** require Parties to co-operate to provide mutual administrative and legal assistance.
  - f. **Articles 30 and 31** deals with extradition, and obliges Parties to ensure that serious offences involving illicit trade, as set out in Article 14, are included in existing extradition treaties, and where no treaty exists between Parties, permits (but does not require) them to consider criminal offences under Article 14 as a legal basis for extradition.
  - g. **Article 36.7** provides that “Parties may require the tobacco industry to bear any costs associated with a Party’s obligations to achieve the objectives of this Protocol, in compliance with Article 5.3 of the WHO Framework Convention on Tobacco Control”.
86. The Protocol will enter into force 90 days after it is ratified by 40 Parties. The Protocol was opened for signature at the World Health Organisation headquarters in Geneva on Thursday 10th January 2013. 12 Parties signed the Protocol in the first week (China, France, Gabon, Libya, Myanmar, Nicaragua, Panama, Republic of Korea, South Africa, Syrian Arab Republic, Turkey and Uruguay), and 5 further Parties have stated that they will sign in the near future (the European Union, Finland, Iran, Mexico and Norway).
87. The costs and benefits of the Illicit Trade Protocol to the UK were estimated in a 2009 study conducted for Action on Smoking and Health by economist Paul Johnson, and updated by economist Howard Reed, a witness to our Inquiry, in 2012, with the costs summarised in the table below.<sup>70</sup>

**Table 8: Estimated annual costs of the Protocol (£)**

	Costs to be incurred by:		
	Manufacturers / Wholesalers	Retailers	Government
<b>Licensing</b>	Licensing already in place	Negligible additional costs	£5m (year 1) £1m (subsequent)
<b>Tracking and tracing</b>	£10m - £20m	Not applicable	None
<b>Customer verification</b>	Customer verification is already in place	Not applicable	None
<b>Record keeping</b>	If tracking and tracing is implemented, record keeping should not require additional expenses	Not applicable	None
<b>Enforcement and international cooperation</b>	Not applicable	Not applicable	£0 - £2m
<b>Total</b>	£15m - £27m (year 1) £11m - £23m (subsequent years)		

<sup>70</sup> Johnson P. “Cost Benefit Analysis of the FCTC Protocol on Illicit Trade in Tobacco Products”. [http://www.ash.org.uk/files/documents/ASH\\_709.pdf](http://www.ash.org.uk/files/documents/ASH_709.pdf). (Accessed 4 February 2013). Reed H update on this analysis as evidence to this Inquiry. [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev)



88. Many of the measures included in the Protocol are already in place as part of the UK's comprehensive anti-smuggling strategy and only the new measures will lead to additional costs. There will be negligible additional costs to retailers. Additional costs to the Government and to manufacturers are insignificant compared to the potential benefits. The total additional cost is in the range of £15 - 27 million in year 1 and £11 - 23 million in subsequent years.
89. Howard Reed's analysis submitted as evidence to this Inquiry estimates the benefits of the Protocol under a range of scenarios dependant on the number of countries that ratify the Protocol. The projected reduction in the size of the UK illicit tobacco market is likely to lead to a reduction in smoking prevalence which has economic benefits in terms of reduced NHS costs, increased output from longer healthy working lives and reduced workplace absenteeism, and the value of extra lives saved. The Protocol would also lead to a reduction in lost tax revenue from illicit sales, increased income tax receipts from longer working lives and reduced absenteeism, and reduced spending on sickness and disability benefits.
90. It is already clear that the Protocol enjoys wide support from Governments around the world, and that worldwide adoption is the most likely single outcome of the ratification process. If the Protocol is adopted worldwide the benefit to the UK will be an estimated reduction in the size of the UK illicit tobacco market of 70%. The total net benefit to the UK of the Protocol in Net Present Value terms (discounted over a 50-year period) is estimated to be around £9.3 billion. In annual terms, over the first five years for which the Protocol is in place, it is estimated that the Protocol will increase tax revenues by around £1.35 billion per year and save around 200 lives per year, with total net benefits to the UK of around £300 million per year. This compares to additional costs which are estimated to be less than £27 million a year. Therefore, the United Kingdom Government should sign and then ratify the Protocol as soon as possible.

## European Union

91. The European Union has been engaged in work against the illicit tobacco trade since at least 1994, when the Commission established a "Task Group Cigarettes" (TGC) as part of the EU anti-fraud office OLAF.
92. The TGC's responsibilities include the co-ordination of criminal cases and customs operations in Member States and other countries. There are currently 35 open cases. The TGC also negotiates Mutual Assistance Agreements with non EU states. There are currently 40 such agreements, covering 54 countries and territories.
93. In 2000, the (then) European Community filed a civil action in New York against Philip Morris and RJ Reynolds. In July 2004, OLAF negotiated a legally binding and enforceable agreement with PMI, while litigation between the parties was pending, as a 'resolution of all past disputes relating to contraband cigarettes' and a 'forward-looking' arrangement for 'strong coordinated action' in combating illicit trade in cigarettes. Subsequent agreements were signed with JTI (in 2007) and with BAT and ITL (both in 2010).<sup>71</sup>
94. Under these agreements, the manufacturers were required:
  - to pay a collective total of \$2.15 billion to the EU and countries participating in the agreement, in view of previous tax losses<sup>72</sup>
  - to prevent their products from falling into the hands of criminals by:
    - supplying only those quantities required by the legitimate market
    - taking care that they sell to legitimate clients only, and
    - implementing a tracking system to help law enforcement authorities if cigarettes are traded illegally.

<sup>71</sup> European Union legal agreements with tobacco manufacturers. [http://ec.europa.eu/anti\\_fraud/investigations/eu-revenue/cigarette\\_smuggling\\_en.htm](http://ec.europa.eu/anti_fraud/investigations/eu-revenue/cigarette_smuggling_en.htm). (Accessed 4 February 2013)

<sup>72</sup> \$1.25 billion for PMI, \$400 million for JTI, \$300 million for ITL, and \$200 million for BAT



95. The EU agreements provide for substantial compensation payments from the manufacturers if their products are seized in illicit channels. For example, the PMI agreement requires payment of five times the value of the seized goods. Even this substantial penalty might be regarded as relatively mild, since HMRC estimate that in the UK only about 10% of illicit tobacco products are successfully interdicted.
96. The available evidence suggests that the EU agreements have contributed to a fall in the proportion of the illicit tobacco trade in the EU that consists of the products of the major manufacturers diverted into illicit channels. The 2011 European Commission Action plan to fight against smuggling of cigarettes and alcohol along the EU Eastern border states that “in the early 2000s, the problem of smuggling at the Eastern border of the EU related largely to the smuggling of genuine product. Today ....the majority of cigarettes entering the EU illegally via the Eastern border are either cheap whites or counterfeit”.<sup>73</sup>
97. It should also be noted that the EU and Member States are not the only FCTC Parties to have entered into agreements with the tobacco industry in relation to illicit trade in tobacco products. Canada and Colombia have also entered into legally binding agreements with tobacco companies, and many states including the UK have in the past signed memoranda of understanding (MOUs) with the major manufacturers, widely seen as unsatisfactory since they are not legally binding and their terms are often kept confidential.
98. The EU agreements have themselves been criticised as raising issues with respect to the obligations of the Parties under article 5.3 of the FCTC, as well as related obligations under article 12 and article 13.<sup>74</sup> The implications of Article 5.3 for work on illicit trade are discussed in paragraphs 67 to 72 of this report. However, the EU agreements clearly represent an important step forward for all Member States, including the UK, and are greatly to be preferred to the previous MOUs.
99. In his evidence to our Inquiry, Mr Austin Rowan, adviser to the OLAF TGC, estimated the total tax losses from illicit trade to the EU and its Member States to be about 10 billion euro a year. It is therefore not surprising that the EU and its Member States took a leading role in supporting a strong Illicit Trade Protocol during the WHO negotiations. The EU Commission has also now published a proposed revision to the 2001 Tobacco Products Directive, which among other provisions includes EU requirements for a tracking and tracing system for tobacco products down to pack level.<sup>75</sup>
100. Mr Rowan identified the following as key current issues for the EU and the Member States in dealing with illicit trade:
  - Imports of counterfeit tobacco products from the Far East (mainly China)
  - Illegal production of counterfeit products inside the EU (OLAF has been involved in raids on 54 illegal factories since 2004, and commonly these are large-scale and sophisticated enterprises)
  - Manufacturers in countries bordering the EU that produce “cheap white” brands with little or no domestic or legal international market
  - Manufacturers in the Tri Border Area (particularly Paraguay)
  - Transshipments of illicit tobacco products via the USA
  - Production of cheap/illicit whites and transshipments of counterfeit and diverted legitimate tobacco products in Free Zones, often concealed (“inter-mingled”) with other cargo.

<sup>73</sup> European Commission. *Communication from the commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions and the Court of Auditors on the Commission anti-fraud strategy* COM(2011) 376 final. June 24 2011. [http://ec.europa.eu/anti\\_fraud/documents/preventing-fraud-documents/ec\\_antifraud\\_strategy\\_en.pdf](http://ec.europa.eu/anti_fraud/documents/preventing-fraud-documents/ec_antifraud_strategy_en.pdf). (Accessed 4 February 2013)

<sup>74</sup> Heyward M. *Legal analysis of the agreements between the European Union, Member States, and multinational tobacco companies. Framework Convention Alliance*. [http://www.fctc.org/index.php?option=com\\_content&view=article&id=466:legal-analysis-of-the-agreements-between-the-european-union-member-states-and-multinational-tobacco-companies&catid=222:meeting-resources&Itemid=230](http://www.fctc.org/index.php?option=com_content&view=article&id=466:legal-analysis-of-the-agreements-between-the-european-union-member-states-and-multinational-tobacco-companies&catid=222:meeting-resources&Itemid=230). (Accessed 4 February 2013)

<sup>75</sup> European Commission. *Proposal for a Directive of the European Parliament and 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*. [http://ec.europa.eu/health/tobacco/docs/com\\_2012\\_788\\_en.pdf](http://ec.europa.eu/health/tobacco/docs/com_2012_788_en.pdf). (Accessed 4 February 2013)



101. The continuing complicity of the major tobacco manufacturers in illicit trade shows the need for enforcement agencies, governments and international bodies to protect their independence from the industry.
102. The tobacco manufacturers should not be involved in any training of customs officials, which should be the responsibility of HMRC and equivalent international agencies. Given that controlling the illicit tobacco trade requires international collaboration, it is important that HMRC and the UK government help promote this message among its international collaborators.
103. Stronger supply chain controls are also needed in relation to a number of tobacco companies producing cigarettes which have appeared in the illicit market throughout Europe including the UK, for example the Baltic Tobacco Company (based in Kaliningrad, an exclave of Russia inside EU borders), Karelia (based in Greece) and Raquel (based in Cyprus).<sup>76</sup> This should be greatly facilitated if, as expected, these countries become Parties to the Illicit Trade Protocol.
104. Partnership working on the international stage has further potential which has not yet been realised. Smuggling is a global and complex problem and smuggling in the EU commonly involves more than one member state. HMRC/UKBA and OLAF should continue to develop their co-operation in tackling the trade.

## UK National Action

105. Since 2000, UK government agencies have co-ordinated and implemented a well-planned and well-resourced strategy to fight illicit trade, and they have been supported by increasingly effective action at regional and local level. In 2000, HM Customs and Excise, as it then was, together with the Treasury launched an action plan “Tackling Illicit Tobacco Smuggling”. In 2006, HM Revenue and Customs and the Treasury published “New Responses to New Challenges: Reinforcing the Tackling Tobacco Smuggling Strategy”. In 2008, HMRC published “Tackling Smuggling Together”. In 2011, the strategy was further updated jointly by HM Revenue and Customs and the UK Border Agency in “Tackling Tobacco Smuggling - Building on our Success”.<sup>77</sup> In 2006, the strategy was reinforced by supply chain legislation making it a legal duty for manufacturers not to facilitate smuggling, with fines of up to £5 million if they fail to comply.<sup>78</sup>
106. The regular updating of the UK’s strategy to tackle illicit trade is both welcome and necessary. In their evidence to our Inquiry both Mr Rowan from OLAF and Mr Leggett from HMRC emphasised the rapidly changing nature of the illicit market and the speed with which organised crime groups involved in illicit trade adapt to new developments in the demand for tobacco products and respond to evolving investigative techniques and procedures.
107. The UK government set outcome measures for a quantified reduction in the market share of illicit cigarettes and tobacco between 2000 and 2007-8. These were achieved in advance of the deadline and proved very effective in helping maintain the incentive to put resources into this area, while helping ensure consistency and transparency. The current strategy includes a commitment “to achieve further sustainable downwards pressure on the illicit market in cigarettes and HRT through to 2015”. This objective is not currently quantified, and we suggest that in future it should be.
108. In a time of tight public spending restrictions, the current government has been willing to invest in what is demonstrably highly cost effective enforcement activity. Paragraph 1.4 of the 2011 strategy states that there has been “£917 million additional investment to tackle organised crime, tax evasion and avoidance through the government’s Spending Review”. The number of HMRC staff working on the illicit tobacco trade has risen by 1,200 since 2000. HMRC has also tightened rules in

<sup>76</sup> Imperial toes the line. *ASH* press release. September 27 2010. <http://www.ash.org.uk/media-room/press-releases/imperial-tobacco-toes-the-line>. (Accessed 4 February 2013)

<sup>77</sup> Reviews of each strategy document. *ASH*. <http://www.ash.org.uk/current-policy-issues/taxation-smuggling/smuggling/smuggling-and-the-uk/> (Accessed 4 February 2013)

<sup>78</sup> HMRC press release. *£5m penalties for tobacco manufacturers who aid smuggling*. 29 September 2006.



relation to travellers bringing tobacco into the UK: from October 2011, the “minimum indicative levels” for travellers bringing tobacco into the UK from the EU were lowered from 3,200 cigarettes to 800, and from 3kg of HRT to 1kg.

109. The Scottish government has introduced a welcome and important new offence of “selling tobacco while unregistered” which came into force in October 2011. By that date all legitimate tobacco retailers were required to be registered with the Scottish government, and any unregistered seller now faces a maximum penalty of £20,000 and/or up to six months in prison.<sup>79</sup> We recommend that the UK Government should consider introducing a similar simple positive licensing scheme and an offence of selling tobacco while unregistered. This creates an additional low cost mechanism to deal with illicit tobacco sellers. Given that the business of legitimate retailers is damaged by the illicit trade in tobacco products, this should be a net positive benefit to the retail sector.

## Regional Action

110. The Tobacco Control Plan for England, published by the coalition Government in 2011, highlights the importance of developing partnerships to facilitate joint working between local authorities and other local agencies, in conjunction with HMRC and the Department of Health in order to tackle illicit tobacco.<sup>80</sup>

111. The government’s strategy supports the development of partnerships between groups of local authorities in order to improve the cost-effectiveness of work to tackle illicit tobacco and to achieve greater impact.

112. In his evidence to our Inquiry, Mr Andy Leggett of HMRC said that co-operation between HMRC and local trading standards officers was patchy around the country, partly because of differing priorities attached to work on illicit tobacco by local authorities. While this is not surprising, it does tend to detract from the effectiveness of action against illicit trade, which requires close co-operation between agencies at the local, national and international levels, and we recommend that this issue should be tackled through work on a joint strategy between HMRC and local government and trading standards representative bodies at a national level.

113. Local action to reduce the demand and availability of illicit tobacco has been shown to be highly cost effective for society, as it:

- helps to reduce tobacco consumption and subsequent tobacco related harm;
- decreases tax revenue losses;
- reduces organised crime; and
- helps to support legitimate local businesses.

## North of England Partnership

114. The North of England Tackling Illicit Tobacco for Better Health Programme was established as a joint partnership across three regions (North West, North East and Yorkshire and Humber) and aimed to reduce smoking prevalence by:

- reducing the availability (supply) of illicit tobacco; and
- reducing the demand for illicit tobacco.

115. The programme was launched in July 2009 and involves partnership working with key stakeholders from HMRC, Trading Standards, Health and Marketing across the three regions. Initial funding was provided by the Department of Health (DH), with further local NHS (PCT) funding contributed via Fresh and Tobacco Free Futures (formerly Smokefree North West). Funding in Yorkshire and Humber ended when financial support for regional tobacco control programmes from DH was withdrawn.

<sup>79</sup> Scottish Government Tobacco and Primary Medical Services (Scotland) Act 2010. <http://www.legislation.gov.uk/asp/2010/3/introduction>. (Accessed 4 February 2013)

<sup>80</sup> HM Government. *Healthy Lives, Healthy People*. A tobacco control plan for England. London. March 2011.



116. The programme commissioned two surveys on illicit tobacco use in the North of England in 2009 and 2011.

117. Following the “Get Some Answers” (GSA) social marketing campaign, which was run in the North West and North East in June/July 2010 and January/February 2011, the survey was repeated in March/April 2011 and showed the following changes<sup>81</sup> compared to the findings in the NW and NE in 2009:

There was a reduction in:

- smoking prevalence from 24% in 2009 to 22% in 2011
- proportion of smokers who had bought duty free from abroad or had someone bring back duty free for them (48% in 2009, 37% in 2011)
- proportion of smokers buying illicit tobacco (20% in 2009, 18% in 2011)
- proportion of tobacco purchased that is illicit, among illicit tobacco buyers (36% in 2009, 33% in 2011)
- total market share of illicit tobacco (9.4% in 2009, 8.8% in 2011)
- proportion of smokers who were comfortable with illicit tobacco (19% in 2009, 15% in 2011)

It is estimated that the volume of illicit tobacco has reduced in the North of England (NW and NE) by 23% from 2009 to 2011 due to the reduction in smoking prevalence, proportion of smokers buying illicit tobacco and proportion of tobacco purchased that is illicit. This occurred when the proportion of smokers ‘struggling financially’ increased from 20% to 25% which would have been expected to lead to an increase in the use of illicit tobacco. The proportion of people responding that they were likely to report someone selling illicit tobacco also increased, from 26% in 2009 to 29% in 2011.

118. There was an increase in related calls to Crimestoppers in the North East and North West following the GSA campaign, from 100 in the year April 2009 to March 2010, to 328 in April 2010 to March 2011. In Yorkshire and Humber the GSA campaign did not run and calls to Crimestoppers fell from 33 to 19 over this period.<sup>82</sup>

119. The North of England programme also commissioned a social marketing company, The Hub, to develop the public facing campaign to reduce demand for illicit tobacco in addition to encouraging members of the public to report sales of illicit tobacco.

120. The Hub used findings from the NEMS North of England Illicit Tobacco Survey in 2009 to inform their campaign strategy. They decided to aim their campaign at local people who already showed some concern about illicit tobacco. They pre-tested messages, brands and imagery with members of the public in four areas in the North of England in January - February 2010 in order to develop the most effective messages for the target population. Qualitative interviews were conducted with 129 adults aged 25-55 years, of whom 73% were current or ex-smokers.<sup>83</sup>

121. Three key messages were tested:

- Illicit tobacco encouraging / making it easier for children to smoke
- Illicit tobacco bringing crime into the community
- Illicit tobacco putting local traders out of business

The programme chose not to use messages discussing the relative health risks of illicit versus licit tobacco, which imply that licit tobacco is healthier than illicit.

122. The message around illicit tobacco encouraging or making it easier for children to smoke was the most successful. It resonated with most participants, reflected their local experience and they had a strong moral objection to children smoking. Although participants did not believe that illicit tobacco encourages children to smoke they believed that it makes it easier or possible for children to smoke.

81 NEMS market research. *North of England Illicit Tobacco Survey, 2011*. [http://www.illicittobaccnorth.org/FileUploads/Illicit\\_tobacco\\_programme\\_public\\_opinion\\_report\\_2011.pdf](http://www.illicittobaccnorth.org/FileUploads/Illicit_tobacco_programme_public_opinion_report_2011.pdf). (Accessed 4 February 2013)

82 UK Centre for Tobacco Control Studies. *Tackling Illicit Tobacco for Better Health. Final Evaluation Report*. 2012. <http://www.ukctcs.org/ukctcs/research/featuredprojects/illicittobacco.aspx>. (Accessed 4 February 2013)

83 Hub Marketing Ltd. *Tackling Illicit Tobacco: Pretesting Findings*. February 2010.



123. Participants were concerned about crime in their area and found the message around illicit tobacco bringing crime into the community engaging and relevant. However, they did not believe that illicit tobacco sellers in their community are linked to criminals with guns.
124. The message around illicit tobacco putting local traders out of business was not believed by most participants.
125. The Hub used the findings from this research to refine the 'Get Some Answers' social marketing campaign using the key messages that illicit tobacco makes it easier for children to smoke and that illicit tobacco is linked with crime in the local community. This campaign was run in the North West and North East as part of The North of England Tackling Illicit Tobacco for Better Health Programme.

## South of England Partnership

126. The South of England Tackling Illegal Tobacco for Better Health Programme is a joint initiative between Smokefree South West, counterparts in the South East, HMRC, Local Authorities, Trading Standards departments, NHS and police across the South of England which was launched in February 2011.<sup>84</sup>
127. The main aim of the programme is to protect communities in the South of England from the damaging impacts of illegal tobacco by:
  - reducing the availability of illegal tobacco; and
  - reducing the demand for illegal tobacco.
128. The programme learnt from the experience gained by The North of England Tackling Illicit Tobacco for Better Health Programme and developed specific materials for the region based on the designs used in The North of England programme.
129. Information was obtained through a detailed problem profile conducted in the South West which informed a public facing social marketing campaign launched in the South West in November 2011, to tackle the demand side of illegal tobacco.
130. In the South West several initiatives have been undertaken to increase knowledge and awareness of illicit tobacco and improve sharing of intelligence. Trading standards departments have identified shops selling cheap/illicit whites to children following identification of empty packs of cheap/illicit whites by street cleaning teams outside schools. Stop smoking services in Bath and North East Somerset are piloting the use of a proforma to record how much smokers pay for tobacco and where they purchase it. Devon and Cornwall Police have agreed to run a pilot in 2013, in one of the police custody suites, where police officers will record possession of illicit tobacco and ask detainees where the illicit tobacco was purchased.

## East of England Partnership

131. The East of England Partnership was set up in 2010 between HMRC, the East of England Trading Standards Association, and the East of England Public Health Directorate.
132. The programme followed the model of the North of England Tackling Illicit Tobacco for Better Health Programme to reduce the availability of and demand for illicit tobacco.
133. A public awareness raising and behaviour change campaign was run from April to May 2012 to reduce demand for illicit tobacco and increase the volume of intelligence reported regarding sales of illicit tobacco.
134. There was an increase in enforcement activity following the campaign, with over 100 joint enforcement visits between HMRC and Trading Standards.

<sup>84</sup> Smokefree Southwest. *Combating Illegal Tobacco*. <http://www.smokefreesouthwest.org.uk/what-we-do/combating-illegal-tobacco.html>. (Accessed 4 February 2013)



## Funding Pressures on Local Authorities

135. In line with general pressures on public expenditure, local authority grants from central government are falling. In England, the Local Government Association estimates that in 2013/14 non-schools funding will fall by 4.8%, with further reductions in 2014/15.<sup>85</sup> The Trading Standards Institute has already expressed its concern about the implications for funding of local authority enforcement work, including work on tobacco, stating that: “the impact of a declining trading standards service would leave consumers increasingly vulnerable to scams, fakes and rogues, which in turn are linked to organised crime. Honest, legitimate businesses would also increasingly suffer from unchecked unfair trading and the black market, instead of receiving the support they need to help ensure economic recovery”.<sup>86</sup>
136. Enforcement work against the illicit tobacco trade is highly cost effective, because it protects government revenues. It also requires the close integration of work from the local and regional to the national and international level. However, the benefits from defending government revenues do not go to local authorities, who may therefore view enforcement work on illicit tobacco as simply an expenditure, vulnerable to reductions along with the rest of their budgets. The government needs to give consideration to how local and regional enforcement work can be adequately funded in future, if necessary through the use of specific grants or other financial incentives, reflecting the net benefits from such work to the UK Treasury.

## Licensing of Retailers

137. The Scottish Government introduced a tobacco retailer licensing scheme in October 2011.<sup>87</sup>
138. This is a low-cost licensing scheme which operates in conjunction with fixed penalty notices and the ability for the courts to impose banning orders. The scheme requires all tobacco retailers to be registered on one national register in order to sell tobacco. The costs to the industry of this scheme are minimal - limited to a one-off labour cost needed to fill in a form. Costs to the government include initial set-up costs of advertising and marketing to give retailers information about the necessity to comply with the scheme and the process to be undertaken, and also the cost of a database to hold national level information on retailers.
139. Based on applying the estimates from the Scottish Government in a UK-wide context, Mr Howard Reed has estimated total costs to the UK government of such a scheme at around £5m in the first year and no more than £1m per year on an ongoing basis.<sup>88</sup>
140. We recommend that the UK government gives consideration to introducing such a scheme in England. We believe that it would give local enforcement agencies a very valuable weapon in tackling illicit trade and in enforcing other tobacco control regulations, for example the ban on sales to minors. It would also help to protect the great majority of honest retailers from unfair competition from the unscrupulous minority who are prepared to deal in illicit products.

<sup>85</sup> Local Government Association Briefing Paper. *Provisional Local Government Finance Settlement 2013-14 and 2014-15*. December 2012. [http://www.local.gov.uk/c/document\\_library/get\\_file?uuid=040e5017-0ec4-49fe-8461-3a2c5b9cf9c6&groupId=10171](http://www.local.gov.uk/c/document_library/get_file?uuid=040e5017-0ec4-49fe-8461-3a2c5b9cf9c6&groupId=10171). (Accessed 4 February 2013)

<sup>86</sup> Trading Standards Institute media release. *Trading Standards Workforce Survey*. <http://www.tradingstandards.gov.uk/policy/policy-pressitem.cfm/newsid/479>. (Accessed 4 February 2013)

<sup>87</sup> Scottish Government. *Proposed Tobacco Sales Licensing (Scotland) Bill: A Consultation*, [http://www.scottish.parliament.uk/S3\\_MembersBills/Draft%20proposals/TobaccoSalesConsultation.pdf](http://www.scottish.parliament.uk/S3_MembersBills/Draft%20proposals/TobaccoSalesConsultation.pdf). (Accessed 4 February 2013)

<sup>88</sup> Written evidence to our Inquiry. [www.ash.org.uk/APPGillicit2013ev](http://www.ash.org.uk/APPGillicit2013ev)





# Tracking and Tracing Tobacco Products

141. Perhaps the single most important provision of the Illicit Trade Protocol (ITP) is Article 8, relating to tracking and tracing. This is because it offers Governments and enforcement authorities across the world a relatively simple means to follow tobacco products throughout their supply chain, verifying that they are genuine, that tax has been paid in the appropriate jurisdiction, and that the product has not been diverted into illicit channels.

142. Article 8 of the Protocol reads as follows:

1. “For the purposes of further securing the supply chain and to assist in the investigation of illicit trade in tobacco products, the Parties agree to establish within five years of entry into force of this Protocol a global tracking and tracing regime, comprising national and/or regional tracking and tracing systems and a global information sharing focal point located at the Convention Secretariat of the WHO Framework Convention on Tobacco Control and accessible to all Parties, enabling Parties to make enquiries and receive relevant information.
2. Each Party shall establish, in accordance with this Article, a tracking and tracing system, controlled by the Party for all tobacco products that are manufactured in or imported onto its territory taking into account their own national or regional specific needs and available best practice.
3. With a view to enabling effective tracking and tracing, each Party shall require that unique, secure and non-removable identification markings (hereafter called unique identification markings), such as codes or stamps, are affixed to or form part of all unit packets and packages and any outside packaging of cigarettes within a period of five years and other tobacco products within a period of ten years of entry into force of this Protocol for that Party.
4. Each Party shall, for purposes of paragraph 3, as part of the global tracking and tracing regime, require that the following information be available, either directly or accessible by means of a link, to assist Parties in determining the origin of tobacco products, the point of diversion where applicable, and to monitor and control the movement of tobacco products and their legal status:
  - 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 who is not affiliated with 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, the shipment date, shipment destination, point of departure and consignee.



- 4.2 The information in subparagraphs (a), (b), (g) and where available (f), shall form part of the unique identification markings.
- 4.3 Where the information in subparagraph (f) is not available at the time of marking, Parties shall require the inclusion of such information in accordance with Article 15.2(a) of the WHO Framework Convention on Tobacco Control.
5. Each Party shall require, within the time limits specified in this Article, that the information set out in paragraph 4 is recorded, at the time of production, or at the time of first shipment by any manufacturer or at the time of import onto its territory.
6. Each Party shall ensure that the information recorded under paragraph 5 is accessible by that Party by means of a link with the unique identification markings required under paragraphs 3 and 4.
7. Each Party shall ensure that the information recorded in accordance with paragraph 5, as well as the unique identification markings rendering such information accessible in accordance with paragraph 6, shall be included in a format established or authorized by the Party and its competent authorities.
8. Each Party shall ensure that the information recorded under paragraph 5 is accessible to the global information sharing focal point on request, subject to paragraph 9, through a standard electronic secure interface with its national and/or regional central point. The global information sharing focal point shall compile a list of the competent authorities of Parties and make the list available to all Parties.
9. Each Party or the competent authority shall:
  - a. have access to the information outlined in paragraph 4 in a timely manner by making a query to the global information sharing focal point;
  - b. request such information only where it is necessary for the purpose of detection or investigation of illicit trade in tobacco products;
  - c. not unreasonably withhold information;
  - d. answer the information requests in relation to paragraph 4, in accordance with its national law; and
  - e. protect and treat as confidential, as mutually agreed, any information that is exchanged.
10. Each Party shall require the further development and expansion of the scope of the applicable tracking and tracing system up to the point that all duties, relevant taxes, and where appropriate, other obligations have been discharged at the point of manufacture, import or release from customs or excise control.
11. Parties shall cooperate with each other and with competent international organizations, as mutually agreed, in sharing and developing best practices for tracking and tracing systems including:
  - a. facilitation of the development, transfer and acquisition of improved tracking and tracing technology, including knowledge, skills, capacity and expertise;
  - b. support for training and capacity-building programmes for Parties that express such a need; and
  - c. further development of the technology to mark and scan unit packets and packages of tobacco products to make accessible the information listed in paragraph 4.
12. Obligations assigned to a Party shall not be performed by or delegated to the tobacco industry.
13. 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.

14. Each Party may require the tobacco industry to bear any costs associated with that Party's obligations under this Article."

143. In addition, European Union countries are likely to be bound in future by the provisions of the draft EU Tobacco Products Directive (TPD), which was adopted by the EU Commission on 19th December 2012.<sup>89</sup>

144. Article 14 of the draft Directive (Traceability and Security Features) includes the following provisions:

1. "Member States shall ensure that all unit packets of tobacco products shall be marked with a unique identifier. In order to ensure their integrity, unique identifiers shall be irremovably printed/affixed, indelible and in no way hidden or interrupted in any form, including through tax stamps and price marks, or by the opening of the packet. In relation to products manufactured outside the Union the obligations laid down in this Article apply only to those destined to or placed on the Union market.
2. The unique identifier shall allow determining:
  - a. the date and place of manufacturing;
  - b. the manufacturing facility;
  - c. the machine used to manufacture the products;
  - d. the production shift or time of manufacture;
  - e. the product name;
  - f. the intended market of retail sale;
  - g. the intended shipment route;
  - h. where applicable, the importer into the Union;
  - i. the actual shipment route from manufacturing to the first retail outlet, including all warehouses used;
  - j. the identity of all purchasers from manufacturing to the first retail outlet;
  - k. the invoice, order number and payment records of all purchasers from manufacturing to the first retail outlet.
3. Member States shall ensure that all economic operators involved in the trade of tobacco products from the manufacturer to the last economic operator before the first retail outlet, record the entry of all unit packets into their possession, as well as all intermediate movements and the final exit from their possession. This obligation can be fulfilled by recording in aggregated form, e.g. of outside packaging, provided that tracking and tracing of unit packets remains possible.
4. Member States shall ensure that manufacturers of tobacco products provide all economic operators involved in the trade of tobacco products from the manufacturer to the last economic operator before the first retail outlet, including importers, warehouses and transporting companies with the necessary equipment allowing for the recording of the tobacco products purchased, sold, stored, transported or otherwise handled. The equipment shall be able to read and transmit the data electronically to a data storage facility pursuant to paragraph 6.
5. Recorded data cannot be modified or deleted by any economic operator involved in the trade of tobacco products, but the economic operator that introduced the data and other economic operators directly concerned by the transaction such as the supplier or the recipient can comment on previously introduced data. The economic operator concerned

<sup>89</sup> European Commission Revision of the Tobacco Products Directive [http://ec.europa.eu/health/tobacco/products/revision/index\\_en.htm](http://ec.europa.eu/health/tobacco/products/revision/index_en.htm) (Accessed 4 February 2013)



shall add the correct data and a reference to the previous entry which requires rectification in their view. In exceptional circumstances and upon submission of adequate evidence, the competent authority in the Member State in which the recording took place or if the recording took place outside the Union the competent authority in the Member State of importation, can authorise the modification or deletion of data previously registered.

6. Member States shall ensure that manufacturers and importers of tobacco products conclude data storage contracts with an independent third party, which shall host the data storage facility for data relating to the manufacturer and importer concerned. The data storage facility shall be physically located on the territory of the Union. The suitability of the third party, in particular its independence and technical capacities, as well as the contract, shall be approved and monitored by an external auditor, who is proposed and paid by the tobacco manufacturer and approved by the Commission. Member States shall ensure full transparency and accessibility of the data storage facilities for the competent authorities of the Member States, the Commission and the independent third party on a permanent basis. In duly justified cases Member States or the Commission can provide manufacturers or importers access to this information, provided commercially sensitive information remains adequately protected in conformity with the relevant national and Union legislations.
7. Member States shall ensure that personal data are only processed in accordance with the rules and safeguards laid down in Directive 95/46/EC.
8. In addition to the unique identifier, Member States shall require that all unit packets of tobacco products which are placed on the market carry a visible, tamper proof security feature of at least 1 cm<sup>2</sup>, which shall be irremovably printed or affixed, indelible and in no way hidden or interrupted in any form, including through tax stamps and price marks, or other elements mandated by legislation.
9. The Commission shall be empowered to adopt delegated acts in accordance with Article 22:
  - a. to define the key elements (such as duration, renewability, expertise required, confidentiality) of the contract referred to in paragraph 6, including its regular monitoring and evaluation;
  - b. to define the technical standards to ensure that the systems used for the unique identifiers and the related functions are fully compatible with each other across the Union and
  - c. to define the technical standards for the security feature and their possible rotation and to adapt them to scientific, market and technical development.
10. Tobacco products other than cigarettes and roll-your-own tobacco shall be exempted from the application of paragraph 1 to 8 during a period of 5 years following the date referred to in paragraph 1 of Article 25."

145. The draft Directive provisions on tracking and tracing would benefit from some minor but significant amendments, to ensure that the consequent system is secure and independent. For example:

- the "unique identifier" should ensure a simple link between all levels of packaging (from pack level, through carton to master case);
- the "third party" chosen for data storage should be chosen by Member State Governments rather than the industry; and
- the "auditor" of the system should be chosen by and answerable to the Commission.

Nonetheless, the tracking and tracing provisions in the draft Directive are a valuable proposal that should help to ensure integrated action against illicit trade across the European Union.



146. Coding technology, which is central to effective tracking and tracing systems is evolving quickly and offers governments a vital means with which to control and monitor the tobacco trade. The key challenge posed by the tobacco sector is that cigarettes are a mass consumer product and that the coding should apply to 290 billion cigarette packs sold globally each year.
147. Neither the Protocol nor the draft Directive specify which technological system should be adopted by governments to meet their obligations under the tracking and tracing provisions. There are in fact a number of companies and business partnerships offering systems that could meet the required specifications.
148. One such system is “Codentify”, a visible code developed and patented by PMI. PMI describe the system as: “a bespoke system for enabling carton tracking and tracing and product authentication. The basic principle of Codentify is simple: a unique and secure, eye-readable, 12-digit code is printed directly onto packs and cartons during manufacturing. The solution works on standard equipment and is easily integrated into the production process. The Codentify solution is secure, including various measures to make it impossible for counterfeiters to replicate or steal a valid code.” It is also claimed that the system provides “full traceability” and allows “product verification” using widely available technology such as mobile phones.<sup>90</sup>
149. Since November 2010, PMI has licensed Codentify for free to the other three major manufacturers. The four majors have set up the “Digital Coding and Tracking Association” (DCTA), registered in Zurich. It is clearly their intention that Codentify should be promoted to Governments and international agencies as the global standard system for tracking and tracing tobacco products.<sup>91</sup>
150. One international agency that appears already to have effectively committed to the development of Codentify is INTERPOL, which announced in July 2012 that it had received a €15 million donation from PMI. INTERPOL’s announcement of the donation stated that “we are appreciative of the financial support provided by PMI which recognizes how entrenched the criminal networks have become, and the need for law enforcement action”.<sup>92</sup> INTERPOL has also announced the creation of a Global Register (IGR). According to INTERPOL: “Unique security features can be placed on any type of consumer goods, such as pharmaceuticals, cigarettes, luxury items, household goods and toys - and in an unprecedented move, the INTERPOL Global Register will actively engage and empower the public, rights holders and law enforcement officials by enabling anyone with a mobile phone or Internet-connected device to verify a product’s legitimacy by screening these features to help determine whether a product is fake or being illicitly traded”. INTERPOL also stated that it was “working with the Digital Coding and Tracking Association ... in identifying ways to make their supply chain control system, known as Codentify, accessible via the IGR”.<sup>93</sup>
151. There are two important issues in relation to Codentify, which the UK government should consider carefully before any decision to treat it as a preferred tracking and tracing solution for tobacco products in the UK market. First, is Codentify actually a system that meets the requirements of the Protocol and the Directive? Secondly, does using a system developed and patented by the manufacturers raise concerns about any potential compromise of independence and reliability of the tracking and tracing regime?
152. Codentify codes are printed onto packs and cartons, but not onto master cases and pallets. These relate as follows:
  - A standard pack of cigarettes contains 20 sticks
  - A carton of cigarettes contains 10 packs = 200 sticks
  - A master case of cigarettes contains 50 cartons = 10,000 sticks
  - A pallet of cigarettes contains 50 master cases = 500,000 sticks
  - A standard 40 foot container might contain 20 pallets = 10 million sticks/500,000 packs.

<sup>90</sup> Philip Morris International. *PMI Product Marking*. [http://www.pmi.com/eng/tobacco\\_regulation/illicit\\_trade/pages/pmi\\_product\\_marking.aspx](http://www.pmi.com/eng/tobacco_regulation/illicit_trade/pages/pmi_product_marking.aspx) . (Accessed 4 February 2013)

<sup>91</sup> For example Hill M. *Digital Tax Verification, Codentify, the Industry Standard*. October 2010

<sup>92</sup> INTERPOL press release. *INTERPOL targets organized crime with global initiative against trafficking in illicit goods* <http://interpol.int/News-and-media/News-media-releases/2012/PR050>. 22 June 2012. (Accessed 4 February 2013)

<sup>93</sup> INTERPOL Red Notice. *INTERPOL Global Register unveiled at Google Ideas INFO summit* 17 July 2012: <http://interpolnoticeremoval.com/tag/secretary-general-noble>. (Accessed 4 February 2013)



153. An effective tracking and tracing system should relate all these packaging sets together - so that, for example, the code number on a pack should enable an investigator easily to discover which carton it came from, and which master case and which pallet, *tracing* the product back to the point of manufacture. Effective *tracking* also requires that the investigator should be able to quickly discover the location of the product in the intended supply chain. Given the history of manufacturer complicity in illicit tobacco, it is also of particular importance that use of the system by the enforcement authorities - including accessing any stored database - should not provide the manufacturers with information about investigations that may be inappropriate.
154. It is not clear that Codentify currently fulfils these standards adequately. PMI state that Codentify codes can be used at pack and carton level, but the company uses its own system ("U-track", which is based on a 2D barcode) for higher level packaging. The other three major manufacturers have their own systems for packaging above pack size, for example BAT has trialled a system offered by the company Bluefin Solutions.<sup>94</sup>
155. Therefore, ITP Parties and EU member states, including the UK, should not encourage or license the use of Codentify as a tobacco tracking and tracing system in any legislation or regulations designed to implement the ITP and the revised Tobacco Products Directive unless and until it can be clearly demonstrated that these minimum criteria have been adequately met. In the event they are not met, the UK government and others should look to alternative technologies already available in the market to provide a robust tracking and tracing system.

## Other Issues

### Shisha Tobacco

156. In written evidence to our Inquiry, Dr Mohammed Jawad, of the University Hospital of North Staffordshire and a fellow of Imperial College School of Public Health, drew our attention to the growing phenomenon of shisha tobacco consumption, pointing out that a large proportion of shisha consumed in the UK is illicit.
157. Shisha smoking is a 600-year old method for smoking tobacco after it has been passed through water. Research into this smoking practice has established similar health effects to those caused by cigarette smoking and its popularity is increasing worldwide.
158. A February 2012 You Gov survey for ASH shows that 11% of the population have used shisha at some time in the past, and 1% within the previous month. Since 2007 there has been a 200% rise in shisha bars in the United Kingdom.<sup>95</sup>
159. Shisha is generally smoked in commercial venues (bars, restaurants, cafes), although shisha tobacco can be purchased in many retail outlets. It usually comes in a 50g packet costing around £5, and is a free, wet mixture composed of 30% tobacco and 70% honey and flavourings.
160. A significant proportion of the shisha tobacco in the UK appears to be illicit and duty unpaid, often sourced from the Middle East. There have been numerous reports of seized shisha tobacco at airports. In November 2012, for example, £60,000 (291kg) of illicit shisha tobacco was seized at Heathrow.<sup>96</sup> This issue requires further research, and the development of an inter-agency strategy to tackle illicit trade in shisha tobacco.

<sup>94</sup> Bluefin web pages. *Bluefin supports BAT in the fight against illicit trade*. [http://www.bluefinsolutions.com/clients/case\\_studies/9259/](http://www.bluefinsolutions.com/clients/case_studies/9259/). (Accessed 4 February 2013)

<sup>95</sup> British Heart Foundation press release. *Rise in 'shisha bars' prompts warning on dangers of waterpipe smoking*. 14 March 2012 <http://www.bhf.org.uk/default.aspx?page=14417>. (Accessed 4 February 2013)

<sup>96</sup> Cook, W. How not to smuggle tobacco into the country: Bungling students caught after taking pictures of themselves packing it into suitcases. *Daily Mail* (Online). 12 November 2012



## Smokeless Tobacco

161. In the UK smokeless tobacco is mainly used by the Indian, Pakistani and Bangladeshi communities. The National Institute for Health and Clinical Excellence has stated that many people using these products are unaware that they contain tobacco and can cause illnesses like cancer, and that awareness is also low about the issue among health professionals.<sup>97</sup> It is believed that the use of smokeless products is one of the main reasons why South Asian women in England are nearly four times more likely to develop oral cancers than women from other ethnic groups.
162. Smokeless tobacco products include chewing tobacco like betel quid and paan, sucked or “moist oral” tobacco as well as inhaled tobacco products like snuff.
163. A 2010 report on smokeless tobacco commissioned by Cancer Research UK, by Professor Ann McNeill, Dr Catherine Pritchard and others,<sup>98</sup> gave results of test purchases from wards in Birmingham, Bradford, Leicester and Tower Hamlets. Thirty different products were purchased. Products were available for sale from a range of retail outlets including supermarkets, corner shops, paan houses but also fast food and DVD hire outlets. Smokeless tobacco products were available both behind and in front of the counter. In over half of the products purchased there was a lack of adherence to the required health warnings.
164. These results suggest that a high proportion of smokeless tobacco consumed in the UK may be illicit. This issue requires further research, and the development of an inter-agency strategy to tackle illicit trade in these products that is consistent with the NICE guidance on smokeless tobacco cessation.

## RIP Cigarettes

165. In November 2010 the European Union standards body CEN introduced a reduced ignition propensity (RIP) standard for all cigarettes manufactured for sale in the EU, which came into effect in November 2011. RIP cigarettes are less likely to continue smouldering when left unattended. According to figures from the Department for Communities and Local Government, in 2011/12 “smokers’ materials” accounted for 2,673 fires, with 84 deaths and 781 casualties.<sup>99</sup>
166. It has been estimated the new cigarettes could prevent 1,800 fires, 67 fire deaths and 600 casualties a year in the UK.<sup>100</sup> Evidence from Finland, for example, has shown a 43% reduction in the number of victims of cigarette-ignited fires following introduction of the RIP standard.<sup>101</sup>
167. It is likely that many counterfeit and cheap white cigarettes entering the UK will not have been manufactured to the RIP standard. This additional danger from illicit cigarettes could usefully be highlighted in local and regional campaigns on the issue, and where evidence is found that fire fatalities were caused by illicit tobacco products, fire investigators should be encouraged to report and coroners to record this fact.

97 NICE. *Smokeless tobacco cessation: South Asian communities* Public Health Guidance no 39. September 2012. <http://www.nice.org.uk/nicemedia/live/13907/60914/60914.pdf>. (Accessed 4 February 2013)

98 McNeill A, Pritchard C et al. *Smokeless tobacco in the UK - products, populations and policy* 2010. <http://www.ukctcs.org/ukctcs/documents/smokelessprojectreport.pdf>. (Accessed 4 February 2013)

99 Department of Communities and Local Government. *Fire Statistics Great Britain, 2011/12* <https://www.gov.uk/government/organisations/departments-for-communities-and-local-government/series/fire-statistics-great-britain>. (Accessed 4 February 2013)

100 European Commission Health & Consumer Directorate-General. *Summary record of the meeting of the committee of Directive 2001/95/EC on general product safety*. 14 October 2010. [http://ec.europa.eu/consumers/safety/committees/docs/sum14102010\\_gpsd\\_en.pdf](http://ec.europa.eu/consumers/safety/committees/docs/sum14102010_gpsd_en.pdf). (Accessed 4 February 2013)

101 RIP Coalition press release. *Fire chiefs say new cigarettes could save one life every five days*. 17 November 2011 <http://www.firesafecigarettes.org.uk/news>. (Accessed 4 February 2013)

# All Party Parliamentary Group on Smoking and Health

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Inquiry into the illicit trade in tobacco products

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