

Spotlight on the FCTC: The Illicit Trade Protocol for Tobacco Products

Article 15 of the FCTC

ISSUE SIX/FEBRUARY 2010



© European communities



© fotolia.com - africa



© fotolia.com - Pavel Losevski

What is the Framework Convention on Tobacco Control?

The Framework Convention on Tobacco Control (FCTC) is the first treaty negotiated under the auspices of the World Health Organisation. It was adopted by the World Health Assembly on 21 May 2003 and entered into force on 27 February 2005. At time of writing it has 168 Parties, including the European Union and all but one EU Member State.

What is Article 15 of the FCTC?

Article 15 of the FCTC commits the Parties to take action against the illicit trade in tobacco products.

What is Illicit Trade?

The illicit trade in tobacco products covers:

- Legitimately produced tobacco products that are then smuggled across borders and sold without all due taxes.
- Illegally produced tobacco products, including counterfeit tobacco products, that purport to be recognised brands but are not.
- Some intermediate categories, including products that may be legitimate in the country or area of origin, but are produced in quantities far in excess of any reasonable demand in the purported destination market.

Please check website for translations
www.smokefreepartnership.eu



What is the Extent of the Problem?

The most authoritative report on the extent of illicit trade in tobacco products is *“How Eliminating the Global Illicit Cigarette Trade would Increase Tax Revenue and Save lives”* published by the International Union against Tuberculosis and Lung Disease (IUALTD) in 2008.¹ The report shows that the total illicit cigarette trade (which of course excludes other tobacco products) accounts for 11.6% of all cigarette consumption, equivalent to 657 billion cigarettes a year. The proportion is estimated at 9.8% in high income countries and 12.1% in low and middle income countries. In many low and middle income countries, illicit trade reaches much higher levels.²

What are the Main Reasons for Action on Illicit Trade?

The three principal reasons for action against illicit trade are:

- **To promote public health.** According to the IUALTD report, if the illicit trade were eliminated, and not substituted by licit consumption, then by 2030 about 164,000 lives a year could be saved. The single most effective means of cutting tobacco consumption is through raising taxation and hence price. This policy is undermined if illicit tax-free tobacco products are widely available.
- **To protect public revenues.** According to the IUALTD report, total revenue losses to governments across the world from the illicit trade in tobacco is estimated at \$40.5 billion a year, with \$17.6 billion lost to governments in high income countries, and \$22.9 billion to governments in low and middle income countries.
- **To fight organised crime.** Recent cases demonstrating the engagement of organised crime in tobacco smuggling, and its relationship to the funding of terrorism and conflict, include a case prosecuted by the US Attorney’s office in Southern Florida, after a long investigation involving a partnership between US customs agents and the EU Anti-Fraud Office (OLAF).³ The investigation revealed that an organisation smuggling cigarettes operated out of Ireland, Germany, the United Kingdom and Miami (US). US Customs agents told the Miami court that they were able to trace the intended destination of the Dublin shipment to associates of dissident Irish Republicans/the Real IRA.⁴ Another major case is being tried in Switzerland, where nine defendants are alleged to be part of an international crime ring, which also included members of the organised crime groups the Camorra of Naples, the Sacra Corona Unita of Apulia, and, allegedly, key figures in the Government of Montenegro.⁵

Evidence of the possible costs and benefits of a strong Protocol is set out in a research report commissioned by Action on Smoking and Health in the UK. The report, “Cost Benefit Analysis of the FCTC Protocol on Illicit Trade in Tobacco Products” by former Treasury economist Paul Johnson, assesses the likely impact of the protocol on the UK, including identifying and quantifying all benefits and costs associated with the protocol and calculating the net benefits. The central estimate of the monetary net benefits to the UK (assuming very wide international take up of the protocol) is £5.7 billion plus 760 premature deaths averted annually. Even on the most pessimistic assumptions, benefits are likely to outweigh costs.⁶

What is the History of the Protocol?

The Illicit Trade Protocol (ITP) is the first subsidiary treaty to be negotiated under the FCTC. Negotiations on the ITP are now far advanced. There have so far been three Intergovernmental Negotiating Body (INB) meetings to negotiate the Protocol text, with the last INB meeting scheduled for March 2010. If the fourth INB agrees on a text, then it will go to the fourth FCTC Conference of the Parties in November 2010.

What are the Main Issues in the Negotiations?**Tracking and Tracing of Tobacco Products**

A proposed international system for tracking and tracing of tobacco products is set out in Article 7 of the Chair’s Text for an Illicit Trade Protocol. Agreement on such a system is likely to be critical to the success of negotiations on the Protocol.

Article 7 would require Parties to set up a tracking and tracing system, including a global information sharing focal point located at the secretariat of the Conference of the Parties. The system would require “unique, secure and non-removable” identification markings on all unit packets and packages of cigarettes manufactured in or imported onto its territory. When scanned by designated authorized authorities in any Party, the unique markings would enable access by means of a link to key information including details of manufacture, first customer, known subsequent purchasers and shipment.

To fight illicit trade effectively requires authorities to monitor the movement of lawfully manufactured tobacco products, and, upon seizure of such products, to access information to assist in recreating the movement of products through the supply chain. Unique and secure marking should be required for all packages, such as packs, cartons and master cases. Technology to mark individual packs already exists (for instance in Turkey, Brazil and California).

1 The report was written by Joossens, L. FCA, Merriman, D., Institute of Government and Public Affairs and Department of Public Administration, University of Illinois, Chicago, USA, Ross, H., Strategic Director, International Tobacco Control Research, American Cancer Society, and Raw, M., Special Lecturer, UK Centre for Tobacco Control Studies, Division of Epidemiology and Public Health, University of Nottingham, Nottingham, UK.

2 The report estimates the level to be 50% in Georgia, 40% or more in Uzbekistan, Bosnia and Herzegovina, Albania and Bolivia, and over 20% in fifteen more countries.

3 See: <http://www.usdoj.gov/usao/fls/PressReleases/090306-02.html> for details of the indictment.

4 The Real IRA, a paramilitary organisation, is an illegal organisation in Ireland and is designated as a terrorist organisation in the United Kingdom and the United States

5 According to the Swiss indictment, “starting in the early 1990s until the beginning of 2001, almost the whole flow of funds stem-

ming from Montenegro’s cigarette smuggling trade, managed by the Camorra and Sacra Corona Unita, went through the Swiss financial market. During this time, more than one billion dollars were laundered.” The background to the case has been well reported by the International Consortium of Investigative Journalists. Please see www.publicintegrity.org/investigations/tobacco

6 Cost benefit analysis of the FCTC protocol on illicit trade in tobacco products. London, ASH, 2009. A full copy of the report can be downloaded from the ASH website at www.ash.org.uk/itp/cba

Licensing

Article 5 of the draft Protocol would require specified entities engaged in the tobacco trade to hold a valid licence.

Licences to be required for those engaged in:

- manufacturing or primary processing of tobacco or tobacco products.
- manufacturing the equipment used to make tobacco products.
- the commercial import, export, wholesaling, brokering, warehousing or distribution of tobacco, tobacco products or manufacturing equipment.
- transporting commercial quantities of tobacco, tobacco products or manufacturing equipment.

This list would not require licences for tobacco growers and retailers (on grounds of practicality), although Article 5 should encourage Parties to do this as appropriate.

Parties should be required to have appropriate authorities to administer the required licence system, with the power to issue, renew, suspend and remove licences. Article 5 should also set out in detail the information that applicants for a licence will be expected to provide.

Article 5 should also require that manufacturers of equipment used in the manufacture of tobacco products must ensure that unique, secure and non-removable identification markings are affixed to their machinery. A full tracking and tracing system for manufacturing equipment would not be practicable, but a unique marking system, such as already exists in the car industry, could be important to better control the trade of manufacturing equipment.

Customer Identification and Verification (Due Diligence)

Article 6 of the draft Protocol would require businesses involved in the tobacco industry to conduct due diligence on those with whom they trade.

Article 6 should provide that the requirement to conduct due diligence is placed on businesses, not governments. Total revenues from sales of all tobacco products across the world in 2007/8 have been estimated at more than \$180 billion.⁷ Across the world about 5.6 trillion cigarettes are sold every year. Together with the trade in other tobacco products, this requires millions of wholesale transactions. If governments were required to conduct due diligence, all entities involved in this trade located in Parties to the Protocol, or trading with entities located in participating countries, would have to be monitored on a continual basis. This would necessarily require the employment of thousands of officials across these countries, a large and unnecessary burden on public finances. It would also amount to a covert subsidy to the tobacco industry, which should be required to meet the cost of due diligence itself, since this amounts to no more than a reasonable obligation on the industry to know its own customers.

Internet Sales

Article 10 of the draft Protocol would include obligations on Parties to restrict or end internet (and other telecommunications based) sales of tobacco products to retail customers.

Retail internet sales contribute to the international problem of illicit trade. Tobacco products are a consumer product intended for immediate consumption. They are available from a wide variety of different sources, including shops, supermarkets, bars, restaurants and street sellers, and they are accessible at all times of day. Therefore internet and other remote sales present disadvantages to the smoker, including bigger investment (buying in bulk), delay in getting the product and additional mailing costs. Such sales are likely to be attractive only where the smoker intends to avoid regulation, including bans on sales to minors and tobacco taxes.

Remote means of retail sale can allow someone in one country to buy tobacco from someone in another country, without the knowledge of anyone other than those arranging payment for the transaction and delivering the goods. Payment of taxes and duties is therefore very hard to monitor.

For these reasons the inclusion of a clear, strong provision requiring a ban on remote means of sale to retail customers is highly recommended.

Free Zones and Duty Free Sales

Article 11 would place restrictions on movement of tobacco products through free zones (also known as free trade zones). Article 11 should therefore prohibit tobacco, tobacco products and manufacturing equipment used in the manufacture of tobacco products in free zones, other than products sold to retail customers resident in the zones.

Article 11 should include an obligation on Parties to ban duty-free sales at airports, ports, land border crossings and on ships and airplanes. There is clear evidence that legal duty-free sales can be a means whereby tax exempt product supposedly intended for duty-free stores is diverted into illicit trade. Parties should resist lobbying from both the tobacco industry and trade associations involved in duty free sales which prevent progress towards ending such sales.

Offences, Penalties and Enforcement

The Protocol will contain provisions specifying a range of unlawful conduct in relation to illicit trade, including but not limited to crimes. It is important that Parties treat engagement in illicit trade in tobacco products as a serious crime. There are relatively light sentences imposed for engagement in illicit trade in tobacco products, and the low priority often given to enforcement action against the illicit trade in tobacco by comparison with illegal drugs and other goods, is a major incentive to organised crime for engaging in this activity.

However, Parties' legal systems differ widely; therefore draw the line between criminal and non-criminal offences in different places. Also, illicit trade is broadly defined in the Protocol, and engagement in illicit trade therefore implies a wide range of behaviours of varying degrees of seriousness.

⁷ http://www.smoke-free.ca/pdf_1/GlobalTobaccoEconomy-2009.pdf



Other international treaties overlap with the Protocol, particularly the UN Treaty on Organised Crime (UNTOC), although not all Parties to the FCTC are also Parties to UNTOC. UNTOC provisions on confiscation and seizure, international cooperation for purposes of confiscation, disposal of confiscated proceeds of crime or property, extradition, transfer of sentenced persons and mutual legal assistance, for example, apply to the illicit trade in tobacco if relevant offences are punishable by a maximum penalty of imprisonment of at least four years.

For these reasons, issues of international criminal justice that are not specific to illicit trade in tobacco, but that are common to many sorts of organised crime should be dealt with, as far as possible, through close cooperation with the UN Office on Drugs and Crime, using the processes set up by UNTOC.

What is the Role of the European Union?

It should be recognised that the European Union, through the Commission and in particular OLAF, has been a key driver of the negotiations for an Illicit Trade Protocol, although it has resisted calls for stronger commitments in some important areas. The EU has legally binding and enforceable Agreements in place with the tobacco multinationals Philip Morris International and Japan Tobacco International.

The European Parliament could play an important role in the run up to the last negotiating meeting on the Protocol. It should recognise that:

- A strong Illicit Trade Protocol would benefit public health, protect government revenues and fight organised crime.
- The European Union has a strong interest in fighting illicit trade, and its Member States and institutions have taken a leading role in negotiations on the Protocol.
- An effective tracking and tracing system is at the heart of a strong Protocol (Article 7). This should cover bulk packaging of tobacco products, but also individual packs of cigarettes and other tobacco products as appropriate.
- A powerful licensing system should be required for every Party to the Protocol (Article 5). Businesses and other entities shown to be engaged in illicit trade, or otherwise engaged in activities related to illicit trade that make them unfit to hold a licence should have their licence cancelled or suspended.
- All relevant businesses involved in the tobacco trade should have to conduct due diligence in relation to their customers (Article 6).
- The Protocol should require Parties to end internet and other remote means of sale of tobacco products to retail customers (Article 10).
- The Protocol should end movement of tobacco products through “free zones” and the sale of duty free tobacco products (Article 11).
- The Protocol should contain a specified list of unlawful conduct, including but not limited to crimes, should require that serious offences in relation to illicit trade are treated as serious crimes, and make appropriate links with UNTOC.

KEY CONCEPTS

Tracking and tracing covers a wide variety of systems used, generally in logistical processes, to determine the current and past locations and other information concerning property in transit. An effective tracking and tracing system allows such information to be uploaded, retained and read in a standardised manner. An example of a common application of tracking and tracing is from shipping and delivery businesses such as UPS and FedEx.

There are several technologies deployed in tracking and tracing systems, which are at various stages of development and standardisation. Two examples are barcode systems, which are ubiquitous, cheap to apply and to read, but relatively restricted in the amount of information that can be stored directly on the product, and radio frequency identification (RFID) systems, which are developing quickly, but are relatively expensive and currently lack agreed international standards.

Licensing of businesses involved in the tobacco trade could be a critical weapon in the fight against illicit trade. Licensing is both a practical and a very powerful way to collect revenue efficiently and to control illicit trade, since withdrawal or suspension of a license would prevent a business from involvement in the tobacco trade in the Party concerned.

Due diligence is a necessary requirement on tobacco businesses. Businesses that manufacture tobacco products or the equipment used in manufacturing them, and those that trade in tobacco, tobacco products or the equipment used in manufacturing them, whether importing, exporting, brokering, or warehousing them, should know their customers. They should collect key facts, keep records, and report any transactions that they have good reason to think are suspicious.

It is important to see due diligence obligations as fitting logically and powerfully with other supply chain control measures: licensing, tracking and tracing, record-keeping, and other “security and preventive” measures.

Free zones (or free trade zones) are defined by the revised International Convention on the simplification and harmonisation of customs procedures (Kyoto Convention) as part of a contracting party where any goods introduced are regarded, in relation to import duties and taxes, as being outside the customs territory. Goods in free zones may have labels and markings removed, be intermingled with other products, etc, largely outside the control of customs and law enforcement agencies. According to the World Customs Organization, free trade zones are a major concern for customs authorities and a potential risk for exploitation from organised crime organizations as well as terrorists.

The **Framework Convention Alliance** is a network of more than 350 health and tobacco control organisations. It played an important role in negotiations on the FCTC, which formally recognised the role of civil society in developing, safeguarding and implementing the Treaty.



The **Smoke Free Partnership (SFP)** is a strategic, independent and flexible partnership between the European Respiratory Society, Cancer Research UK, the Institut National du Cancer and the European Heart Network. It aims to promote tobacco control advocacy and policy research at EU and national levels in collaboration with other EU health organisations and EU tobacco control networks.

Drafter: *Ian Willmore*

Editors: *Luk Joossens, Jean King, Susanne Logstrup, Jean-Luc Eiselé, Florence Berteletti-Kemp, Brian Ward and Sam Villiers*

Smokefree Partnership
49-51 rue du Treves, 1040 Brussels, Tel: +32 2 238 53 63
www.smokefreepartnership.eu