

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT **D**  
BUDGETARY AFFAIRS

Budgets

Budgetary Control



# WORKSHOP Cigarette Smuggling

PROCEEDINGS







**DIRECTORATE GENERAL FOR INTERNAL POLICIES**  
**POLICY DEPARTMENT D: BUDGETARY AFFAIRS**

# **WORKSHOP ON**

# **CIGARETTE SMUGGLING**

**Wednesday, 22 January 2014**

**9:00 - 12:30**

**European Parliament, Brussels**  
**Altiero Spinelli Building, Room ASP 5G3**

## **PROCEEDINGS**

# WORKSHOP

Policy Department D Budgetary Affairs  
Committee on Budgetary Control

Wednesday, 22 January 2014

ALTIERO SPINELLI BUILDING

9.00-12.30 ROOM: ASP5G3

# CIGARETTE

# SMUGGLING

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RAPPORTEUR: BART STAES

To subscribe fill in the registration form or send an email to [poldep-budg@ep.europa.eu](mailto:poldep-budg@ep.europa.eu)

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## Foreword

On 22 January 2014, at the request of the Committee on Budgetary Control, the Policy Department for Budgetary Affairs organised a half-day workshop on "Cigarette Smuggling".

Experts from academia and NGOs working in the field were invited to exchange views and experiences on how to tackle the problem of cigarette smuggling.

The aim of this brochure is to summarise and to spread what was discussed during this half day.

This document can not constitute an authentic record of proceedings.

All workshop documents can be found on European Parliament's Internet website under:

[http://www.europarl.europa.eu/RegData/etudes/workshop/join/2014/490681/IPOL-JOIN\\_AT\(2014\)490681\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/workshop/join/2014/490681/IPOL-JOIN_AT(2014)490681_EN.pdf)

The workshop was public and live webstreamed. The video record can be found under the following link:

<http://www.europarl.europa.eu/ep-live/en/committees/video?event=20140122-0908-COMMITTEE>

# WORKSHOP ON CIGARETTE SMUGGLING

*Organised by the Policy Department D on Budgetary Affairs*

**Wednesday, 22 January 2014, 9:00 - 12:30**

**European Parliament, Brussels  
Altiero Spinelli Building, Room ASP 5G3**

## **DRAFT WORKSHOP PROGRAMME**

### **9:00 - 9:10      *Welcome and Introduction***

9:00 - 9:05      **Welcome by Michael Theurer**  
5 minutes      Chair of the Committee on Budgetary Control

9:05 - 9:10      **Introduction by Bart Staes**  
5 minutes      Vice-Chair of the Committee on Budgetary Control

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9:10 - 9:25      **First speaker: Prof. Anna Gilmore (UK)**  
Director, Tobacco Control Research Group (University of Bath) - evaluate impact of public health policy and the impact of broader policy changes. Part of UK Centre for Tobacco Control Studies (UKCTCS):

**The Current State of Smuggling of Cigarettes**  
***Followed by Q&A (15min)***

9:40 - 9:55      **Second speaker: Aamir Latif (*cancelled*)**  
The International Consortium of Investigative Journalists (ICIJ):  
**Terrorism and Tobacco: Extremists, Insurgents Turn to Cigarette Smuggling**  
***Followed by Q&A (15min)***



- 10:10 - 10:25      **Third speaker: Howard Pugh (EUROPOL)**  
Project Manager AWF Smoke:  
**How Does EUROPOL Contribute to the Fight Against Global Cigarette Smuggling?**  
***Followed by Q&A (15min)***
- 10:40 - 10:55:      **Fourth speaker: Leszek Bartłomiejczyk**  
Warsaw School of Economics, expert in excise duties and border control, team of Prof. Wiesław Czyżowicz:  
**Illicit Trade of Tobacco at the EU Eastern Border**  
***Followed by Q&A (15min)***
- 11:10 - 11:25:      **Fifth speakers: Luk Joossens**  
Advocacy Officer, Association of European Cancer Leagues (ECL), Tobacco Control Expert, Belgian Foundation against Cancer, International Expert on Illicit Tobacco Trade;  
**Hana Ross, Michał Stokłosa**  
Respectively Managing Director and Economist in the Economic and Health Policy Research at the American Cancer Society:  
**EU Policy and Cigarette Smuggling: Assessing the Impacts**  
***Followed by Q&A (15min)***
- 
- 11:40 - 12:30      *Conclusions and debate***
- 11:40- 11:50      **Concluding remarks on the Cooperation between EU and Tobacco Industry by Inge Grässle,**  
Member of the Committee on Budgetary Control  
***Followed by debate (30 min)***
- 12:20 - 12:30      **Closing remarks by Bart Staes,**  
Vice-Chair of the Committee on Budgetary Control

**DIRECTORATE GENERAL FOR INTERNAL POLICIES**  
**POLICY DEPARTMENT D: BUDGETARY AFFAIRS**

**WORKSHOP ON**  
**CIGARETTE SMUGGLING**  
**PROCEEDINGS**

**Speakers:**

Michael Theurer

Bart Staes

Anna Gilmore (First speaker; Director, Tobacco Control Research Group, University of Bath)

Ingeborg Gräßle

Søren Bo Søndergaard

Adrian Welsh (Imperial Tobacco)

Karin Kadenbach

Howard Pugh (Second speaker; Europol)

Karl-Heinz Florenz

Leszek Bartłomiejczyk (Third speaker; Warsaw School of Economics, expert in excise duties and border control, team of prof. Wiesław Czyżowicz)

Jens Jacob Juul Rasmussen (Fracture Code Corporation, Copenhagen):

Dominik Schnichels (European Commission, DG Sanco)

Luk Joossens (Fourth speaker; Advocacy Officer, Association of European Cancer Leagues (ECL), Tobacco Control Expert, Belgian Foundation against Cancer)

Austin Rowan (OLAF)

Antoni Bohdanowicz (Journalist, NaTemat.pl)

9:08

**Michael Theurer** - Chair of the Committee on Budgetary Control

Gave a general presentation of the topic and presented the speakers.

9:14

**Bart Staes** - Vice-Chair of the Committee on Budgetary Control

Introduced the topic. Explained the agreements with the tobacco industry, baselines and fees which are paid to the EC and redistributed among the MS. No clear picture about what the MS do with the money. EUR 10 billion in smuggled cigarettes are lost each year. The MS should make some common efforts to deal with this. Companies are being called as experts that assess whether the smuggled cigarettes are counterfeit: is this assessment reliable? OLAF's work against smuggling was raised, also OLAF's contract with the Scottish Oceans Institute (SOI). Baselines are set in the agreements with the tobacco industry. Are the companies involved in the smuggling of smaller amounts?

9:24

Prof **Anna Gilmore** - Director, Tobacco Control Research Group (University of Bath) - evaluates impact of public health policy and the impact of broader policy changes - part of the UK Centre for Tobacco Control Studies (UKCTCS)

Topic: *The Current State of Smuggling of Cigarettes*

There is evidence of on-going tobacco industry involvement in the illicit trade and oversupply of their products, which leak into the illicit market. The "big four", as an important element of the cigarette smuggling in Europe, seem to be overlooked (example of JTI and other evidence). Overproduction in some countries reaches as high as 240% of the legitimate demand. Based on 13 years of research, illicit trade is a core part of the business strategy.

There has been a shift to more counterfeit products and "illicit whites" (i.e. legally produced cigarettes sold on the illicit market) after agreements were signed with the "big four". The companies fail to control the supply chain. A review of the PMI's Project Star Report (produced by KPMG) shows: a good model used; however the methodology is not transparent and the data may have been

compromised. Results are opposite to seizure data, which are increasingly unrepresentative (see graphs on slides 11-12).

A review of industry data on the illicit trade was made. Empty pack surveys (EPS): it is not possible to distinguish whether the non-domestic packs are legal. The industry refused to provide methodological details (Project Star has a methodology, but few details are revealed). Results of independent studies, based on the different conditions, give different results. Surveys conducted for the tobacco industry tend to overestimate the phenomenon of illicit tobacco (e.g. inflated data for 2011 and 2012 in the UK as the methodology used for different for each of the years). Government and industry data are coherent up to 2010; since around 2011 it is the opposite (see slide 19). According to the industry in UK: illicit trade increases (no methodology provided or change of methodology from one year to another), and according to the government, it declines (slide 20). In another comparison of surveys – overestimations are apparent in 12 countries, and are especially high for the MS where the cross border shopping is common (Austria, Finland and France). Problems were encountered while carrying out the EPS. There are conflicts of interest where the tobacco companies are involved in assessing whether the seized cigarettes are counterfeit.

Conclusions. Seizure and Project Star data differ. There is growing evidence of involvement of the tobacco industry in illicit trade. Data provided by the industry are unrepresentative and unreliable. Agreements do not appear to have deterred the industry's involvement. Illicit trade is increasing, according to Project Star, and decreasing according to seizure data (unrepresentative). There is a lack of adequate representative data.

9:42 - Q&A session.

1. **Bart Staes:** Have you ever been approached by any authority of any Member States and if so, which? Have you had any discussions with the services of the European Commission? Have you had contacts with OLAF? How was your information received? In August 2013, Commissioner Šemeta (DG Taxud) published a communication on illicit trade; were you involved in its preparation? Has the tobacco industry ever approached you? Did you have a dialogue with them? We would like to broaden the discussion about what to do with this specific data.

9:45

2. **Ingeborg Gräbke:** What should we do now about the data from the Star report?

9:47

3. **Søren Bo Søndergaard:** The tobacco industry moves its production to countries with lower salaries, to maximize their profits. Is it your impression that it moves its production to countries with less control?

9:48

**Anna Gilmore:**

1. Has never been approached by OLAF, but has been approached by Her Majesty's Revenue and Customs (HMRC). She has done some work with DG Taxud, as a part of FP7, performed research of documents provided by OLAF about meetings between the tobacco industry and OLAF, and taken seizure data from these documents and compared it with Project Star report.

2. The Project Star uses a good model (combining data from EU27 to get comprehensive data). To have more reliable data it should be conducted by an independent organisation not linked to the tobacco industry.

3. She assumes that this is the case in Ukraine, Russia, and Belarus. Corruption is also higher there and control is weaker, which helps the illicit trade.

9:51

1. **Michael Theurer:** Why does the tobacco industry focus so much on the illicit tobacco trade?

9:52

2. **Adrian Welsh** (Imperial Tobacco): Imperial Tobacco entered into the agreement in 2010 on a voluntary basis and is committed to it. Since the agreement with OLAF, there has been an annual seizure of only 21 million Imperial cigarettes. The company discontinued the production its "Classic" brand for the market in Ukraine, from where it was smuggled into the EU. There is a large amount of counterfeit cigarettes still coming into the market.

9:55

3. **Ingeborg Gräble:** Regarding the "Track&Trace" system: did it have an impact on reducing smuggling? Now, under the agreement, do you consider that the EU has given a certain degree of impunity to the tobacco companies?

9:56

**Anna Gilmore**

1. Illicit tobacco is cheaper and more people buy it, so the tobacco companies get money from both legal and illegal channels. Young smokers are the most price conscious, so having cheap cigarettes on the market is very important for the tobacco companies. Companies also use the illicit trade as a way of getting into a market (e.g. in USSR and China) and use the illicit trade as an argument against the tobacco control policy. Illicit trade works for the tobacco industry.

2. If "Classic" was only sold in Ukraine, why would someone bother to counterfeit it and sell in Europe? Why, only in 2012, did Imperial Tobacco close the brand and not make public the fact that "Classic" was an illegal white?

3. Track&Trace: she leaves the question for Luk Joossens to answer.

Agreements: there is insufficient transparency on interactions with OLAF. Tobacco companies use the penalties to rehabilitate their image. She is concerned about the close cooperation between the companies, which are a part of the problem. Penalties for the tobacco industry are inadequate, insufficient.

10:01

**Karin Kadenbach:** Are cigarettes bought in another country for private use counted as illegal trade?

10:02

**Anna Gilmore:** Explains the difference between illicit whites, counterfeit and genuine cigarettes. Cigarettes produced in greater amounts are intended to be smuggled. Most smokers know if they smoke illicit product or not.

10:03

**Howard Pugh** (Europol) - Project Manager AWF Smoke

*Topic: How Does Europol Contribute to the Fight Against Global Cigarette Smuggling?*

Presentation by Europol:

Figures on the illegal tobacco trade – about EUR 12.5 billion per year in lost revenue in the EU.

Intelligence analysis – careful use of resources (not to slow down the legal trade), only 2% of container movements are inspected. Europol is supporting the MS in targeting organised crime groups involved in trafficking and manufacturing. It pools information and intelligence.

Focal Point Smoke – has 26 MS and 6 associates, OLAF and US (FDA) are interested in joining. 4 areas of illegal tobacco trade: counterfeit, cheap whites cigarettes (produced e.g. in the Middle East), illegal factories, and excise movement and control system.

Op tsar – gave an example of smuggling from Ukraine to France (EUR 7 million of value seized plus links to 2 previous transportations).

Presentation of achievements and tools (e.g. multi languages identifying intelligence) of Europol, which cooperates with Eurojust and MS police.

Explained the role of Europol in fighting organised crime.

10:21 - Q&A session

1. **Bart Staes:** Could you elaborate more on the relation between the illicit tobacco trade, the drop in seizures and the legislation? This is obviously connected to legislation and we would like to draw the attention of the new committee to that.

10:23

2. **Ingeborg Gräßle:** How does your cooperation with OLAF work? What are the competencies of OLAF (after the restructuring)?

10:23

3. **Søren Bo Søndergaard:** Does the level of control allow cigarettes to escape to other EU MS with less efficient legislation? Do you have concrete examples?

10:25

**Howard Pugh**

1. Law enforcement has a window to look at the movements. It is not done though the Track&Trace system. Organised crime groups were working under the radar (false entries to the system were made) and were not paying the taxes. Administrative systems (duty collection dates and guarantees for excise tax) vary among the MS which causes problems for law enforcement.

2. They communicate with the OLAF based on the existing legal gateway (Council decision). The approach was made under the EMPACT project (European Multidisciplinary Platform Against Criminal Threats). OLAF was invited as a key partner and agreed to associate with Focal Point Smoke (FPS). OLAF has been sent a feasibility study. When it completes the feasibility study, it will be voted by the MS and allow much closer cooperation with FPS.

Mutual assistance teams – work closely together and with good cooperation, assistance on the spot. More work has to be done, however, especially regarding the area of tobacco smuggling. Slow progress in cooperation with OLAF, there are different levels of cooperation between different units of Europol and OLAF. Barriers in sharing information exist and criminal groups benefit from that.

3. No statistics to be presented on this subject. Europol is not involved in the matter of legal factories; it targets illegal factories.

10:29

**Michael Theurer:** Since meetings of law enforcement representatives where exchange of information takes place (e.g. joint strategy to fight the illicit trade) are also attended by the tobacco industry, could it be considered as counterproductive as some information could be distributed to the tobacco industry? Could this enforce the illicit trade?

10:31

**Howard Pugh:** Tobacco industry representatives are invited to sessions, but there are open and closed sessions. They are an important source of information. Some of the industry's intelligence is an important aspect to produce a quality report.

10:32

**Ingeborg Gräßle:** What kind of data do you receive? Are they obliged to provide it? What is the legal basis for that?

10:33

**Howard Pugh:** There are no legal agreements or understandings with the tobacco industry; it makes contributions. Europol does not give away this information (it is a "one way street"), it only uses it for investigation purposes, to target their resources in the most efficient ways. It can be a starting point for a dialogue with the MS, to know what information to ask for.

10:35

1. **Ingeborg Gräßle:** According to prof. Gilmore, 25% of illicit cigarettes are smuggled by the tobacco companies. How should we react to that?

10:36

2. **Karin Kadenbach:** What about the other 75% of smuggled cigarettes and their origins, raw materials and supply chains? Are the official supply chains also engaged in smuggling? Is there any data on this issue? It is claimed that large companies produce more than they can legally sell, so eventually the product ends up on the market.

10:37

**Adrian Welsh** (Imperial Tobacco): We are part of the solution; we do address the problem (gives the example of smuggling of the "Classic" brand from Ukraine). We have intelligence officers in countries from where cigarettes are smuggled. E.g. in 2011 Imperial Tobacco cooperated with OLAF and Belgian customs which resulted in capturing cigarettes, together with counterfeit perfumes, from China. The tobacco industry does a lot of work in the area of illicit trade.

10:40

3. **Karl-Heinz Florenz:** Do the German customs authorities cooperate in relation to the Track&Trace system? Are they effective?

10:42

**Howard Pugh:**

1. Europol has no other statistical data than those presented from the Star Project.
2. Raw materials used for Roll Your Own (RYO) are often not restricted or regulated; they can also be used for other products. If there is no duty, and law enforcement looks at problems of the duty, it is difficult to track, to see who the producers are, as the components might go to users not involved in tobacco manufacturing.

10:44



3. **Karl-Heinz Florenz** (rephrasing the question): What was the cooperation like with the German custom authorities?

10:44

**Howard Pugh:** There is no unified approach. There is room for improvement in every MS. It could be that information channels with law enforcement agencies are created, but they are not used. Sometimes cooperation with Customs agencies goes well, but not with the police. The cooperation could be improved, because the role of Europol is to support investigations. Europol has no memoranda of understanding with the tobacco industry (they do have them only with internet providers); they receive no financial payments to maintain their impartiality.

10:47

**Leszek Bartłomiejczyk** - Warsaw School of Economics (SGH), expert in excise duties and border control, team of prof. Wiesław Czyżowicz

*Topic: Illicit Trade of Tobacco at the EU Eastern Border*

Poland is the country in the EU which is most affected by the illicit trade as it has the longest eastern land border. In past years, Poland has managed to successfully fight the illicit cigarette trade. Now the majority of seized cigarettes comes from Belarus (60%). Border controls have become stronger. However, new channels then emerged via Austria.

There has been a new phenomenon since 2009: trade in dry raw cut, usually untaxed, tobacco, which caused losses in income as illegal factories were created in Poland. After the customs offices managed to reduce smuggling, organised crime found different channels, e.g. via postal services. A more comprehensive approach must be taken; actions within a country and cooperation abroad. Seizures occur across Poland (see slide 10). The tactics should also be changed to minimize the losses: smaller seizures but more often, since they can add up to big numbers and are often not reported due to their small size.

Illegal trade causes losses to the budget, health and those who sell legally. Project Star data for Poland were refused by the Polish customs, as they were considered inflated. Large illegal factories are located in the centre of Poland, while the smuggling occurs at the borders.

The Protocol to Eliminate Illicit Trade in Tobacco Products mentions the Track&Trace system with a separation of duties (i.e. the tobacco industry should not be involved in control activities). The EU tobacco directive includes the Protocol elements (Track&Trace), however, it gives the tobacco industry a central role in Track&Trace (which is contrary to the FCTC Protocol) and it excludes the word "secure" from "secure unique identifier".

Effective Track&Trace: The whole supply chain should be monitored. Secure product marking (serial secure marking) – both visible and invisible – should be introduced for customers/wholesalers and customs to control the supply chains and get adequate information. Marking (visible and invisible) has to be done directly at the factory; otherwise products can enter the market without identification. Large boxes should also be marked to ease the controls. Currently only 2% of containers are controlled.

Benefits of Track&Trace: Some countries/states (Brazil, Turkey and California) after having installed Track&Trace noted an increase of over 30% in income from taxes on tobacco (in spite of lower production) and other noted 30% decrease in smuggling.

Conclusions: FCTC to be ratified as soon as possible, especially by the countries bordering the EU on the East. The tobacco Directive should be revised in accordance with the FCTC Protocol and access to data should be facilitated. Hercule 3 is an efficient tool.

11:13 - Q&A session

1. **Ingeborg Gräßle:** Is there a more important smuggling channel than those we have seen at the borders between Poland and Kaliningrad, and between Greece, Bulgaria and Turkey? In the case of cut raw tobacco leaves, is there a legal loophole? Where is the raw tobacco manufactured, produced and sold? Where are the counterfeit cigarettes manufactured?

11:15

2. **Bart Staes:** How many countries have ratified the FCTC protocol? Regarding the tobacco directive, the compromise reached will be voted in plenary, so chances to change anything now are marginal. 10 years after the agreements with tobacco industry, has Track&Trace been put in place? Is it efficient?

11:17

3. **Søren Bo Søndergaard:** During the visit to the Eastern border, we saw a very modern control unit. However, there were no traces of oil on the ground, which should be there in cases where they carry out a thorough control and dismantle cars. Is the border control connected to a lack of know-how or a lack of political will?

11:19

4. **Jens Jacob Juul Rasmussen** (Fracture Code Corporation, Copenhagen): Are you working for a private company or are you a university representative? What is the potential use of open standards such as GS1 that can be used for Track&Trace? How can we use these open standards to the benefit of the taxpayers, since smuggling also relates to other goods?

11:21

**Dominik Schnichels** (European Commission, DG Sanco D4 Head of Unit): Art. 14 of the Tobacco Directive says that illicit trade has many different facades: tax revenue, corruption, organised crime and public health. DG Sanco puts emphasis on the health aspects, e.g. that the cigarettes circulating on the EU market comply with the EU legislation.

Art. 14 is built on 3 pillars: 1. Track&Trace system which should cover the whole supply chain; 2. Secure and unique identifications at pack level (master cases and pallets); 3. Track&Trace as a state controlled system should be independent and free from tobacco company influence. Right now they conduct a study of available technical options and test different Track&Trace systems to independently choose the best solution.

11:31

**Leszek Bartłomiejczyk**

1. Production and distribution of dry and raw tobacco leaves ceased to be controlled in 2008. Some countries, for example Poland, introduced excise for dry and raw tobacco leaves to be able to control it and limit the phenomenon. The leaves are mostly produced in Europe. In Poland, only intermediary agents can trade tobacco leaves legally.

2. FCTC has been signed by 54 countries and the EU so far and the ratification process has just started. There are loopholes in the tobacco directive: EU MS will be able to introduce their own solutions, e.g. stricter measures than those set out in the directive. Track&Trace systems are not built or used by any EU MS. It is used to monitor some of the distributions channels by the industry. Brazil and Turkey have got Track&Trace systems, in the EU they were blocked by the agreements with the tobacco industry and the States did not build them. Systems proposed by the tobacco industry are

useless unless they contain individual markings on packages. Currently the numbers can be copied and used for different packages.

3. Border control: You might have seen X-ray equipment being used instead of cars being dismantled. Kaliningrad used to be an important smuggling route; Eastern European countries are used as testing places, where distribution channels are verified and then are taken further to the West. It is more profitable to sell cigarettes in Western Europe (e.g. in the UK), where the prices are higher.

4. I do work in the private sector. My presentation today has been brought together with Prof Czyżowicz. The best practices of Track&Trace (T&T) system mentioned in the presentation are of general nature but are based also on T&T and authentication system produced by his company, that has competitors on some of its solution components, however according to the statement in World Customs Organisation WCO OMD Databank on Advanced Technology: "To date, it is the only organisation in the world to have successfully installed secure track and trace systems that are independently run and controlled by governments only. These systems monitor hundreds of tobacco and beverage production lines worldwide"

11:41

**Luk Joossens** - Advocacy Officer, Association of European Cancer Leagues (ECL), Tobacco Control Expert, Belgian Foundation against Cancer, International Expert on Illicit Tobacco Trade

**Hana Ross** - Managing Director and Economist in the International Tobacco Control Research Society

**Michał Stokłosa** - Health Policy Research at the American Cancer Society

Topic: *EU Policy and Illicit Tobacco Trade: Assessing the Impacts*

1. EC Strategy and Action Plan: There is a lack of reliable data on seizures and empty pack surveys (EPS) (no methodology provided for Project Star). Since 2000, when the EU sued tobacco companies, there has been a decrease in cigarette smuggling in the EU. E.g. in Italy: from almost 2 billion (1998-1999) to 300 million (2001-2002) cigarettes seized and in the EU it still continues to decrease (data on seizures), contrary to the results of Project Star, based on EPS.

FCTC protocol – slow progress in ratification. Problem of untaxed raw tobacco, which next to filters and cigarette papers, is one of the 3 ingredients needed to produce cigarettes. No measures have been proposed in the strategy to deal with this problem. There are too few OLAF EU liaison officers; the position in China has been cancelled; only one officer remains in the Ukraine. By comparison, the UK has 28 overseas intelligence officers who prevented EUR 815 million of revenue loss between 2011 and 2012. The EU should have a liaison officer at least in China. China shows a will to cooperate and has signed the FCTC.

2. Impact of the revised tobacco directive. The 2001 Directive did not increase the illegal trade or cause massive job losses, contrary to the tobacco industry's forecast. Imperial Tobacco exported massive quantities of cigarettes from the UK to Latvia, Kaliningrad, Moldova, Afghanistan and Andorra, from where 65% were smuggled back into the EU. Tobacco companies issued reports on the impact of the revised directive, which were incorrect. It is likely that there will only be a very small effect on the smuggling of menthol cigarettes (see slide 13) due to the specific target group which is less likely to use illicit cigarettes (young, well-educated females living in the city).

3. Agreements with the tobacco industry. Imperial Tobacco's "Classic" brand was the second most seized brand in Poland in 2011 and fifth in 2012. According to EuroMonitor (October 2013), it is the second most popular brand of Imperial Tobacco cigarettes.

Seizure-based payments: there are large differences between the share of cigarettes consumed and seized when it comes to counterfeit cigarettes. Surveys based on the EPS show only 16% of illicit cigarettes consumed in the market are counterfeit; however, 92% of seized cigarettes are classified as counterfeit (source: Project Star) by the tobacco industry which examines whether the cigarettes are counterfeit or not. Tests are only conducted by the tobacco companies (e.g. in 2012 in the UK 0.2% of seized cigarettes were claimed to be genuine products produced by the four major tobacco companies).

Seizure payments received by the MS: some States earmark payments to fight smuggling (Estonia, Poland and Slovakia), others direct them into the general budget. Poland and the Czech Republic use payments to purchase equipment for customs, police and border guards to combat the illicit trade of cigarettes. The tobacco industry uses the agreements to promote corporate social responsibility.

12:09

Q&A session

1. **Ingeborg Gräßle**: When was the OLAF liaison officer in China withdrawn?

2. **Bart Staes**: Regulation regarding the illicit use of raw materials (tobacco leaves, filters and paper) should be reflected in the Action Plan. Seizure of cigarettes – there are differences in the numbers (16% against 92%). On the website of the Scottish Ocean Institute (SOI), which is an independent controller financed by the Hercule programme, there is no link to cigarettes in the company's profile. How is it that they were in charge of the controls? How did Commissioner Šemeta come up with the data on the decrease in seized cigarettes produced by the four companies that signed the agreements, whereas the smuggling of other brands went up 58%? Could you explain that figure?

12:13

**Luk Joossens**

1. In 2012, the activities of liaison officer in China stopped, which is surprising as the majority of illegal cigarettes come from China.

2. Raw tobacco and other key materials were discussed during the FCTC negotiations. The EU was against the control of key materials. The problem of illicit manufacturing of tobacco exists in Europe, so raw tobacco manufacturing should be monitored.

The European Commission (EC) believes the agreements are effective based on the number of seizures of other brands which increased to 58%. The EC claims that illicit whites are gaining importance which means they know the brands are seized. At the same time, the EC claims that it does not have data on the seized brands, which suggests it does not want to share the information.

12:18

**Austin Rowan** (OLAF, dir. D): will check the data concerning the 58% and provide the answer. The SOI developed a system to identify the origins of tobacco. OLAF wanted a contract with the SOI to be able to identify the origins of tobacco (e.g. China), but it was not published on the SOI website in order to maintain independence. The manufacturers were not aware of that contract. The MS notify OLAF of the seizure and the manufacturer determines if the product is genuine or counterfeit. In cases of doubt, the MS were told to come to OLAF to perform the check. The SOI would not go before the court, but could help in identifying the fakes. Next an independent laboratory would verify the seizure, which is set out in the agreement. However, no samples were ever taken to the SOI, as no MS ever reported any cases.

12:23

1. **Ingeborg Gräßle**: Why was the baseline raised for PMI in spite of the fact that it has never been achieved?

12:24

2. **Antoni Bohdanowicz** (Journalist, NaTemat.pl): Which solutions would you propose for tracking?

**Luk Joossens:**

2. An independent system where the national authorities control the data should be introduced, which will be possible when the Tobacco Directive comes into force. It cannot be controlled by the tobacco industry

12:27

**Austin Rowan** (OLAF, dir. D):

1. The baseline was based on the market share in 15 MS. New MS had a very high smuggling rate. The PMI in Europe is 3 times bigger than the BAT and the baseline was changed, in spite of the fact that the original baseline has never been reached. OLAF has never used or relied on data from Project Star. However, it was the only data available; it determined if new MS were entitled to the seizure payments. It was never intended that the document would be a source of information for OLAF or the EC, it was not intended to be released to public, but it was leaked.

12:31

**Ingeborg Gräßle:** Member of the Committee on Budgetary Control  
Concluding remarks on the Cooperation between EU and Tobacco Industry

Agreements with Tobacco companies have not lead to an increase in transparency. New agreements should be more transparent. The EP should discuss the issue of the agreements with the industry and the payments with OLAF. The liaison officer in the Ukraine, his contract comes to an end this year. These issues should be given special attention.

12:35

**Bart Staes**

Closing remarks. This session was very useful and summarizes what can be improved. For the next Parliament and those in charge in CONT, a working document resulting from this workshop will be at their disposal.

12:36

**Michael Theurer**

Special thanks to the Belgian customs authorities, OLAF and all participants. Today we heard voices which are not heard in the normal lobby set-up in Brussels, which was the goal of the workshop.

**DIRECTORATE GENERAL FOR INTERNAL POLICIES**  
**POLICY DEPARTMENT D: BUDGETARY AFFAIRS**

# **EU Policy and Illicit Tobacco Trade: Assessing the Impacts**

## **BRIEFING NOTE**

### **Abstract**

This report analyses the relationship between EU policy and the illicit trade in tobacco products. We consider three EU policies: (1) the EC Strategy and the Action Plan to tackle the illicit trade in tobacco products, (2) the revised Tobacco Products Directive, and (3) the Agreements between the European Community, individual Member States and the four major tobacco companies.

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## EXECUTIVE SUMMARY

This report analyses the relationship between EU policy and the illicit trade in tobacco products. We consider three EU policies: [1] the EC Strategy and the Action Plan to tackle the illicit trade in tobacco products, [2] the revised Tobacco Products Directive, and [3] the Agreements between the European Community, individual Member States, and the four major tobacco companies.

### **Analysis of the European Commission Strategy to Tackle the Illicit Trade in Tobacco Products**

In June 2013, the European Commission published its two-year strategy to tackle illicit tobacco trade in the EU. Both the publication of the action plan and its general approach are positive developments.

The Commission refers to two sets of data to measure the financial losses and the level of illicit cigarette trade in Europe: the KPMG Project Star empty pack surveys financed by the tobacco industry and the seizure data. Data from seizures and empty pack surveys provide useful information on the origin of illicit products, but are unreliable for measuring the level of illicit cigarette trade in the EU. KPMG Project Star data cannot be used to estimate the illicit cigarette market in the EU because the report was commissioned to meet specific terms of reference which are only known to Philip Morris International and KPMG.

We comment on several points regarding the EU strategy. First, the Commission pledges to support signing, ratifying and implementing the WHO Framework Convention on Tobacco Control (FCTC) Protocol on eliminating illicit trade in tobacco products and acknowledges the protocol's provisions on tracking and tracing measures as one of the most important elements of the Protocol. However, many countries lack technical expertise in the technical matters of the tracking and tracing provisions. There is a risk that the global tracking and tracing system will not or hardly function, without the EU technical and financial support to the FCTC Protocol implementation. Second, while the Commission acknowledges that illegal tobacco manufacturing in the EU is a growing problem, the Strategy and the Action plan do not propose any measures to control and prevent the illegal diversion of raw tobacco, acetate tow or cigarette papers.

Finally, we recommend that posting additional EU liaison officers to important illicit cigarette source and transit countries would be beneficial. While OLAF has only one EU liaison officer in Kiev, the UK has 28 overseas intelligence officers who helped the country to prevent a revenue loss of 815 million euros between 2011 and 2012. At a minimum, the EU should have liaison officers in China, UAE, Ukraine and Russia, which could prevent substantial financial losses in the entire EU.

### **Impact Assessment of the Revised Tobacco Products Directive on Cigarette Smuggling in the European Union**

Most of the reports concerning the impact of the revised Tobacco Products Directive on illicit trade levels are commissioned by cigarette manufacturers. Growing evidence suggests that the industry tends to overstate the illicit cigarette trade problem.

Among provisions of the revised Directive, three are claimed by the tobacco industry to be drivers of illicit cigarette trade:

- graphic health warnings
- restrictions on packaging
- and regulation of ingredients

Pictorial health warnings and the minimum pack size restriction are commonly adopted tobacco control laws globally, and no convincing evidence of the impact of this law on illicit trade has been presented so far. Many countries that adopted these measures have seen declines in their illicit cigarette markets. The impact of the ban of non-menthol flavors on illicit cigarette trade will be marginal, as these other cigarette flavors constitute only a fringe of the EU cigarette market. The ban on menthol flavor will have only a minimal impact in countries where menthol cigarettes are not popular, which is the majority of the EU.

In countries with high prevalence of menthol cigarettes, the impact of flavor bans on illicit cigarette trade is also likely to be insignificant, because those who currently smoke flavored cigarettes are much less likely than other smokers to use illicit cigarettes. Based on data from Poland, a country that consumes over a third of EU menthol cigarettes, we found that a typical smoker of flavored cigarettes is a young, well-educated female who lives in a city, while a typical smoker of illicit cigarettes is an older, less-educated male living in a rural area.

We estimate that illicit and non-domestic legal menthol cigarettes accounted for only 0.2% of total EU cigarette consumption in 2010. This is a combined effect of menthol cigarettes not being popular in the EU and of a small illicit menthol cigarettes market share. The associated revenue loss was at a mere 0.19% of total EU cigarette excise tax revenue.

The impact of the revised Tobacco Products Directive on cigarette smuggling in the EU is highly dependent on how the companies decide to respond to the new regulations. However, even in the worst-case scenario of large-scale tobacco industry involvement in supplying illicit cigarettes to the EU, both the share of illicit menthol cigarettes in the total EU cigarette market and the associated excise tax revenue loss would remain at minimum levels. The benefits of the ban on menthol cigarettes far outweigh any risks associated with the possible increase in illicit cigarette trade.

### **Analysis of the Agreements between the EU and Major Tobacco Companies and Assessment of How the Member States Make Use of the Money Paid by the Tobacco Industry to Fight Illicit Trade**

During the period 1996-2012, cigarette seizures in EU were highest in 1999-2000 (around 6 billion a year), when the international tobacco companies were accused of being involved in the smuggling operations, and among the lowest in 2003, when the lawsuit against these companies had already been filed, but the EU had not yet signed any agreement with the tobacco companies.

Investigations and lawsuits by the authorities have resulted in a review of the export practices of the international tobacco companies in Europe, but it remains unclear whether the agreements with the tobacco industry in 2004-2010 have contributed to the reduction of the smuggling

activities. The high share of PMI contraband products in the EU, the large prevalence of an Imperial Tobacco cigarette brand from Ukraine on the contraband market and recent investigations over Japan Tobacco's involvement in large-scale cigarette smuggling call into question the effectiveness of the agreements.

The cigarette seizure payments might be an incentive for the tobacco companies not to be involved in the smuggling operations, but their possible effect should not be overestimated as very few seizures qualify for seizure payments. No seizure payments are made when the cigarettes are counterfeit, and customs officials often rely on the industry to determine whether cigarettes are counterfeit (not eligible for seizure-based payments) or genuine (eligible for the payments). The industry has an incentive to classify seized cigarettes as counterfeit.

The amounts and the use of payments from the agreements with the tobacco industry are not transparent. Only a few EU Member States shared information about the payments from the cigarette manufacturers with us. Some of the EU Member States earmark the payments to fight cigarette smuggling, while others direct the money to the general budget. The recovered value of taxes and duties of seizure-based payments is minimal compared to what has been lost on the smuggled cigarettes from the large seizures (as low as 0.4% in the UK).

Finally, the way the agreements are being presented to the general public may lead to confusion. The agreements with Philip Morris International and Japan Tobacco International were part of a settlement of legal claims concerning the involvement of these companies in cigarette smuggling. The payments from these agreements are, however, being presented to the public as the industry's philanthropy and corporate social responsibility rather than as settlement money.



## 1. ANALYSIS OF THE EUROPEAN COMMISSION STRATEGY TO TACKLE THE ILLICIT TRADE IN TOBACCO PRODUCTS

### KEY FINDINGS

- In June 2013, the European Commission published its two-year strategy to tackle illicit tobacco trade in the EU. Both the publication of the action plan and its general approach are positive developments.
- The Commission refers to two sets of data to measure the financial losses and the level of illicit cigarette trade in Europe: the KPMG Project Star empty pack surveys financed by the tobacco industry and the seizure data. Data from seizures and empty pack surveys provide useful information on the origin of illicit products, but are unreliable for measuring the level of illicit cigarette trade in the EU. KPMG Project Star data cannot be used to estimate the illicit cigarette market in the EU because the report was commissioned to meet specific terms of reference which are only known to Philip Morris International and KPMG.
- There is a risk that the global tracking and tracing system will not or hardly function, without the EU technical and financial support to the FCTC Protocol implementation.
- While the Commission acknowledges that illegal tobacco manufacturing in the EU is a growing problem, the Strategy and the Action plan do not propose any measures to control and prevent the illegal diversion of raw tobacco, acetate tow or cigarette papers.
- We recommend that posting additional EU liaison officers to important illicit cigarette source and transit countries would be beneficial. While OLAF has only one EU liaison officer in Kiev, the UK has 28 overseas intelligence officers who helped the country to prevent a revenue loss of 815 million euros between 2011 and 2012. At a minimum, the EU should have liaison officers in China, UAE, Ukraine and Russia, which could prevent substantial financial losses in the entire EU.

On 6<sup>th</sup> June 2013, the Commission published its communication to step up the fight against illicit trade in tobacco products. The communication sets out the Commission's proposals for a comprehensive EU strategy to tackle this illicit trade. The communication is accompanied by an action plan, which contains 50 measures, time lines and outcome measures to be developed and implemented over the next two years.<sup>(1)</sup>

The objective is to protect the financial interests of the EU and its Member States. The annual losses from illicit trade in tobacco products are estimated at 10 billion euros.

The communication notes that the seizure of other brands is steadily increasing. Other brands are defined as brands not produced by the four manufacturers with which the EU has cooperation agreements. The communication refers to the KPMG Project Star report to highlight the importance of the EU illicit cigarette trade, estimated at 11.1% of total cigarette market in 2012. This corresponds to an increase of 30% over the last 6 years.

## 1.1. INTRODUCTORY COMMENTS

The communication lists a whole range of approaches to be implemented by the EU institutions (Commission, Council, Parliament and the Member States). No new budgets are allocated to implement this policy. The action plan provides timelines (between 2013 and 2015) and outcome indicators, without the description of specific objectives to achieve.

The strategy proposes specific actions in 4 key areas:

- Measures to decrease incentives for smuggling activities
- Measures to improve the security of the supply chain
- Stronger enforcement of tax, customs, police and border authorities
- Heavier sanctions for smuggling activities

The description of the planned measures is kept rather general without going in too many details. Both the publication of the action plan and its general approach are positive developments. The measures are:

- More investment in equipment and IT tools to protect borders
- Improved intelligence gathering, risk management and Joint Customs Operations
- Enhanced cooperation among EU agencies and with major source and transit countries
- Strengthened sanctions
- Sharing of expertise and best practises
- Endorsement of the WHO Framework Convention on Tobacco Control (FCTC) protocol on combating the illicit trade in tobacco products

Investments in protection along the EU Eastern Border, for instance, should be encouraged. Already in 2011, the Commission published an action plan to fight smuggling of cigarettes and alcohol along the EU Eastern border. This action plan reports that Eastern Partnership countries, in particular Moldova, Ukraine and increasingly Belarus and Russia are major sources of illicit cigarettes and alcohol in the European Union.<sup>(2)</sup> Lithuanian customs officials believe that the funding of border control services for automated licence plate and container code recognition have resulted in more seizures.<sup>(3)</sup> Cigarette detectors, X-ray scanners, mobile customs teams and reinforced controls at the border also resulted in less cigarette smuggling from Ukraine into Poland and Hungary.<sup>(4,5)</sup>

Despite the positive approach, the absence of reliable data makes it difficult to evaluate the action plan. The lack of new resources will affect its effectiveness. The OLAF policy towards EU liaison officers and the lack of proposals to tackle illegal cigarette manufacturing are rather worrisome. Despite the close cooperation between the tobacco industry, OLAF and Member States, the major tobacco companies still seem to fail to control their supply chain.

## 1.2. THE LACK OF RELIABLE DATA

The communication refers to two sets of data to measure the financial losses and the level of illicit cigarette trade. Based on the cigarettes seizure trends, the problem of illicit cigarettes is decreasing and based on empty pack surveys financed by PMI, illicit cigarette trade is increasing in the EU. In the press release of 6<sup>th</sup> June 2013, the Commission says that "the overall illicit trade is increasing".(6) Data from seizures and empty pack surveys provide useful information on the origin of illicit products, but are unreliable for measuring the level of illicit cigarette trade in the EU.

### 1.2.1. Cigarette seizure data

OLAF estimates the annual financial losses due to illicit cigarette trade at more than 10 billion euros in the budget of the EU and the Member States. The OLAF estimate is based on seizures reported by member States, which amounted to 4.5 – 4.6 billion cigarettes per year between 2005-2011.(1)

Seizures are a function of law enforcement activity. While seizure data provide an indication of the trends in the illicit market, they cannot be used to make estimates of the illicit market, because they do not take into account the efficiency, number and intensity of law enforcement activities to seize cigarettes, nor the illicit trade of smaller consignments (below 100.000 cigarettes). For example, seizures of 100.000 cigarettes will not reveal the practice of 'ant smuggling', which refers to the organized and frequent crossing of borders by a large number of individuals with relatively small amounts of low taxed or untaxed tobacco products. Ant smuggling, for instance, was very common between the Ukraine and Poland six years ago.(7)

**Table 1. Cigarette seizure data in the EU-15 (1996-2003), EU-25 (2004-2006) and EU-27 (2007-2012).**

Year	EU-15 Billion cigarettes	Year	EU-25 Billion cigarettes	Year	EU-27 Billion cigarettes
1996	3.1	2004	4.1	2007	4.8
1997	2.6	2005	4.4	2008	4.6
1998	4.7	2006	4.6	2009	4.7
1999	5.7			2010	4.7
2000	6.2			2011	4.4
2001	4.8			2012	3.8
2002	3.6				
2003	3.3				

Source: OLAF (8,9,10)

**Note:** During the period 1996-2012, cigarette seizures in EU were highest in 1999-2000 (around 6 billion), when the international tobacco companies were accused of being involved in the smuggling operations, and among the lowest in 2003, when the EU had not yet signed any agreement with the tobacco companies. In the EU-27, cigarette seizures have decreased from 4.8 billion in 2007 to 3.8 billion cigarettes in 2012. Based on the cigarettes seizures trends alone, one might conclude that the problem of illicit cigarettes is decreasing in the EU.

### 1.2.2. Empty pack surveys financed by PMI

The communication refers to the KPMG Project Star data which estimated illicit consumption of cigarettes in the EU at 8.4% in 2007, 8.6% in 2008, 8.9% in 2009, 9.9% in 2010, 10.4% in 2011 and 11.1% for 2012. This corresponds to an increase of 30%, over the last 6 years,<sup>(11)</sup> while the cigarette seizure data showed a decrease of 21% over the same 6 years.

KPMG data cannot be used to estimate the illicit cigarette market in the EU because the report was commissioned to meet specific terms of reference which are only known to Philip Morris International and KPMG. Page 1 of the 2012 KPMG report says: "KPMG wishes all parties to be aware that KPMG's work for Philip Morris International was performed to meet specific terms of reference agreed between PMI and KPMG and that there were particular features determined for the purposes of the engagement. The Report should not therefore be regarded as suitable to be used or relied on by any other person or for any other purpose."<sup>(11)</sup>

Project Star uses empty cigarette pack surveys to make estimates on the illicit cigarette market in the EU. This method can be valid if it provides a well described and at random methodology on how the empty packs were collected, for instance, by collecting empty packs from the ground in a random sample of sub-areas, which cover a city completely.<sup>(12)</sup> Project Star says that it collects empty packs in the major cities of the 27 Member States, but it does not explain in which neighborhoods they collect the packs. In each city there are neighborhoods with a high level of illicit trade and neighborhoods with a low level of illicit trade. For instance, in the socio-economic deprived area of New York, the South Bronx, a survey of empty packs showed that 76% avoided or evaded taxes.<sup>(13)</sup> It makes a difference whether the empty packs are collected in deprived areas, such the South Bronx, or the wealthier areas.<sup>(12)</sup> Similarly, a survey among 4812 smokers in 2001 showed a large variation between London boroughs on the ease of buying smuggled cigarettes. Among smokers in Islington, 80% thought smuggled cigarettes would be easy to find, against only 45% of the smokers in another London borough, Wandsworth.<sup>(14)</sup> Surveys conducted around sports stadia are also likely to have higher levels of illicit tobacco, certainly where visiting fans have travelled from abroad.<sup>(15)</sup> Not the number of packs, but the at random collection of the packs is important. Project Star does not provide this information. In addition, Project Star underestimates the legal tax avoidance by smokers living close to the border of a country with lower cigarette prices. Legal cross-border cigarette purchasing is very common in European regions bordering countries with lower cigarette prices. In French and German provinces/states bordering countries with lower cigarette prices, 24% and 13% of smokers, respectively, reported purchasing cigarettes frequently outside their country. In non-border regions of France and Germany, and in Ireland, Scotland, the rest of the UK and the Netherlands, frequent purchasing of cigarettes outside the country was reported by 2–7% of smokers.<sup>(16)</sup> Project Star will tend to overestimate illicit cigarette levels, particularly where cross-border shopping is frequent (Austria, Finland, France).<sup>(17)</sup>

A recent and detailed analysis of Project Star comes to the following conclusion: "Project Star overestimates illicit cigarette levels in some European countries and suggests PMI's supply chain control is inadequate. Its publication serves the interests of PMI over those of the EU and its member states. Project Star requires greater transparency, external scrutiny and use of independent data."<sup>(17)</sup> Other articles concluded also that tobacco companies are exaggerating the threat of illicit tobacco based on surveys whose methodology and validity remain uncertain.<sup>(18,19)</sup>

PMI claims that Project Star was commissioned by PMI, the Commission and 27 Member States. This information is misleading, because Project Star is only financed and commissioned by PMI.(20)

KPMG claims that OLAF endorsed the methodology of Project Star. This is astonishing as a spokeswoman for OLAF recently made a statement that “OLAF had not endorsed an empty pack survey undertaken by BAT or any other cigarette manufacturer.”(21)

In a mail of OLAF to the authors of this report on 8th January 2014, OLAF explained that: “The Project Star Report was a tool under the Agreement between the Member States of the European Union, the Commission and Philip Morris International. The main purpose of the report was to determine if Member States who joined the EU on or after 1 May 2004 would be entitled to seizure payments as foreseen in the Agreement. It was never intended that the Project Star report would be made public or used as a reference by the EU or the Member States when highlighting the volume of the illicit trade in the EU, or used for any other purposes. However, the Project Star document did become a public document following a request for access to the report by a non-governmental organisation. It should be noted that as of now, the Project Star report is no longer required under the terms of the Agreement in question.”

### **1.3. NO SPECIFIC MEASURES AGAINST ILLICIT EU PRODUCTION**

According to the Commission communication, significant amounts of cigarettes are probably produced illegally inside the EU. The number of known illegal factories has increased rapidly from only five in 2010 to nine illegal factories in 2011.(1)

Europol also expects that illicit manufacturing within the EU will increase, since it is more difficult to detect imports of raw tobacco and materials than imports of manufactured cigarettes.(22)

Since the end of EU tobacco subsidies, there is no more control over the production of raw tobacco and without duties on raw tobacco, raw tobacco is a product without registration, monitoring or control. For this reason, Member States have reintroduced measures to monitor the production of raw tobacco. One example is Poland, where customs agencies observed large increases in the circulation of raw tobacco leaf throughout Poland – from only 38 tons of illegal raw tobacco discovered in 2009 to 170 tons disclosed in 2010. With easy access to shredders, cigarette filter paper and roll-your-own cigarette machines, those smokers in Poland who sought to circumvent the tobacco tax may have done so easily. Moreover, this growing trend in the unregulated trade of raw tobacco leaf among ordinary consumers created additional concern over the potential emergence of in-country factories specializing in the production of counterfeit cigarettes.(23)

In order to prevent this, Poland introduced a tax on dried (cured) tobacco in January 2013. Everybody who buys raw dried tobacco, which is still not a tobacco product, needs to pay this tax, with the exception of registered agents or manufacturers. But the law contains a loophole. Producers would sell moist tobacco leaves, straight from the fields and claim that this is a product without taxes because it not dried tobacco.

In order to fix this circumvention, Poland plans to change the law this year. All raw tobacco that is separated from a living plant, but is not yet a tobacco product, will be subject to this tax. The tax rate will be 229.32 PLN per kilogram, exactly the same rate as the minimum rate for the fine cut smoking tobacco. The mechanism stays the same: a registered manufacturer or agent is exempt from this tax, because the excise tax will be paid when it is turned into a tobacco product. But, all other purchasers need to pay this tax on raw tobacco.(24)

The objective of the Polish legislation is to regain control over the production of raw tobacco, which is the main component for manufacturing illicit tobacco products. Besides raw tobacco, cigarette papers and acetate filter tow are other components for manufacturing illicit cigarettes. Cigarette papers and acetate filter tow are listed in the harmonized tariff schedules of the European Union, Canada, Brazil, China and the United States. Although cellulose acetate has several industrial uses, acetate tow is used in very few products. More than 80% of world production is used in the manufacture of cigarettes. There are also only a handful of companies worldwide that manufacture acetate tow; seven are members of the Global Acetate Manufacturers Association (GAMA).(25)

In a plenary address on combating counterfeiting and piracy last year, Secretary General Noble from Interpol raised the issue of “acetate tow” and illicit manufacturing. Interpol aims to seek collaboration with the acetate tow industry, in order to provide assistance in containing illegal diversion.(26)

While the Commission acknowledges that illegal tobacco manufacturing is a growing problem, no measures are proposed to control and prevent the illegal diversion of raw tobacco, acetate tow or cigarette papers.

#### **1.4. THE SIGNATURE, RATIFICATION AND IMPLEMENTATION OF THE FCTC PROTOCOL**

One of the first and foremost measures to control the supply chain is the signature, ratification and implementation of the FCTC protocol on combating illicit trade of tobacco products. The protocol was adopted on the 12<sup>th</sup> November 2012. After 14 months, 54 parties (15 EU Member States and the EU) have signed and one party (Nicaragua) has ratified the protocol.(27) In comparison, 168 parties had signed the FCTC and 23 parties had ratified the FCTC after one year. The protocol will come into force 90 days after the ratification by 40 parties.

The most important article of the protocol is article 8, which contains specific provisions and fixed deadlines:

- 8.1 provides for 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” within five years of entry into force of the Protocol;
- 8.3 stipulates that “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”;
- 8.3 also stipulates a 10-year deadline for similar markings on other tobacco products.(28)

The signature and ratification of the protocol is much slower than of the FCTC, and this for several reasons:

- Many parties lack expertise in the technical matters of the tracking and tracing provisions and would need technical assistance
- The secretariat of the FCTC has only a budget of \$US 610.000 in 2014 and 2015 for the protocol (or an annual budget of 222,000 euros in 2014 and 2015).(29)
- The FCTC protocol foresees a global information sharing focal point, but so far no feasibility studies have been undertaken or no information is available on how this global focal point would function.

The aim of the tracking and tracing system is to assist in the investigation of illicit trade of tobacco products. Europe is the region where most of the cigarette seizures take place (30) and would profit the most from such a system. Moreover, European agencies have the capacity to undertake such investigations. There is a risk that the global tracking and tracing system will not or will minimally function, without funding of the EU to support FCTC protocol implementation. The Commission communication mentions financial support and technical assistance to the WHO FCTC Secretariat and non-EU countries, but no information is yet available on how much this support would be.

We do not expect the protocol to come into force in 2014. However, the 2014 adoption of the EU Tobacco Products Directive and its article 14 on traceability will be an important incentive for EU countries to ratify the protocol. In 2019 a traceability system for cigarettes and roll-your-own tobacco will be obligatory by law under the Tobacco Products Directive in all EU countries.

### **1.5. THE FAILING EU POLICY TOWARDS EU LIAISON OFFICERS**

According to available data, the main countries of provenance for smuggled tobacco products in the EU are, in the order of importance: China, the United Arab Emirates (UAE), Vietnam, Malaysia, the Russian Federation, Singapore, Belarus and Ukraine. China continues to be the source country for the majority of seized cigarettes.(1)

OLAF had one liaison intelligence officer in Beijing from 2008 to 2012, but ended his contract for budgetary reasons in 2012. Currently OLAF has only one liaison officer in Kiev.(31) The Commission explained in its communication that it will examine “the usefulness of posting additional EU liaison officers to important source and transit countries.”(1) While OLAF has only one EU liaison officer, the UK has 28 overseas intelligence officers.(32) Not without success. The seizure of cigarettes destined for the UK occurs twice as much abroad as in the UK. In 2012-3 1,858 million cigarettes were seized, of which 586 million were in the UK and 1,272 million overseas.(32)

The UK has a successful policy to combat cigarette smuggling: the illicit UK cigarette market was reduced from 21% in 2000 to 7% in 2011.(33) The National Audit Office reviewed in 2013 the UK policy in tackling tobacco smuggling and focused in its key findings on the efficiency of overseas officers. According to the audit, “HM Revenue & Custom’s focus on building overseas intelligence is yielding success. As part of the 2010 spending review, HMRC funded 11 overseas intelligence



officers, bringing the total to 28. Overseas intelligence officers work with host countries to gather and exchange information on criminal activity including customs fraud. HMRC estimates that its intelligence officers worked with overseas authorities to seize goods equivalent to preventing a revenue loss of 658 million British pounds (815 million euros) between 2011-12 and 2012-13. In total, the overseas intelligence officers facilitated the seizure of an estimated 1,270 million cigarettes and 56 tonnes of hand-rolling tobacco overseas in 2012-13.”(32)

The EU policy towards liaison officers is rather difficult to understand. The investment is small, but the gains could be significant. At a minimum, the EU should have liaison officers in China, UAE, Ukraine and Russia, which could prevent financial losses in the EU of hundreds of millions of euros. The most important source country for illicit cigarettes is China, but the EU decided not to continue the contract of its liaison officer there. China is willing to cooperate and was one of the first countries to sign the FCTC illicit trade protocol in January 2013.(27) In its communication, the Commission stresses the importance of “illicit whites” coming from UAE, Ukraine, Russia and Belarus, but only one liaison officer is funded in these countries. In 2011, the Commission staff working paper emphasized that “it is necessary to engage with the Russian Ministry of Interior and other relevant Russian Services on the problem of cigarette smuggling and seek their cooperation.”(2) Cooperation agreements or official visits will not replace the utility of an officer who lives in the country, who is in permanent contact with the local enforcement officials, who is able to build personal relationships and to obtain intelligence. As an enforcement official said, intelligence sharing between agencies rarely happens automatically, but is often the result of interpersonal relationships.(34)

## 2. IMPACT ASSESSMENT OF THE REVISED TOBACCO PRODUCTS DIRECTIVE ON CIGARETTE SMUGGLING IN THE EU

### KEY FINDINGS

- Most of the reports concerning the impact of the revised Tobacco Products Directive on illicit trade levels are commissioned by cigarette manufacturers. Growing evidence suggests that the industry tends to overstate the illicit cigarette trade problem.
- Among provisions of the revised Directive, three are claimed by the tobacco industry to be drivers of illicit cigarette trade: graphic health warnings, restrictions on packaging, and regulation of ingredients.
- Pictorial health warnings and the minimum pack size restriction are commonly adopted tobacco control laws globally, and no convincing evidence of the impact of this law on illicit trade has been presented so far. Many countries that adopted these measures have seen declines in their illicit cigarette markets.
- The impact of the ban of non-menthol flavors on illicit cigarette trade will be marginal, as these other cigarette flavors constitute only a fringe of the EU cigarette market. The ban on menthol flavor will have only a minimal impact in countries where menthol cigarettes are not popular, which is the majority of the EU.
- Those who currently consume flavored cigarettes are less likely than other smokers to use illicit cigarettes. Based on data from Poland, a country that consumes over a third of EU menthol cigarettes, we found that a typical smoker of flavored cigarettes is a young, well-educated female who lives in a city, while a typical smoker of illicit cigarettes is an older, less-educated male living in a rural area.
- We estimate that illicit and non-domestic legal menthol cigarettes accounted for only 0.2% of total EU cigarette consumption in 2010. This is a combined effect of menthol cigarettes not being popular in the EU and of a small illicit menthol cigarettes market share. The associated revenue loss was at a mere 0.19% of total EU cigarette excise tax revenue.
- The impact of the revised Tobacco Products Directive on cigarette smuggling in the EU is highly dependent on how the companies decide to respond to the new regulations. It will also depend on the effectiveness of the Tobacco Products Directive's mechanisms to prevent illicit cigarette trade and on the comprehensiveness of the ban. However, even in the worst-case scenario of large-scale tobacco industry involvement in supplying illicit cigarettes to the EU, both the share of illicit menthol cigarettes in the total EU cigarette market and the associated excise tax revenue loss would remain at minimum levels.
- The benefits of the ban on menthol cigarettes far outweigh any risks associated with the possible increase in illicit cigarette trade.

## **2.1. BACKGROUND**

A possible change in illicit cigarette trade levels is only a small portion of the full and complex impact of the revised Tobacco Products Directive (TPD) on the economy of the European Union and welfare of its citizens. The socio-economic benefits of the revised TPD resulting from reduction in health care costs, productivity losses, and premature mortality alone are estimated at over 9.4 billion euros annually.<sup>(35)</sup> However, a comprehensive assessment of the effects of the Directive on cigarette smuggling is arguably the most important element of the regulatory impact analysis, because the illicit cigarette trade plays a key role in the debate over the new law.

There is much fear around the impact of the revised Directive on illicit trade in tobacco products. Numerous reports presented to policy makers and the public demonstrate harmful effects of the revised Tobacco Products Directive on the scope of illicit trade in Europe.<sup>(36–41)</sup> There is no doubt that illicit trade in tobacco products has serious economic, as well as health and social implications. It decreases governments' tax revenue and can lead to higher levels of corruption, both among citizens and public officials.<sup>(42)</sup> It also undermines the use of effective tobacco control measures such as tobacco taxation,<sup>(43)</sup> youth access laws,<sup>(44)</sup> and health warnings,<sup>(45)</sup> thus reducing their potential to prevent many tobacco-related premature deaths.<sup>(46)</sup> However, most of the reports concerning the impact of the revised Directive on illicit trade levels are commissioned by cigarette manufacturers. It is estimated that approximately 30% of Philip Morris's profit, 18% of British American Tobacco's profit, 20% of Japan Tobacco's profit, and as much as 60% of Imperial Tobacco's profit is coming from the EU market,<sup>(47)</sup> and these companies are obligated to maximize profits for their shareholders—although they must do so lawfully.

## **2.2. THE TOBACCO INDUSTRY TENDS TO EXAGGERATE THE ILLICIT CIGARETTE TRADE PROBLEM**

It is no surprise that the proposed regulations of the new Tobacco Products Directive have been strongly opposed by the tobacco lobby. In the past, tobacco companies countered policy proposals supporting the control of tobacco use by arguing that cigarettes were not harming the health of smokers. Few people would believe those arguments today. That is why tobacco lobbyists reoriented the debate using economic arguments, particularly the argument regarding the increases in illicit cigarette trade, when trying to persuade policy makers and the public around the harmful impact of the tobacco control.

Because of the competing interests between profit-maximizing tobacco companies and the public health and economic concerns of the EU, arguments regarding illicit tobacco trade that are being presented by tobacco companies in public discussions around new tobacco control regulations need to be treated with a special caution. Studies paid for and presented by cigarette manufacturers are generally not independently verified or peer reviewed. Unlike academic research studies, these studies provide only limited information about their methodology and data collection, thus are not replicable.<sup>(18)</sup>

The revision of the Tobacco Products Directive is certainly not the first time that tobacco companies have raised concerns about illicit cigarette trade. The illicit trade argument has been used lately by these companies to lobby against virtually any new tobacco control measure around the world,(44) particularly tobacco tax increases, standardized packaging, and product display bans.(48) These messages have been very effectively disseminated not only to policy makers,(48,49) but also to the public. In Poland, for example, there have been at least four tobacco industry corporate social responsibility (CSR) campaigns focusing on illicit cigarette trade since 2010.(50) These campaigns involved presentations on TV, in the press and on billboards, as well as the distribution of over a million leaflets to the public. The information was disseminated directly at schools and Catholic parishes, and the industry even organized workshops for customs officers.(50)

Growing evidence suggests that the industry tends to overstate the illicit cigarette trade problem. For example, researchers from Germany found that the sampling method used in an industry-funded study was not nationally representative, with systematic overrepresentation of geographic regions along the country's eastern border and around U.S. military bases, where more illicit cigarettes can be expected.(51) Illicit trade estimates from industry-commissioned studies were found to be significantly higher than those from academic studies in the UK,(52) France,(53) Poland,(18) Australia,(54) and South Africa.(49) Also Project Star, a pan-European study conducted by KPMG LLP and paid for by the tobacco industry, tends to exaggerate the size of illicit cigarette trade.(17) Globally, contrary to tobacco industry predictions, increasingly strict tobacco control regulations (55) did not affect the scope of illicit cigarette trade. The share of illicit cigarette trade in the global cigarette market has remained relatively stable since 2000.(46,56)

### **2.3. THE INFLUENCE OF THE TOBACCO DIRECTIVE FROM 2001 ON ILLICIT CIGARETTE TRADE IN THE EU**

The 2001 Tobacco Products Directive regulates tar, nicotine, and carbon monoxide levels in cigarettes, the size of text health warnings on all tobacco products' packages, and bans the use of misleading product descriptors, such as "light" and "mild" in the European Union.(57) The directive had been strongly opposed by the tobacco industry, which challenged it in the European Court of Justice.(58)

There is no evidence that the provisions of the 2001 Tobacco Products Directive increased illicit cigarette trade levels in Europe. In fact, the number of smuggled cigarettes seized declined by nearly half between 2000 and 2003,(see Table 1 in Chapter 1), which most likely indicates a decrease in the levels of illicit cigarette trade in the EU in the years following the approval of the Directive. In the UK, in spite of the 2001 Directive, the estimated illicit cigarette market share declined from 21% in the fiscal year 2000/2001 to 13% in 2005/2006. This might be attributed to the country's 2000 anti-smuggling action plan and to the UK Parliamentary Public Accounts Committee's investigation on Imperial Tobacco's suspected involvement in large scale smuggling of its Regal and Superkings brands to the UK.(59)

## **2.4. THE CURRENT INDUSTRY-COMMISSIONED IMPACT ASSESSMENTS OF THE REVISED TOBACCO PRODUCT DIRECTIVE ARE DUBIOUS**

Most of the claims regarding the impact of the revised Tobacco Products Directive on illicit cigarette trade in Europe made by the cigarette manufacturers are entirely unsubstantiated. For example, in 2013 Philip Morris International commissioned studies aiming to measure the impact of a ban on menthol cigarettes on illicit trade in Finland and Poland – the two markets with the highest share of menthol cigarettes in the EU. To measure consumers' preferences, a choice of cigarette brands and sales channels was presented on computer screens to smokers who took part in this study. The studies concluded that removing menthol cigarettes from regular stores increases preference for brands sold through street vendors (the study's assumed source of the illicit cigarettes) by 233% and 250% in Finland and Poland, respectively.<sup>(37,38)</sup>

There are serious methodological flaws in this approach. First, although the aim of the revised Tobacco Products Directive is to protect the health of EU citizens by decreasing smoking prevalence, the respondents to this study had no option to indicate that they would like to quit smoking if the menthol cigarettes were no longer available in regular stores. The smokers were only allowed to either indicate that they would continue smoking menthol cigarettes sold by street vendors (black market) or to choose some other, non-menthol brand of cigarettes. There was no "none of the above" option in this study forcing the respondents to indicate that they will continue to smoke cigarettes, even if their preferred response to the menthol ban is to quit or switch to menthol e-cigarettes. Second, it is not clear whether the respondents were even fully aware that the "street vendor" was the study's alias for the illicit channel. The methods section of the study indicate that: "Subjects were not directly informed that this [street vendor] is an illicit channel, but sufficient information was provided for them to reach this conclusion." Third, the costs of obtaining illegal cigarettes are higher. These include, for example, costs of obtaining information on where the illicit cigarettes are being sold, costs of the trips to the place where they are sold (since the illicit cigarettes are not as readily available as legal cigarettes), and the moral costs of breaking rule (most people have reservations against breaking rules). However, these two studies treated the decisions to buy cigarettes in regular stores and from street vendors as equivalent and interchangeable. In the study setting, the brand choices available by street vendors were presented to the smokers in the same way as the choices available in regular stores, which is not the case. Finally, these studies do not address the issue of a menthol ban's effect on youth smoking initiation nor the long term effects of the ban.

## **2.5. THE POSSIBLE IMPACT OF THE PROVISIONS OF TOBACCO PRODUCTS DIRECTIVE ON ILLICIT CIGARETTE TRADE**

Among the provisions of the revised Tobacco Products Directive, three are claimed by the tobacco industry to be potential drivers of illicit cigarette trade:

- 1) graphic health warnings
- 2) restrictions on packaging
- 3) regulation of ingredients

The following reasoning for these assertions is provided. First, pictorial health warnings will make cigarette packaging less pleasant looking, which will cause smokers to switch to more attractive, illicit packs. Second, the minimum pack size restrictions will increase the unit price of the packs, shifting smokers to the black market. Third, removing cigarettes with certain flavors from the legitimate market will once again drive consumers to the illicit trade.(36)

### **2.5.1. Graphic Health Warnings**

There is no indication that implementation of pictorial health warnings increases illicit cigarette trade. More than 60 countries now require pictorial health warnings on cigarette packs, and there is no research evidence of increased levels of illicit cigarette trade due to these new regulations. In the UK, after implementation of pictorial health warnings in 2008, the illicit cigarette share of the cigarette market dropped from 12% in 2008/2009 to 9% in 2012/2013, according to estimates by HM Revenue & Customs.(60) This drop in illicit cigarette trade levels occurred with the UK having one of the highest tobacco taxes in Europe. Similarly, a recent survey of 1,024 smokers in Belgium revealed no significant purchases of cheap cigarettes from friends and street vendors (illicit cigarettes) after the country's implementation of graphic health warnings in 2007.(61)

### **2.5.2. Restrictions on Packaging**

The minimum pack size restriction is also a commonly adopted tobacco control law, and no convincing evidence of the impact of this law on illicit trade has been presented so far. Laws requiring cigarette packs to contain at least 19 or 20 cigarettes are present in 18 Member States, and some Member States have requirements for the sizes of packs of Roll-Your-Own (RYO) tobacco. Similarly to countries that adopted graphic health warnings, those which implemented pack size restrictions have not experienced increases in illicit cigarette trade levels. For example, in the mid-2000s more than 15% of all cigarettes smoked in Finland were sold in packs of less than 20 sticks. These packs were banned and phased out of the Finnish market by 2009. Despite the minimum pack size law, according to Euromonitor, a market intelligence company, the illicit cigarette trade in Finland stayed at constant 5% to 6% levels so far.(56) Belgium banned cigarette packs of 19 cigarettes in October 2003, but since then the purchases of illicit cigarettes have remained marginal.(61) A similar law requiring a minimum pack size of 20 cigarettes was implemented in Malaysia in July 2010. This law prohibited sales so called “kiddie packs”, packs of 14 cigarette sticks, which accounted for over a third of the Malaysian market in 2009. With illicit cigarettes being very prevalent in Malaysia (38% of the total cigarette market in 2009 according to Euromonitor), smokers in this country would have no problem with buying their small packs on the black market after they were banned from the legitimate sales. However, this did not happen. Illicit cigarette trade remained at stable levels of 37% and 36% of the total cigarette market in 2010 and 2011, respectively.(56)

### 2.5.3. Ingredients Regulation

The impact of ingredients regulations on illicit cigarette trade is unknown. Only a few countries (e.g. Canada, USA, and France) have implemented regulations of tobacco products flavoring so far, but these regulations affected only a small share of the tobacco market. Until now no country has ever implemented ban on menthol cigarettes. Due to a lack of empirical data, the impacts of the flavoring bans remain conjecture.

Among different cigarette flavors available in the EU market, the menthol flavor is unquestionably most prevalent. According to Euromonitor, menthol cigarettes accounted for roughly 5% of all cigarettes sold among the EU Member States in 2012, an increase from 4.5% of sales in 2009. In 10 EU countries (Austria, Bulgaria, Croatia, Germany, Greece, Ireland, Italy, Latvia, Slovenia, and Spain) the share of the menthol cigarettes in total cigarette market is less than 3%. It is very unlikely that this share will increase after the implementation of the new Tobacco Product Directive. As noted in a recent report submitted to the U.S. Food and Drug Administration, "it would be very difficult to build a significant market for menthol cigarettes without advertising, marketing, and packaging them as such".<sup>(62)</sup> Only Finland, Poland and Slovakia have a retail volume share of menthol cigarettes exceeding 10%. Menthol-flavored cigarettes accounted for 24%, 20% and 11% of total cigarette sales in Finland, Poland and Slovakia, respectively, in 2012.<sup>(56)</sup>

Other cigarette flavors available in the European market include vanilla, chocolate, caramel, cherry, mango, strawberry, and passion fruit. The leading brand among these other flavors is Black Devil, a product of Dutch manufacturer Heupink & Bloemen Tabak.<sup>(56)</sup> France already adopted regulations that restrict use of flavouring ingredients in cigarettes in 2009. This law prohibits sales and distribution of cigarettes with an excess of sweet and acidulous flavour.<sup>(63)</sup> It, however, does not restrict menthol cigarettes sales. The law was implemented in order to prevent younger people from starting smoking, and impacted sales of vanilla, orange, and chocolate cigarettes in the country.<sup>(56)</sup> In the US, where the Food and Drug Administration implemented a ban on several cigarette flavors in 2009 (menthols were not a part of this ban), there have been no reports of black market in flavored cigarettes so far.<sup>(64)</sup> Banning non-menthol flavors cannot significantly affect illicit cigarette trade in Europe since these cigarettes constitute only a small portion of the EU cigarette market.

#### **Smokers of flavored cigarettes are less likely to avoid and evade tobacco taxes than other smokers**

Although the impact of a menthol ban on illicit cigarette trade is unknown, particularly in countries with substantial menthol cigarettes market share, it seems that smokers of menthol cigarettes are less inclined to participate in the black market than other smokers. This is evident from the abovementioned Project Star, an EU-wide study commissioned by the tobacco industry and relying on discarded pack surveys and industry data. Although Project Star tends to exaggerate the scope of illicit cigarette trade and its findings should be treated with special caution,<sup>(17,18)</sup> the stunning difference between the Project Star estimated shares of non-domestic (counterfeit, contraband, and legal non-domestic) cigarettes among all cigarettes and among menthol cigarettes is indicative of how different smokers of menthol cigarettes and smokers of illicit cigarettes are. For example, according to Project Star, in Estonia the non-



domestic market share was 2% in menthol cigarettes and 25% in all cigarettes in 2012. The share of non-domestic cigarettes among menthols was also much smaller than among all cigarettes in Finland (12% vs. 23%), Hungary (2% vs. 5%), Latvia (9% vs. 34%), Lithuania (4% vs. 32%), Poland (5% vs. 14%), Romania (1% vs. 10%), and Slovakia (0% vs. 2%).<sup>(11)</sup>

To find the reasons for the discrepancy in tax evasion among menthol and non-menthol cigarette smokers, we used data on individual smoking behavior and smokers' demographic characteristics from the Global Adult Tobacco Survey (GATS) Poland.<sup>(65)</sup> Poland is the single biggest market for menthol cigarettes among all Member States, as this country consumes one in every three menthol cigarettes smoked in the European Union.<sup>(56)</sup>

GATS is a nationally representative household survey of non-institutionalized men and women aged 15 and older. The study interviewed 7 840 individuals in Poland in 2009-2010. Among other survey questions, current smokers were asked about their last cigarette purchase, including whether the last purchased cigarettes were flavored. Additionally, they were asked to show a pack of currently smoked cigarettes, and detailed information on the packs was collected, including information on the tax stamp, and the health warning. These two questions permitted the identification of smokers of flavored cigarettes, as well as those who possessed cigarettes not intended for the Polish market. Socio-economic characteristics of each smoker were also collected.

We used two pack features to determine whether the pack was intended for the Polish market: excise tax stamps and health warnings. A damaged tax stamp is not always an indicator of tax avoidance/evasion, as the stamps may be removed by a consumer. Therefore, only packs with a tax stamp issued by another country, no stamp, or packs without the Polish health warning were classified as packs non-taxed in Poland. We counted packs with damaged stamps, but with a Polish health warning as cigarettes intended for the Polish market. The total of 2 270 respondents answered the question about cigarette flavor, and out of those 1 915 respondents showed a cigarette pack. We used a mean comparison test to compare the characteristics of respondents and packs presented by these 1 915 respondents.

We found that the share of packs not intended for the Polish market was more than twice lower among the smokers of flavored cigarettes than among the smokers of non-flavored cigarettes (3.3%; 95% CI: 1.4% to 5.2% vs. 6.8%; 95% CI: 5.5% to 8.0%). This difference is statistically significant ( $t=2.4418$ ;  $p=0.0147$ ). When comparing the socio-economic characteristics of smokers of flavored cigarettes with those of cigarettes not intended for the Polish market, we found that these two groups are very different. Smokers of flavored cigarettes are predominantly women, whereas less than one third of smokers of non-Polish packs are female (63.2% female among smokers of flavored cigarettes vs. 31.9% female among non-Polish packs smokers). Smokers of flavored packs are younger (mean age 40.3 vs. 45.3 ) and less likely to live in rural areas (35.2% vs. 63.0% ) than smokers of non-Polish cigarettes. Only 2.5% of smokers of non-Polish packs had some college education, whereas this share among flavored cigarette smokers was 24.7%. All these differences are statistically significant (see Table 2).



**Table 2. Socio-economic characteristics of smokers of menthol and those of cigarettes not intended for the Polish market**

	Gender (female)	Age	Education (college) <sup>3</sup>	Residence (rural)
<b>Smokers of flavored cigarettes<sup>1</sup> N=386</b>	63.21% [58.38% to 68.04%]	40.33 [39.11 to 41.55]	24.74% [20.40% to 29.07%]	35.23% [30.45% to 40.02%]
<b>Smokers of cigarettes not intended for the Polish market<sup>2</sup> N=119</b>	31.93% [23.43% to 40.43%]	45.34 [42.93 to 47.76]	2.52% [-0.34% to 5.38%]	63.03% [54.22% to 71.83%]
<b>Mean comparison</b>	t=6.22 p<0.001	t=-3.84 p<0.001	t=5.49 p<0.001	t=-5.52 p<0.001

**Source:** GATS Poland (65)

**Note:** The numbers in brackets represent the 95% confidence intervals.

<sup>1</sup> Includes smokers who possessed cigarettes not intended for the Polish market

<sup>2</sup> Includes smokers of flavored cigarettes

<sup>3</sup> For the education variable, the sample of smokers of flavored cigarettes was 384, because of two smokers who did not report their education levels.

People who smoke flavored cigarettes and those who smoke illicit cigarettes belong to very different, almost disjoint groups. A smoker of flavored cigarettes is likely to be a young, well-educated female who lives in a city. On the other hand, a typical smoker of illicit cigarettes is an older, less-educated male living in a rural area. The share of all smokers who belong to this first group and buy illicit cigarettes is very small. Only 0.6% of smokers surveyed in Poland were smokers of flavored cigarettes who presented packs not taxed in Poland. Our findings are consistent with findings from Belgium, where young women, a group not particularly prone to illicit cigarette smoking, were found to be much more likely to smoke menthol cigarettes than other age and gender groups.<sup>(61)</sup> This difference between the characteristics of illicit cigarettes and menthol cigarettes smokers indicates that the impact of banning flavored cigarettes on illicit cigarette trade is likely to be insignificant.

The availability of close substitutes for menthol cigarettes will make it even more unlikely for smokers of menthol cigarettes to switch to the black market. Smokers of menthol cigarettes who choose not to or are not able to quit will still be able to legally buy unflavored cigarettes and other products containing nicotine. There are many smokers who switch from menthol to non-menthol cigarettes each year. For example, the 1991 "Philip Morris Switching Book", a study on cigarette brand loyalty in the US, found that over 2% of menthol smokers switched to non-menthol cigarettes from June 1990 to June 1991.<sup>(66)</sup> Another product that the smokers of menthol cigarettes can choose instead of switching to black market is the menthol-flavored e-cigarette, a product that will still be readily available in the European market even after the implementation of the revised Tobacco Products Directive.

## 2.6. ECONOMIC AND SOCIAL IMPACT

To estimate the impact of the revised Tobacco Products Directive's menthol cigarettes ban on illicit cigarette trade in the EU, we used data from the European Commission's Taxation and Customs Union Directorate-General (data on excise tax revenues),(67) Euromonitor (data on menthol cigarettes market share),(56) and from the Pricing Policies and Control of Tobacco in Europe (PPACTE) project (data on illicit and non-domestic legal cigarette market share).(53) The last source is an academic study that collected data from packs presented by smokers interviewed in 16 EU countries in 2010. We decided to use PPACTE over the Project Star estimates, because some evidence suggests that the tobacco industry-commissioned Project Star might exaggerate the illicit cigarette trade problem,(18) and in some EU countries a comparison of official government estimates with the PPACTE and Project Star estimates suggested that the PPACTE estimates tend to be more accurate than the Project Star estimates.(17) Table 3 presents the baseline state of non-domestic menthol cigarettes consumption in the EU in 2010, as well as summarizes the result of three simulations of the effects of the revised Tobacco Products Directive's menthol cigarette ban on illicit menthol cigarettes consumption and the resulting excise tax revenue loss in the EU.

The PPACTE estimates that out of all cigarettes consumed in the 16 EU countries in 2010, 6.5% were illicit (mostly packs from outside the EU and counterfeited) and 2.5% were non-domestic legal (mostly packs from other EU countries). Based on these estimates and the findings from Poland suggesting that the share of non-domestic packs (illicit packs and non-domestic legal packs) is roughly twice as low among smokers of flavored cigarettes than among all cigarette smokers, we estimate that illicit cigarettes accounted for 3.25%, and non-domestic legal cigarettes accounted for 1.25% of all menthol cigarettes consumed in the EU in 2010. Given that, according to Euromonitor, there were over 28 billion legal menthol cigarettes sold in the EU in 2010, we estimate the consumption of illicit menthol cigarettes was at 945 million and non-domestic legal menthol cigarettes was at 363 million in the EU that year. The total 1.3 billion non-domestic menthol cigarettes consumed in the EU in 2010 accounted for only 0.20% of all cigarettes consumed in the EU in 2010.

Using the European Commission data on EU Members' excise tax yields, we estimated that on average EU Members lost 0.12 euro on each illicit menthol cigarette and 0.07 euro on each non-domestic legal menthol cigarette in 2010.(67) The difference results from the fact that generally all EU tax revenue is lost on illicit cigarettes (packs mostly from outside the EU and counterfeited) and only a portion of EU tax revenue is lost on the non-domestic packs. This is because, in general, the non-domestic legal packs were taxed in an EU country with lower tobacco taxes and consumed in an EU country with higher taxes. The loss on non-domestic legal packs results from the difference between the excise tax yield in the destination and the source EU country. The share of total cigarette excise tax revenue lost due to non-domestic menthol cigarettes consumption in the EU was a mere 0.19% in 2010.

**Table 3. Scenario analysis for non-domestic menthol cigarettes market share in the EU after implementation of the revised Tobacco Products Directive**

	Baseline 2010	Scenario 1	Scenario 2	Scenario 3
<b>A. Legal sales of menthol cigarettes (in millions)</b>	28,139	0	0	0
<b>B. Illicit menthol cigarettes consumption (in millions)</b>	945	945	1,308	1,956
<b>C. Non-domestic legal menthol cigarettes consumption (in millions)</b>	363	0	0	0
<b>D. Total menthol consumption (A+B) (in millions)</b>	29,084	945	1,308	1,956
<b>E. Non-domestic menthols share in total cigarette consumption</b>	0.20%	0.15%	0.20%	0.30%
<b>F. Share of total cigarette excise tax revenue lost due to non-domestic menthol cigarettes</b>	0.19%	0.16%	0.21%	0.32%

**Source:** PPACTE (53), European Commission (67), Euromonitor (56)

**Note:** Non-domestic legal menthol cigarette consumption (C) is assumed to be a subgroup of legal sales of menthol cigarettes (A). These are the cigarettes taxed in one EU Member State and consumed in another EU Member State. Revenue lost on these cigarettes is just 0.07 euro per stick, a difference between the average excise tax yield in the source and destination countries. After the EU-wide ban on menthol cigarettes sales, non-domestic legal menthol cigarette consumption will discontinue. In each scenario we make a conservative assumption that there will be no smoking cessation due to the law and all former menthol cigarettes smokers would switch to non-menthol cigarettes.

In Scenario 1, we assume that illicit trade in menthol cigarettes stays at the 2010 levels, while non-domestic legal menthol cigarette consumption discontinues with the ban on menthol sales in the EU. This scenario is plausible, because both manufacturers and smokers will have time to prepare for the ban up until 2020. Besides, the smokers of menthol cigarettes are in general less likely to smoke illicit cigarettes. Under this scenario the non-domestic menthol cigarette share in total cigarette consumption would fall to 0.15% and the share of total cigarette excise tax revenue lost due to non-domestic menthol consumption would fall to 0.16%.

Under Scenario 2, we assume that all smokers of illicit menthol cigarettes will continue to smoke cigarettes from the black market and former smokers of non-domestic legal menthol cigarettes will switch to illicit menthol cigarettes. That is, under this assumption the number of non-domestic cigarettes smoked in the EU remains at the baseline level. In this scenario the non-domestic menthol share stays at 0.20% of the total cigarette market and the tax loss increases to 0.21% of total cigarette excise tax revenue in the EU, because the EU loses more tax revenue on illicit cigarettes than on the non-domestic legal cigarettes.

As noted above, smokers of menthol cigarettes are less inclined to smoke illicit cigarettes than other smokers. In Scenario 3, we assume that the illicit menthol cigarette share is scaled up to the levels of illicit cigarette trade observed for all cigarettes. That is, we assume that the share of illicit menthol cigarettes increases from 3.25% to 6.5% of the menthol market. We believe that the levels of tax evasion observed among all cigarette smokers represent each nation's general tendency to circumvent tobacco taxation, and therefore this simulation represents the upper level for tax evasion among menthol cigarette smokers. This scenario would be only possible with the tobacco industry facilitating a large-scale illicit cigarette trade from outside the EU. Under this scenario the non-domestic menthol share increases to 0.30% of the total cigarette market and the tax loss increases to 0.32% of total cigarette excise tax revenue in the EU.

The current usage of menthol cigarettes in the EU has multiple adverse social impacts. Like all cigarettes, menthol cigarettes are very dangerous, killing roughly half of lifelong users. Besides, it is well established that menthol flavoring in cigarettes is associated with smoking initiation, especially among youth. It increases nicotine dependence in young smokers and decreases smoking cessation in adult smokers. Prohibiting menthol as a cigarette flavoring would result in reduced smoking initiation increased smoking cessation, and a significant reduction in the number of premature deaths.(64,68) The benefits of the ban on menthol cigarettes far outweigh any risks associated with the possible increase in illicit cigarette trade.

## **2.7. THE MAGNITUDE OF THE IMPACT**

The probability of each of the above scenarios depends on different, exogenous factors. Evidence shows that the levels of illicit cigarette trade are generally lower in countries with stricter tobacco control laws, and that factors other than tobacco control measures are more important determinants of illicit cigarette trade. These factors include the presence of informal distribution channels (e.g. street vendors), weak tax administration, poor law enforcement, and corruption.(46)

We identified three main factors that will influence the magnitude of the impact of the revised Tobacco Products Directive on illicit cigarette trade in Europe:

- 1) the strategy of the cigarette manufacturers
- 2) the effectiveness of Tobacco Products Directive's mechanisms to prevent illicit cigarette trade
- 3) comprehensiveness of the ban

### **2.7.1. Strategy of the cigarette manufacturers**

The single most important factor that will influence the size of the illicit cigarette market in Europe is the business strategy of the cigarette manufacturers.

Tobacco companies are among the main stakeholders benefiting from cigarette smuggling. Smuggling helps these companies to generate higher profits by enabling them to circumvent some taxes. Through smuggling, cigarettes taxed in countries with lower tobacco taxes, such as Belarus, Russia, Ukraine, and Serbia are being sold in countries with higher tobacco taxes, such as the EU Member States. In addition, because the black market is not subject to any regulations, through smuggling it is easier for those companies to reach children and youth, who are potential new clients.

**Case Study 1. Cigarette smuggling from Ukraine**

In 2008, Ukraine's cigarette consumption and legal exports amounted to 100 billion cigarette sticks. However, tobacco companies in Ukraine manufactured and imported nearly 130 billion cigarette sticks that year. Most of these excess cigarettes (c.a. every fourth cigarette taxed in Ukraine) have been illegally exported to the EU. As a result, Ukraine was identified by the World Customs Organization as the most frequent source of contraband cigarettes in the world in 2008.

When asked whether the tobacco industry loses money to the illicit trade, Dmytro Redko, the Director of Corporate Affairs at the Japan Tobacco International in Ukraine responded: "What do you mean by loss? From the point of view of a company operating on the market, production of extra goods means extra profits".

**Sources:** The Center for Public Integrity (69), World Customs Organization (70)

It has been well documented that the business strategies of the tobacco industry have a vast impact on the illicit cigarette market. For example, trading cigarettes illegally enabled the industry to access closed Asian markets and created pressure for market openings.<sup>(71)</sup> Worldwide, transnational tobacco companies have been found guilty of organising illicit tobacco trade, and have paid billions of dollars in fines and penalties in compensation.<sup>(72)</sup> Also in Europe, a civil action filed by the European Community against Phillip Morris and RJ Reynolds in New York in 2000 accused the companies of smuggling cigarettes into the European Union.<sup>(73)</sup> The parties settled in 2004, when the European Commission and Member States agreed to drop their case in return for legal binding agreements (see Chapter 3).<sup>(74)</sup>

The same transnational companies that operate in the EU market also dominate the markets outside the EU. Over 90% of all cigarettes sold in the EU are products of just four tobacco companies: Philip Morris International, British American Tobacco, Imperial Tobacco Group, and Japan Tobacco. The very same four companies control the markets of the biggest suppliers of illicit cigarettes to the EU. In 2012, they owned 97.3% of Ukraine's, 89.8% of Russia's, and 81.2% of Serbia's manufacturers. In Belarus, British American Tobacco and Japan Tobacco International have a long-term relationship with Neman Tobacco Factory Grodno, a company that dominates the Belarusian cigarette market.<sup>(56)</sup> Because each of these four companies operates at multinational levels, their strategies and goals are also global. Altering their product portfolio in one market in order to satisfy consumer needs in other markets is definitely within the scope of operation of these companies, regardless if those needs are being satisfied in legal or illegal ways.

There is little doubt that the tobacco companies will try to circumvent the provisions of the revised Tobacco Products Directive. For example, in 2013 Philip Morris International commissioned a series of market research studies on a sample of 1 270 adult smokers of menthol cigarettes in Finland and Poland, testing the possibility of introducing self-flavoring devices to these markets. Such devices would allow adding flavor to either non-flavored cigarettes or to loose tobacco prior to rolling it into a cigarette. The company made it clear that these tests were conducted in response to a possible Tobacco Product Directive's ban on the menthol cigarettes, although the sales of such devices would be a clear circumvention of the Article 6 of the Directive.<sup>(37,38)</sup> The self-flavoring devices are certainly not the only option considered by the

tobacco companies to circumvent the provisions of the revised Tobacco Products Directive. If facilitating illicit cigarette trade would turn out to be more profitable for these companies than the introduction of self-flavoring devices, we can expect a rise in cigarette smuggling in Europe.

### **2.7.2. The effectiveness of Tobacco Products Directive's mechanisms prevent illicit cigarette trade**

The Directive has mechanisms embedded that are designed to prevent illicit cigarette trade. These include an EU-wide tracking and tracing system and security features designed to make cigarette counterfeiting harder. The effectiveness of such system will highly influence illicit cigarette trade in the EU. Codentify, a tracking and tracing system currently used by Philip Morris International to control their supply chain, has many limitations.<sup>(75)</sup>

### **2.7.3. Comprehensiveness of the ban**

According to Project Star, France has the largest inflows of non-domestic menthol cigarettes among all European countries.<sup>(11)</sup> However, evidence from the International Tobacco Control Policy Evaluation Project (ITC) shows that these cigarettes come to France predominantly from other EU countries. In 2008, out of 1 540 respondents who reported having last purchased cigarettes from a low or untaxed source, 81% reported that this pack was from another EU country.<sup>(76)</sup>

With the provisions of the revised Tobacco Products Directive, menthol and other flavored cigarettes will not only be banned in countries that are destinations for illegal menthol cigarettes, such as France, but also in the source countries for these cigarettes, such as Poland and the Czech Republic. This will further deter illicit cigarette trade in flavored cigarettes.

Therefore, it is extremely important that the ban on menthol cigarettes take effect in all EU Member States and that no Member State be granted a transition period before this ban. Having the ban in effect in all but one EU Member State would allow menthol cigarettes to flow almost freely within the Schengen Area. This would highly increase non-domestic cigarette market share levels in the EU, increase the resulting tax revenue losses and hinder the beneficial impact of the directive on health.

### 3. ANALYSIS OF THE AGREEMENTS BETWEEN THE EU AND MAJOR TOBACCO COMPANIES AND ASSESSMENT OF HOW THE MEMBER STATES MAKE USE OF THE MONEY PAID BY THE TOBACCO INDUSTRY TO FIGHT THE ILLICIT TRADE

#### KEY FINDINGS

- During the period 1996-2012, cigarette seizures in EU were highest in 1999-2000 (around 6 billion a year), when the international tobacco companies were accused of being involved in the smuggling operations, and among the lowest in 2003, when the lawsuit against these companies had already been filed, but the EU had not yet signed any agreement with the tobacco companies.
- Investigations and lawsuits by the authorities have resulted in a review of the export practices of the international tobacco companies in Europe, but it remains unclear whether the agreements with the tobacco industry in 2004-2010 have contributed to the reduction of the smuggling activities.
- The high share of PMI contraband products on the EU market, the large prevalence of an Imperial Tobacco cigarette brand from Ukraine on the contraband market and recent investigations over Japan Tobacco's involvement in large-scale cigarette smuggling call into question the effectiveness of the agreements.
- The cigarette seizure payments might be an incentive for the tobacco companies not to be involved in the smuggling operations, but their possible effect should not be overestimated as very few seizures qualify for seizure payments.
- No seizure payments are made when the cigarettes are counterfeit, and customs officials often rely on the industry to determine whether cigarettes are counterfeit (not eligible for seizure-based payments) or genuine (eligible for the payments). The industry has an incentive to classify seized cigarettes as counterfeit.
- The amounts and the use of payments from the agreements with the tobacco industry are not transparent. Only a few EU Member States shared information about the payments from the cigarette manufacturers with us.
- Some of the EU Member States earmark the payments to fight cigarette smuggling, while others direct the money to the general budget.
- The recovered value of taxes and duties from seizure-based payments is minimal compared to what has been lost on the smuggled cigarettes from the large seizures (as low as 0.4% in the UK).
- The agreements with Philip Morris International and Japan Tobacco International were part of a settlement of legal claims concerning the involvement of these companies in cigarette smuggling. The payments from these agreements are, however, being presented to the public as the industry's philanthropy and corporate social responsibility rather than as settlement money.



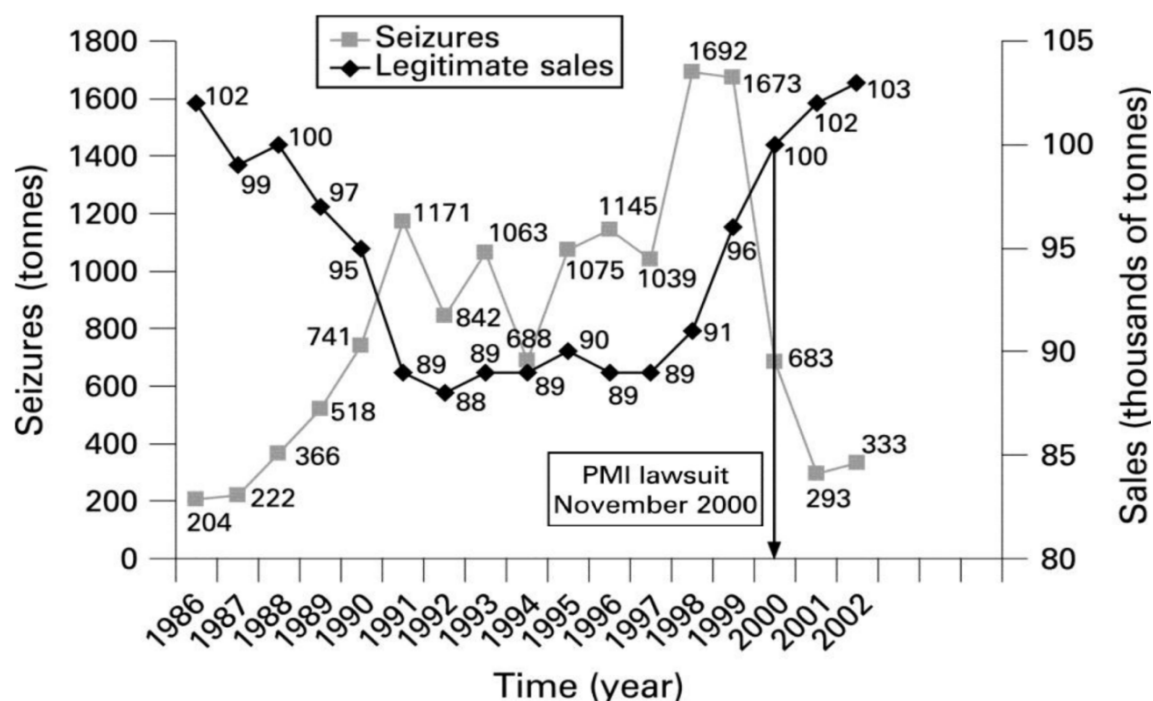
### 3.1. BACKGROUND

One of the key elements of the Commission policy to combat illicit cigarette trade is the collaboration and agreements with the four major international tobacco companies: Philip Morris International (PMI), Japan Tobacco International (JTI), British American Tobacco (BAT), and Imperial Tobacco Limited (ITL).

#### 3.1.1. Investigation and lawsuits regarding tobacco companies' involvement in illicit cigarette trade

Cigarette seizures in the EU peaked in 1999-2000 and reached 6 billion cigarettes a year. By 1998, European governments and OLAF officials believed that the major cigarette manufacturers were selling American cigarettes to traders who resold them into markets within the EU set up to evade taxes. This belief led to investigations. In November 2000 in New York, the EC filed a civil action against PMI, RJ Reynolds, and JTI accusing the companies of "an ongoing global scheme to smuggle cigarettes, launder the proceeds of narcotics trafficking, obstruct government oversight of the tobacco industry, fix prices, bribe foreign public officials, and conduct illegal trade with terrorist groups and state sponsors of terrorism".<sup>(78)</sup> In 2001, 10 EU countries joined the lawsuit.

**Figure 1. Cigarette seizures and legitimate sales in Italy 1986–2002.**



**Source:** figure is based on data from Guardia di Finanza annual reports, 1986 to 2003 and Italian Institute for Statistics

The investigations, which started in 1998 and the lawsuits, filed in 2000 against the tobacco companies, were effective. Cigarette smuggling in Spain and Italy decreased from around 15% of consumption in the 1990s to 1–2% of consumption in 2006. In both countries, cutting off supply from the major tobacco companies to the illicit market was a key factor in reducing smuggling. In this instance, investigating the role of the industry seems to have been an effective strategy to combat smuggling. The OLAF investigation of the tobacco companies in 1998 and the Spanish and Italian customs activities and ensuing lawsuit against the tobacco companies appear to have had a significant impact. Over the period covered by these actions, there was a dramatic fall in



the dubious US exports to Europe. A plausible interpretation of the data is that the industry changed its export practices promptly in response to the investigations. What the investigations and threat of legal action did was change the risk-benefit equation for the industry. The prospect of a lawsuit and possible financial penalties increased the risks of supplying cigarettes that were reaching the illicit market and reduced the benefits.<sup>(59)</sup>

### **3.1.2. Agreements with the four major tobacco companies**

In 2004, the EU and Member States dropped the case against Phillip Morris in return for an enforceable and legally binding agreement. Under the agreement, PMI agreed to pay the EC \$1 billion over 12 years. The key feature of this agreement is that PMI will be heavily penalized if it does not control smuggling of its cigarettes. PMI agreed to make payments in the event of any seizures of its genuine products above 50,000 cigarettes in the 10 EU countries that were party to the lawsuit. If more than 90 million genuine cigarettes are seized in those 10 EU countries during one year, PMI agreed to pay 5 times the amount of taxes due (recently increased to 450 million genuine cigarettes for the 27 EU countries). The agreement also required PMI to control future smuggling through a range of measures, which included controlling the distribution system and contractors supplied, and implementing tracking and tracing measures.

Similar agreements were concluded with JTI (which had by then acquired the international division of RJ Reynolds) in December 2007 (agreed payments: \$400 million over 15 years), with British American Tobacco (BAT) in July 2010 (agreed payments: \$200 million over 20 years) and with Imperial Tobacco Limited (ITL) in September 2010 (agreed payments: \$300 million over 20 years). The three agreements also include seizure payments, similar to those included in the PMI agreement (see above). While the first two agreements (PMI and JTI) were part of a settlement of all legal disputes between the companies and the EC in relation to smuggling, the two latter agreements (BAT and ITL) were not part of such settlement.

Neither the BAT Agreement nor the ITL Agreement signed in 2010 settled any existing legal claim; both established extensive systems of cooperation between the manufacturers and the relevant authorities of the EU and various Member States.

## **3.2. EFFECTS OF THE AGREEMENTS**

The Commission states that the measures implemented by the four big manufacturers under the cooperation agreements, such as tracking and tracing, due diligence and prevention of money laundering, are effective and have led to a significant reduction of these companies' products on the illicit market. According to the Commission, the share of the other brands seized compared to the main brands produced by the four big manufacturers is steadily increasing and reached 58% in 2011.<sup>(1)</sup>

We believe that the increase of seizures of other brands does not prove that the agreements are effective. In Canada during the period 1992-2008 <sup>(79)</sup> or Brazil during the period 1990-2008,<sup>(80)</sup> the share of the international seized cigarette has also diminished without tobacco industry agreements. Tax regulations, investigations and lawsuits by the authorities have resulted in a review of the export practices of the international tobacco companies in Europe and the USA, but it remains unclear whether the agreements with the industry have contributed to the reduction of smuggling activities.

The cigarette seizure payments might be an incentive for the tobacco companies not to be involved in the smuggling operations, but their possible effect should not be overestimated as very few seizures qualify for seizure payments. No seizure payments are made when the cigarettes are counterfeit, and customs officials often rely on the industry to determine whether cigarettes are counterfeit (not eligible for seizure-based payments) or genuine (eligible for the payments). The industry has an incentive to classify seized cigarettes as counterfeit. For example, one industry-commissioned study states that on the one hand 16% of illicit Philip Morris cigarettes consumed in the EU were counterfeit (page 53), but, on the other hand, 92% of illicit Philip Morris cigarettes seized in the EU were counterfeit in 2011 (page 56).<sup>(81)</sup> In both cases, it is mainly PMI who classifies the products as counterfeit or not. The reason why the industry-estimated prevalence of counterfeits among seized cigarettes is almost six times higher than among consumed cigarettes is unknown. Independent research should provide explanations for the high percentage of genuine PMI products among the cigarette packs collected in the EU.

**Table 4. Prevalence of counterfeits among seized cigarettes vs. consumed cigarettes in the EU**

Counterfeit share of PMI seizures in the EU		Counterfeit share of PMI contraband packs in the EU (Project Star empty pack surveys)	
Year	%	Year	%
2006	81%	2006	15%
2007	83%	2007	20%
2008	83%	2008	18%
2009	79%	2009	17%
2010	88%	2010	16%
2011	92%	2011	16%

**Source:** KPMG Project Star 2011 (81)

The high prevalence of illicit whites produced by the companies that are a party to the agreements is an indication that the seizure-based payments are not effective. Illicit whites are defined by the EU (1) and Europol (22) as cigarettes produced entirely independently of the traditional tobacco manufacturers. In Project Star, illicit whites are defined differently, without making reference to the independent production of the traditional tobacco manufacturers. Project Star classifies Classic, a cigarette brand produced by Imperial Tobacco (<https://www.tmdn.org/tmview/welcome>), as an illicit white. Classic was the third most seized cigarette brand in the EU (219.120.000 seized cigarettes) in 2008 (10) and was each year the most prominent “illicit white” in the Project Star empty pack surveys in the period 2007-2012. (11) During this period, the total consumption of contraband Classic was estimated at 17 billion cigarettes in the EU. (11) Imperial Tobacco’s production facility in Ukraine is one of the largest Imperial Tobacco manufacturing facilities in the world and produces both for the domestic and export market.<sup>(82)</sup> In 2012, Imperial Tobacco sold 2,311 million cigarettes of its brand Classic in Ukraine.<sup>(83)</sup> The company exports its cigarettes to rather dubious markets, such as Armenia, Azerbaijan, Georgia, Moldova, Lebanon, the UAE, the US and Uzbekistan.<sup>(82)</sup> Imperial Tobacco has signed a co-operation agreement with the EU to combat cigarette contraband in 2010, which includes seizure payments for its cigarette brands. Due to the secrecy around the agreements, we do not know whether Imperial Tobacco has paid seizure payments for the seized Classic cigarettes, but we do note that the Imperial Tobacco cooperation agreement has failed to address the problem of one of most prominent illicit cigarettes brands in the EU.

Finally, investigative journalists made detailed accusations in 2011 that Japan Tobacco International was involved in large-scale cigarette smuggling activities in the Middle East.<sup>(84)</sup> On the 5th December 2011, OLAF started an official investigation on this case, but two years later no further information is available.<sup>(85)</sup> It becomes more and more doubtful whether the agreements with the major tobacco companies are successful in the fight against cigarette smuggling.

### **3.2.1. The use of payments from tobacco industry**

In October and November 2013 we contacted the governments of 27 EU Member States to collect information about the execution of agreements with the four major tobacco companies. We requested information on:

- How much money in general did each Member State receive each year from 2004 to 2012 under the terms of the aforementioned agreements?
- Was the money from these agreements used to combat illicit cigarette trade? If yes, how much money from the aforementioned agreements was used to combat illicit cigarette trade each year?
- What portion of the funds from Point 1 came from the recovered value of taxes and duties in the event of seizures of over 50 000 smuggled cigarettes?

In most cases, we made this request under each country's Freedom of Information Act.

Publically available information on the agreements is scarce. We received some information from eight EU Member States: Belgium, Estonia, Finland, Germany, Poland, Slovakia, Slovenia, and the UK. The failure for countries' response might be associated with different laws regarding access to public information or the fact that some countries might not want to share this information. For example, when asked how much money did Spain receive from the agreements, the Spanish Ministry of Finance and Public Administration, a body responsible for the country's budget, responded that they are not the best agency to answer our question.<sup>(86)</sup> Detailed payment data provided by the Member States and by the European Commission is presented in the Annex.

Out of the countries that provided us with data on the use of payments from the tobacco industry, Estonia, Poland, and Slovakia earmark the payments to fight cigarette smuggling and counterfeiting, while Belgium, Finland, Germany, Slovenia and the UK direct the money to the general budget. The Czech Republic has a mixed system, where the base payments are used to fight illicit cigarette trade, while the supplemental, seizure-based payments are directed to the general budget.

Poland and the Czech Republic reported using these funds to purchase technical equipment for authorities involved in combating illicit cigarette trade, such as customs, police, and border guards.<sup>(87,88)</sup> Examples of such equipment are cars and communication equipment purchased in Poland in 2013.<sup>(89)</sup> In addition, Poland uses the money for investment purposes, such as building construction for the aforementioned involved in combating illicit cigarette trade,<sup>(88)</sup> and for modernizing border checkpoints.<sup>(90)</sup>

We cannot determine whether earmarking of the tobacco industry payments or directing them to the general budget is the best use of the money from the agreements. However, countries need to make sure that the payments from the tobacco industry are not crowding out

government investment in combating illicit cigarette trade. The UK, perhaps the most successful Member State in terms of curbing cigarette smuggling, directs far more money to tackling illicit trade in tobacco than it receives from the agreements with the tobacco industry. At the latest Spending Round, the UK government decided strengthen the HMRC and UK Border Agency (now Border Force) strategy called “Tackling Tobacco Smuggling: Building on our Success” with a 25 million British pounds,<sup>(91)</sup> a sum over 12 times higher than the country’s 2012/13 receipts from the agreements with the tobacco industry. Such large commitments allowed the country to decrease the illicit cigarette share in its cigarette market, which dropped from 21% in 2000/2001 to 9% in 2012/2013, according to the estimates by HM Revenue & Customs.<sup>(60)</sup>

### 3.2.2. Ineffectiveness of the seizure-based payments

The seizure-based payments are the main mechanism of the agreements to deter the tobacco industry from further involvement in illicit cigarette trade. Their intention is to punish the tobacco manufacturers each time there is a large seizure of cigarettes produced by these companies. Specifically, the agreements with each of the four tobacco companies allow EU Member States to recover taxes and duties lost in the event that a Member State seizes more than 50,000 smuggled genuine cigarettes produced by any of the four companies. These payments are supplemental to the fixed baseline payments that the companies are committed to pay. We analyzed how successful the EU countries were in recovering the lost tax revenue. This was only possible for countries that provided the data on both the seizures and the supplemental payments.

**Table 5 Tax revenue lost on smuggled cigarettes vs. the revenue recovered from the supplemental payments in the UK**

Year	2010/11	2011/12	2012/13	Total 2010-2013
Large cigarette seizures that qualified for the supplemental payments				
A. Number of seizures	7	5	5	17
B. Quantity of cigarettes seized	4,262,440	782,842	1,070,480	6,115,762
C. Seizure payments (£)	931,631	255,034	291,548	1,478,213
Total cigarette seizures of over 100,000				
D. Number of seizures	257	231	265	753
E. Quantity of cigarettes seized	579,387,990	473,522,534	460,635,259	1,513,545,783
F. Revenue lost (£)	142,049,944	123,084,157	122,952,763	388,086,864

**Sources:** HM Revenue & Customs (91)

**Note:** The data on seizures of over 50,000 but less than 100,000 cigarettes, which could also potentially qualify for the seizure-based payments, was not provided. We estimate total tax revenue lost on smuggled cigarettes seized in all seizures of over 100,000 cigarettes based on the average tax recovered per smuggled cigarette in the qualifying seizures ( $F=(C/B) \cdot E$ ).

The UK reported 753 cigarette seizures of over 100,000 cigarettes in the financial years 2010-2013. There were over 1.5 billion cigarettes seized during this time and we estimate the amount of taxes lost on these cigarettes at 388 million British pounds (459 million euros). However, the UK reported that there were only 17 cigarette seizures that qualified for the seizure-based payments in that period and less than 1.5 million pounds have been paid (see Table 5).<sup>(91)</sup> This

means that based on the agreements with tobacco companies the UK managed to recover less than 0.4% of what have been lost on the smuggled cigarettes from the large seizures.

In Poland, in addition to the information from the Ministry of Finance, we received detailed information on seizures of over 50 000 smuggled cigarettes from individual customs chambers. There are four customs chambers in Poland that mount guard over the eastern EU border, out of which three agreed to share their seizure data with us. There were 3,000 large cigarette seizures in these three chambers alone from 2008 to 2012 and a total of nearly 912 million cigarettes were seized in these seizures.<sup>(92-95)</sup> We estimate that the lost tax revenue on these smuggled cigarettes amounted to over 303 million Polish zloty (75 million euros) from 2008 to 2012. Our data does not include information on large seizures by other customs chambers and by other law enforcement authorities, such as the police and fiscal authorities. However, in 2008-2012 Poland managed to recover only 4.4 million Polish zloty based on the agreements with tobacco companies,<sup>(88)</sup> which represents a mere 1.5% of the 303 million lost on the smuggled cigarettes seized just in the 3 customs chambers (see Table 6).

**Table 6. Tax revenue lost on smuggled cigarettes vs. the revenue recovered from the supplemental payments in Poland**

Year	2008	2009	2010	2011	2012	Total 2008-2012
Supplemental payments received by Poland in 2008-2012 in PLN						
						4,400,000
Cigarette seizures of over 50,000 in three customs chambers: Biała Podlaska, Białystok, and Przemyśl						
Number of seizures	931	887	723	590	537	3,668
Number of cigarettes seized	209,468,571	203,079,140	157,864,724	157,730,770	183,809,609	911,952,814
Tax revenue lost in PLN	53,341,957	56,992,130	54,203,484	61,086,371	77,511,664	303,135,606

**Sources:** Customs Chambers in Poland,<sup>(90-93)</sup> Ministry of Finance in Poland,<sup>(86)</sup> European Commission <sup>(67)</sup>

**Note:** We estimate tax revenue lost based the European Commission data on cigarette taxes on the most popular price category (MPPC) cigarettes for 2008-2010 and on the weighted average price (WAP) of cigarettes for 2011-2012. In 2008 and 2009 the agreements with British American Tobacco and Imperial Tobacco were not in effect, so seized cigarettes manufactured by these two companies were not subject to supplemental payments for those years.

In the Czech Republic, there were 48 cases of cigarette seizures of over 50,000 cigarettes from 2008 to 2012. In these seizures a total of 30.5 million cigarettes were seized. We estimate that the lost tax revenue on these smuggled cigarettes amounted to at least 71.6 million Czech crowns (2.6 million euros). However, the country managed to recover the lost taxes and duties from only 8 out of these 48 cigarette seizures. A total of 11 million Czech crowns were paid in these supplemental payments – at most 15% of what has been lost on the seized smuggled cigarettes.<sup>(87)</sup>

In Estonia in 2009, the only year for which both the seizure data and the supplemental payments data were available, there were 27 cigarette seizures of over 100,000 cigarettes, in which almost 11 million cigarettes were seized.<sup>(96)</sup> Based on the European Commission data on cigarette taxes in Estonia,<sup>(67)</sup> we estimate that the tax revenue lost on these cigarettes amounted to 885

thousand euros. That year Estonia received 107 thousand euros in the seizure-based payments,(97) which was over 12% of what have been lost on the smuggled cigarettes from the large seizures, a ratio 30 times higher than in the UK in 2010-2013.

Even with the most liberal estimates of the levels of illicit whites and counterfeit cigarettes in the EU, the ratio of the seizure-based payments to the revenue lost on seized smuggled cigarettes should be much higher than the levels currently reported by the Member States (e.g. less than 1% in the UK). This low ratio proves that the way the agreements with tobacco industries were set up and/or executed allows the industry to keep costs low and prevents the States from getting the intended benefits, as envisioned by the agreements. Moreover, with low probability of contraband cigarettes being seized and a low prospect for seizure-based payments, it is unlikely that the supplemental payments will deter the tobacco industry from facilitating illicit cigarette trade.

### **3.3. PRESENTING THE AGREEMENTS AS CORPORATE SOCIAL RESPONSIBILITY**

The way the agreements are being presented to the general public may lead to confusion. Although the agreements with Philip Morris International and Japan Tobacco International were part of a settlement of legal claims concerning the involvement of these companies in cigarette smuggling,(73) this fact is often omitted from industry announcements, and the agreements are being misrepresented as the corporate social responsibility.

By signing the cooperation agreements with the EC and the participating Member States, these two tobacco companies sought for and obtained a dismissal of all pending legal claims. The preamble to the agreement with Philip Morris states that: “the Parties agree that it is in the public interest (...) to swiftly resolve (...)without any admission of liability, all matters between the Parties that relate to the alleged conduct, acts or omissions that were asserted or could have been asserted in the Litigation”.(98) The agreement with Japan Tobacco states that: “the EC and the Participating Member States hereby absolutely and unconditionally fully release and discharge JT Group Companies (...) from any and all EC Claims and all such claims are hereby waived.”(99)

The language of the JT press release concerning the agreements is, however, very different: “The JT Group cooperates with government authorities around the globe in its efforts to combat the illegal trade of cigarette products. (...) JT believes that today’s forward-looking agreement represents a significant milestone in the JT Group’s endeavours to tackle this societal issue while protecting the brand equity of the company’s products.”(100)

Following the tobacco industry statements, a distorted impression of the agreements is given in the press. For example in Poland, when reporting about the payments that Polish law enforcement authorities received from the tobacco companies based the agreements, one of the country’s most influential news magazines called these payments “sponsoring” and stated that the payments were made because the industry was “vividly interested in combating cigarette smuggling”.(90) In other case, when the agreed payments allowed the law enforcement authorities in Poland to purchase cars and other equipment to combat illicit cigarette trade, media called this purchase “assistance” from the tobacco industry to the Polish authorities.(89)

Even the Ministry of Finance in Poland in its official statement about the payments from the tobacco industry, explains that these payments were possible thanks to the agreements with the companies and states that “the aim of the agreements with tobacco companies is cooperation in combating illicit cigarette production and cigarette smuggling, including cigarette counterfeiting.” Moreover, even though the title of the agreement with Philip Morris is “Anti-Contraband and Anti-Counterfeit Agreement and General Release”, the Polish Ministry refers to this document as an “Agreement between the European Community, Member States, and Philip Morris International Inc. on combating cigarette contraband and counterfeiting”, which ignores the “general release” aspect of that document.(101)

The fact that the payments from Philip Morris International and Japan Tobacco International are being presented to the public as philanthropy rather than as settlement money paid by the industry charged with organizing cigarette smuggling is to the advantage of the industry. First, it helps the industry to unwind some of the effects of the industry’s poor reputation.(102) Second, it helps to build industry rhetoric around cigarette smuggling. Tobacco lobbyists use arguments about increasing illicit cigarette trade to oppose many pro-health regulations, such as cigarette tax increases. However, some evidence suggests that the industry claims about the scale of the illicit cigarette problem are exaggerated.(17,18) By presenting the agreed settlement payments as their commitment to combat illicit cigarette trade, tobacco companies shift perceptions of their credibility as a partner in the discussions around the public policy.

The industry’s transformation from the accused into the benefactor demonstrates the industry’s capability to control the narrative in public discussions around tobacco business and tobacco control.



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## ANNEX

Payment data provided by the Member States and the European Commission.

### EU

The plan for the distribution of the payments was agreed between the EU and the participating Member States. The payments are based on a formula which involves a number of factors, including the amount of taxes and duties on cigarettes in each of the Member States. The amount allocated to the EU (9.7%) corresponds to the EU's share of custom duties and VAT accruing to the EU budget as revenue.

The remaining 90.3% of the payments received from the tobacco manufacturers related to the annual installments consist of 3 shares: 10% equal sharing between the MS, 40% based on tax receipts on sales and 50% based on seizures.

The Commission has distributed the following amounts received under the cooperation agreements to the MS until 2014:

- 840,531,763.21 U.S. dollars from PMI (619 million euros in 2014 exchange rates)
- 195,669,829.27 U.S. dollars from JTI (144 million euros in 2014 exchange rates)
- 27,929,724.84 British pounds from ITL (34 million euros in 2014 exchange rates)
- 6,473,833.77 euros from BAT

**Source:** European Commission (103)

### Czech Republic

73 million Czech crowns received from the agreements from 2008 to 2012. Supplemental payments amounted to 11 million crowns that time.

### Estonia

Payments from the agreements with tobacco companies in EUR

Year	Base payments	Seizure-based payments	Grand Total
2008	293 280,23		293 280,23
2009	137 810,51	106 857,83	244 668,34
2010	157 782,52		157 782,52
2011	101 120,41	465 547,69	566 668,1
2012	212 144,25	218 273,55	430 417,8
2013	106 084,63	134 243,71	240 328,34
<b>Grand Total</b>	<b>1 008 222,55</b>	<b>924 922,78</b>	<b>1 933 145,33</b>

### Finland

Payments from the agreements with tobacco companies in EUR

2004/2005	2006	2007	2008	2009	2010	2011	2012
0	11 795 209	2 814 908	1 942 686	2 278 347	1 163 738	1 326 360	1 146 653



**Germany**

Payments from the agreements with tobacco companies in EUR

Year	Total payments	Base payments	Seizure-based payments
2004	- (first payment in 2006)	-	-
2005	- (first payment in 2006)	-	-
2006	80.311.881,96 €	80.311.881,96 €	-
2007	26.385.879,55 €	12.220.652,82 €	14.165.226,73 €
2008	10.827.818,91 €	9.991.119,56 €	836.699,35 €
2009	15.756.875,45 €	14.606.102,61 €	1.150.772,84 €
2010	12.407.551,22 €	11.352.416,57 €	1.055.134,65 €
2011	9.610.657,36 €	8.795.245,45 €	815.411,91 €
2012	14.288.208,03 €	13.145.880,34 €	1.142.327,69 €

**Poland**

46,646,244.96 Polish zloty received from the agreements from 2008 to 2012, out of which 9.48% were the supplemental, seizure-based payments.

**Slovenia**

Payments from the agreements amounted to around 2 million euros in the period from 2007 to 2013.

**The UK**

Payments from the agreements with tobacco companies in GBP

	2010/11	2011/12	2012/13	Total	% of all Payments
Base payments	1,983,321	1,720,033	1,703,365	5,406,721	79%
Seizure payments	931,631	255,034	291,548	1,478,215	21%
Total payments	2,914,953	1,975,069	1,994,915	6,884,937	100%



## EU Agreements with four cigarette manufacturers - main facts

Company	Philip Moris International (PMI)	Japan Tobacco International (JTI)	British American Tobacco (BAT)	Imperial Tobacco Limited (ITL)
Signed	2004	2007	2010	2010
Duration	12 years (2016)	15 years (2022)	20 years (2030)	20 years (2030)
Payments to be made	USD 1 billion over 12 years	USD 400 million over 15 years	USD 200 million over 20 years	USD 300 million over 20 years
Payments so far	Almost 100%	USD 280 million	USD 27 million	USD 50 million
Supplemental/additional payments	<p>1. In case of seizure of 50,000 or more genuine cigarettes, payment of 100% of the duties and taxes due</p> <p>2. If the number of seized cigarettes exceeds the <b>baseline amount</b>, supplemental payment rises to 500% of the evaded duties and taxes</p>			
Baseline amount	90 million (now 450 million)	90 million	150 million	90 million
Main elements	<p>(a) conduct rigorous checks on its customers and contractors ("EC Compliance Protocols");</p> <p>(b) accept only limited forms of payment for cigarettes in order to combat money laundering;</p> <p>(c) implement far-reaching product-tracking and product-tracing procedures so that information can be obtained about the chain of supply if cigarettes are subsequently found in illicit channels;</p> <p>(d) cooperate fully with law enforcement authorities; and</p> <p>(e) make substantial payments to the EU and the participating Member States.</p>			
Provision for the negotiation of a possible new Agreement	Yes	No	Yes	Yes

## ANNEX I: BIOGRAPHIES OF INVITED SPEAKERS

### First speaker: Prof. Anna B Gilmore

**UNITED KINGDOM - MBBS (hons) DTM&H MSc (dist) PhD FFPH**

#### Current position

Professor of Public Health, Department for Health, University of Bath (from 1/10/2010)

#### Other current relevant appointment

- Director Tobacco Control Research Group, University of Bath (from 2007)
- European Editor, Tobacco Control (previously Senior Editor) (from 2012)
- Member, Royal College of Physicians Tobacco Advisory Group (from 2006)
- Member, Council of ASH (from 2007)
- Member, Smokefree South West Steering Committee and Programme Board (from 2009)



#### Qualification

- PhD, London School of Hygiene & Tropical Medicine (LSHTM) (2006); Certificate of Completion of Specialist Training (CCST) in public health (2003); Membership of the Faculty of Public Health (1999); MSc Public Health with **distinction**, LSHTM (1997); MB BS (with **honours**), University of London 1991.

#### Distinction

- Fellowship of the Faculty of Public Health (FFPH) (2006)
- Public Health Advocacy Institute and Centre for Tobacco Control Research and Education, International Award for Outstanding Use of Tobacco Industry Documents (2009)
- WHO World No Tobacco Day Medal (in recognition of "outstanding efforts in [the] research of tobacco control and tobacco industry strategies in Europe") (2008)
- Health Foundation Clinician Scientist Fellowship (2006-2013)
- Member, International Agency for Research & Cancer international team of experts convened to write IARC Handbook "Effectiveness of Tax & Price Policies for Tobacco Control" (2011)
- Member, Expert Reference Group for WHO Europe World No Tobacco Day report (2010)
- Member, WHO Expert Committee to examine tobacco industry interference (2007-2009)

#### Current Research grants

1. Gilmore A (PI) et al. TobaccoTactics.org. ESRC Knowledge Exchange Grant, (£124,526), 2013-14.
2. Britton J, Gilmore A, et al. UK Centre for Tobacco and Alcohol Studies. MRC, (£3,523,631.20), September 2013 – 2018.
3. West R, McNeill A, Gilmore A. Price paid for cigarettes and tobacco and its association with smoking cessation. Cancer Research UK, (£48,000), 2012- 2015. (C1417/A15631).
4. Gilmore A (PI), Lubbers E, Monitoring tobacco industry activity to inform public health policy: developing a wiki as a new model of knowledge exchange. Cancer Research UK, (£99,549), 2013 – 2015 .
5. Gilmore A with Lewis S et al, University of Nottingham. The effectiveness and cost-effectiveness of mass media campaigns in reducing smoking and smoking-related disease in the UK. MRC NPRI, (£143,370), 2012 –2014.
6. Gilmore A (PI) with Collin J, Fooks G. Tobacco companies, global governance and public health. National Cancer Institute, US NIH, (1,341, 828 USD), 2011- 2014.

#### Most recent Peer Reviewed Papers

Fooks GJ, Gilmore AB (2013) Corporate Philanthropy, Political Influence, and Health Policy. PLoS ONE 8(11): e80864. doi:10.1371/journal.pone.0080864.

Gilmore A, Rowell A, Gallus S, Lugo A, Joossens L, Sims M. Towards a greater understanding of the illicit tobacco trade in Europe: A review of the PMI funded "Project Star" report. Tobacco Control Published Online First, 12 December 2013, doi:10.1136/tobaccocontrol-2013-051240.

Peeters S, Gilmore A. Transnational tobacco company interests in smokeless tobacco in Europe: analysis of internal industry documents and contemporary industry materials. PLoS Med 2013;10(9): e1001506. doi:10.1371/journal.pmed.1001506.

Fooks G, Gilmore A. International trade law, plain packaging and tobacco industry political activity: the Trans-Pacific Partnership. Tob Control Published Online First: 20 June 2013 doi:10.1136/tobaccocontrol-2012-050869.

Gilmore A, Reed H. The truth cigarette price increases in the UK. Tob Control Published Online First: 12 August 2013, doi: 10.1136/tobaccocontrol-2013-051048

Sims M, Maxwell R, Gilmore A. Short-term impact of the smokefree legislation in England on emergency hospital admissions for asthma among adults: a population-based study. Thorax thoraxjnl-2012-202841 Published Online First: 15 April 2013 doi:10.1136/thoraxjnl-2012-202841.

Gilmore A, Tavakoly B, Taylor G, Reed H. Understanding tobacco industry pricing strategy and whether it undermines tobacco tax policy: the example of the British cigarette market. Addiction 2013;108(7):1317-26. doi: 10.1111/add.12159. Epub 2013 Apr 16.

Joossens L, Gilmore A. The transnational tobacco companies' strategy to promote Codentify, their inadequate tracking and tracing standard. Tob Control Published Online First: 12 March 2013. doi:10.1136/tobaccocontrol-2012-050796.

Branston R. Gilmore A. The case for OFSMOKE: the potential for price cap regulation of tobacco to raise £500M per year in the UK. Tob Control Published Online First: 14 January 2013. doi:10.1136/tobaccocontrol-2011-050385.

Joossens L, Gilmore A et al. Illicit cigarettes and hand-rolled tobacco in 18 countries: a cross-sectional survey. Tob Control. Published Online First: 10 December 2012. doi:10.1136/tobaccocontrol-2012-050644

Roberts B, Gilmore A, Stickley A, Kizilova K, Prohoda V, Rotman D, Haerpfer C, McKee M. Prevalence and psychosocial determinants of nicotine dependency in nine countries of the former Soviet Union. Nicotine & Tobacco Research 2013; 15(1):271-6.

## Second speaker: Aamir Latif

### PAKISTAN

#### Current position

He is a Member of Washington-based International Consortium of Investigative Journalists (ICIJ), and he has worked for its various projects, including "Tobacco Underground".

Recently he joined Turkish State News Agency Anadolu as its Pakistan correspondent.

He joined Pakistan's Wire Service Pakistan Press International (PPI) in February 1997 and worked as its Karachi Bureau Chief till January 2000.

He worked as correspondent for the US News and World Report, the Washington Times, and Doha-based Islamonline.net from 2001 to 2009.

He worked as a stringer for Christian Science Monitor and Global Post in Pakistan and Afghanistan from 2010 to 2012.

He was recipient of a Freedom Forum Scholarship that took him to the George Washington University in 2000, where he received a diploma in Media and Public Affairs.

#### Education

Diploma in Media and Public Affairs from the George Washington University, Washington D.C in 2000. Major subjects were advance reporting, and comparative studies of communication systems.

Master's in Mass Communication from Karachi University in 1996 with major subjects advance reporting, research methods, and English

B.A (Hons) in Mass Communication in 1995 from Karachi University

#### Other achievements

Obtained Freedom Forum Scholarship in 2000, and studied at the George Washington University, frequently appear at Al-Jazeera English, CBS radio and other national and international TV channels as an analyst on political and counter-terrorism affairs, have covered various events of international importance abroad.

Have traveled to several countries of four continents i.e. Asia, Europe, Africa and Northern America in regard with journalism related activities.

#### ICIJ Projects

- Tobacco Underground

#### Publications/Articles

Aamir Latif and Marina Walker Guevara April 8, 2013, 8:00 pm. Son of Leading Pakistani Politician Tied To Secret Caribbean Company. Secrecy for Sale: Inside the Global Offshore Money Maze, <http://www.icij.org/offshore/son-leading-pakistani-politician-tied-secret-caribbean-company>

Kate Willson with contribution by Alain Lallemand and Aamir Latif, June 29, 2009, 10:30 am. Terrorism and tobacco. Tobacco Underground, <http://www.icij.org/project/tobacco-underground/terrorism-and-tobacco>

Aamir Latif and Kate Willson June 29, 2009, 10:15 am. The Taliban and tobacco. Tobacco Underground, <http://www.icij.org/project/tobacco-underground/taliban-and-tobacco>



### **Third speaker: Howard Pugh**

**THE NETHERLANDS**

#### **Current position**

Senior Specialist, Operations Department, EUROPOL

Smoke Team

Economic Crime Group

Serious and Organised Crime Business Area



18 years of law enforcement experience, working in the criminal investigation and intelligence environments. This has included periods in international liaison, customs investigations, anti-fraud and anti-corruption roles.

He has been a Senior Specialist at Europol since 2009. Currently leading and managing a criminal intelligence analysis team providing operational support to law enforcement agencies, combating organised crime groups engaged in the illicit tobacco trade and other excise frauds. Since 2012, he has been the Deputy Head of Unit of Europol's Economic Crime Group, which includes five specialist teams dealing with various financial and customs related crime areas.

In addition to this role, he leads for Europol on two EMPACT (European Multidisciplinary Platform Against Crime Threats) Projects, including smuggling in containers (2011-2013) and excise fraud (2014-2017). He coordinates and supports numerous Member State projects which translate EU law enforcement policy in these priority crime areas, into workable operational actions to target organised crime groups.

Prior to joining Europol he was a criminal investigator for Her Majesty's Revenue and Customs (HMRC). He worked on an operational target team, investigating and managing cases from referral to prosecution in various crime areas. These included tobacco, alcohol and oils frauds, drug and weapons smuggling, money laundering, VAT and MTIC (Missing Trader Intra Community) fraud.

From 2006 to 2009, he was the HMRC Europol Liaison Officer based in the UK Liaison Bureau at Europol. He had the privilege of representing HMRC and UK law enforcement on a pan European level, by providing effective liaison with the other 71 agencies, from 38 different countries which are represented at Europol.

## **Fourth speaker: Leszek Bartłomiejczyk**

### **POLAND**

#### **Current position**

Currently, in the team of Prof. Wiesław Czyżowicz, conducting research in areas of effective managerial solutions to combat illicit trade in excise goods in the light of EU and UN regulations with using of technical solution like identification and tracking and tracing.

Director, Business Development North East Europe, Russia, Central Asia at SICPA Security Solutions Poland

Expert with more than 30 year experience in the Public Sector.

In the beginning of 90's member of Science and Technology Development Committee of Polish Government. For years researcher and head of departments at the Military Institute of Informatics and

Computing Center of General Staff of the Armed Forces where contributed to national security and border protection. Since 1998, regional (Central and Eastern Europe, Middle East, Africa) and national levels director and managing partner for public sector in leading information technology corporations (1998-2000 Unisys, IBM 2000-08, SAP 2008-10).

Co-author and responsible for **the** implementation of several nation-wide projects for the public sector, including for defense and enforcement agencies, Ministries of Finance, Customs or Border Guard in Poland and in Central and Eastern Europe, Middle East and Africa . Specialized in ICT solutions to secure and improve processes and logistics.

Currently in SICPA that is the leading global provider of high- technology security ink that protect majority of world's banknotes, identification documents as well as many others valuable documents and products from counterfeiting and fraud. SICPA Security Solutions is provider of new security standard that integrates ink-based covert features and sophisticated track and trace technology for product authentication and excise tax enhancement. Responsible for providing governments in North, Eastern & Central Europe, Russia and Central Asia with anti-counterfeiting and anti-fraud solutions to secure excise tax revenue, protect public health and safety.

Graduated from the Cybernetics Faculty of Military University of Technology, completed Post-Graduated Study of Telecommunication, IT and Management CITCOM-PW at Warsaw University of Technology and got MBA from common program of School Business of WUT, London Business School, HEC Management School Paris, Norwegian School of Economics & Administration. Completed Doctoral Study (Economy/Management) at Warsaw School of Economics SGH.



## **Fifth speakers: Luk Joossens**

### **BELGIUM**

#### **Current position**

Advocacy Officer, Association of European Cancer Leagues (ECL), Tobacco Control Expert, Belgian Foundation against Cancer, International expert on illicit tobacco trade.

#### **Education**

Licence in Sociology (K.U. Leuven), Maîtrise en Sociologie (Sorbonne, Paris).

#### **General tobacco control policy**

He is the author of more than 400 articles, reports and presentations on the different aspects of the smoking prevention policy, such as smoking prevalence studies, smoking cessation, passive smoking, advertising, labelling, taxes, smuggling, tobacco industry tactics, EU policy.

#### **Illicit tobacco trade**

Since 1994, Luk Joossens has published, together with Martin Raw, several scientific articles on cigarette smuggling and advised the World Bank, The European Commission, the World Health Organization (Geneva Headquarters, the Regional Office for Europe, the Regional Office for the Eastern Mediterranean and the Regional Office for the Western Pacific), the US Surgeon General, the Finnish government, the Belgian government, the UK Presidency, the International Union against Cancer, the Association of European Cancer Leagues, the Framework Convention Alliance, the Bloomberg Initiative to Reduce Tobacco Use and many national organisations about smuggling. He was of one the rapporteurs of the WHO expert group on illicit tobacco trade in 2007, which prepared a template for a protocol on illicit trade which is the basis for discussion of the negotiations on the protocol on illicit tobacco trade in 2008. He attended all five INBs which negotiated the Illicit trade protocol. He was the lead author of the background paper on cigarette smuggling of the 2000 World Bank Report "Curbing the Epidemic". He wrote a report on tracking and tracing systems which was funded by the European Commission Seventh Framework Programme Grant Agreement HEALTH-F2 in 2011. He has given more than 100 presentations on cigarette smuggling in 50 countries.

#### **Awards**

In 1991, he received the World Health Organization Commemorative Award and Medal for promoting the concept of tobacco-free societies. In July 2006, he received the Luther Terry Award for Outstanding Individual Leadership in tobacco control..





## Fifth speakers: Hana Ross, PhD

USA

### Current position

Managing Director, Economic and Health Policy Research Program, American Cancer Society



Hana Ross earned her B.A. and M.A. at the **Prague School of Economics**. In 2000, she received her Ph.D. in Economics from the **University of Illinois at Chicago**. She has over fifteen years' experience in conducting research on the economics of tobacco control and in management of research projects in low and middle income countries, including projects funded by the World Bank, WHO, the Rockefeller Foundation, the Open Society Institute, the Robert Wood Johnson Foundation, the European Commission, the Bloomberg Global Initiative, and the Bill & Melinda Gates Foundation. Dr. Ross joined the American Cancer Society's Intramural Research Department in 2006 and currently serves as a managing director of the Economic and Health Policy Research Program. She published more than 60 articles and independent reports on issues related to tobacco taxation, cigarette prices, costs of smoking, illicit trade, youth access laws and other economic aspects of tobacco control. She also co-authored the 3rd and 4th editions of Tobacco Atlas. Her current research projects focus on the economic impact of tobacco control interventions in Africa, South East Asia, and in the European Union. She is also interested in the economic impact of smokeless tobacco use, in behavioral economics, and in the overall economic impact of noncommunicable diseases. Dr. Ross currently supports several research capacity building projects primarily focusing on Africa and Latin America.

Email: [hana.ross@cancer.org](mailto:hana.ross@cancer.org)

### Selected Publications

- Stoklosa M, Ross H. Contrasting Academic and Tobacco Industry Estimates of Illicit Cigarette Trade: Evidence from Warsaw, Poland. Tobacco Control. August 13, 2013.
- Blecher E, Ross H, Stoklosa M. Lessons learned from cigarette tax harmonization in the European Union. Tobacco Control. February 13, 2013.
- Ross H, Stoklosa M. Development Assistance for Global Tobacco Control. Tobacco Control. 2012.
- Ross H, Joossens L, Chaloupka F. Tax Avoidance and Tax Evasion. In Effectiveness of Tax and Price Policies for Tobacco Control. Volume 14, IARC Handbooks, 2011.
- Ross H, Stoklosa M, Krasovsky K. Economic and Public Health Impact of 2007 - 2010 Tobacco Tax Increases in Ukraine. Tobacco Control. June 14, 2011, 10.1136/tc.2010.040071
- Ross H, Blecher E, Yan L, Cummings KM. "Predictors of what smokers say they will do in response to future price increases. Findings from the International Tobacco Control (ITC) Four Country Study ". Nicotine & Tobacco Research. 2011; doi: 10.1093/ntr/ntr015
- Ross H, Blecher E, Yan L, Hyland A. "Do cigarette prices motivate smokers to quit? New evidence from the ITC survey." Addiction. 2011 Mar;106(3):609-19.



## **Fifth speakers: Michal Stokłosa, MA**

**USA (POLAND)**

### **Current position**

Economist,  
Economic and Health Policy Research Program,  
American Cancer Society.



Michal Stokłosa received his MA in Managerial Economics at University of Warsaw in 2009 and MA in Economics at Georgia State University in 2013. He also earned a Certificate in Global Tobacco Control at the Bloomberg School of Public Health, Johns Hopkins University in 2009. He advanced his skills and expertise working on projects in Central and Eastern Europe and currently serves as an economist within the Economic and Health Policy Research program at the American Cancer Society.

Mr. Stokłosa's research focuses on the economics of tobacco control and covers analysis of tobacco market, tobacco taxation policies, and illicit trade in tobacco products. Mr. Stokłosa served in advisory roles in areas of smoke-free policies, pictorial health warnings, and tobacco industry surveillance. He is also interested in tobacco companies' marketing techniques, particularly in pricing strategies. He has also deep understanding of the European Union's regulations on tobacco control.

### **Selected Publications**

- Stokłosa M, Ross H. Contrasting Academic and Tobacco Industry Estimates of Illicit Cigarette Trade: Evidence from Warsaw, Poland. Tobacco Control. August 13, 2013, 10.1136/tobaccocontrol-2013-051099
- Ross H, Kostova D, Stokłosa M, and Leon M. The Impact of Cigarette Excise Taxes on Smoking Cessation Rates From 1994 to 2010 in Poland, Russia, and Ukraine. Nicotine & Tobacco Research, January 1, 2014, 10.1093/ntr/ntt024.
- Blecher E, Ross H, Stokłosa M. Lessons learned from cigarette tax harmonization in the European Union. Tobacco Control. February 13, 2013.
- Ross H, Stokłosa M, Krasovsky K. Economic and Public Health Impact of 2007 - 2010 Tobacco Tax Increases in Ukraine. Tobacco Control. June 14, 2011.

### **Selected Projects**

- 2010 – present: MANKO Association, Krakow, Poland  
Expert within advocacy project funded by Bloomberg Philanthropies
- 2010 – 2012: Smokefree Partnership, Brussels, Belgium  
Expert within European Commission project: TobTaxy Making Tobacco Tax Trendy
- 2009 – 2010: Health Promotion Foundation, Warsaw, Poland  
Technical Advisor within European Commission project: HEM "Closing the health gap in European Union"



## ANNEX II: PRESENTATIONS

### PRESENTATION BY ANNA GILMORE

# ***Cigarette smuggling: current issues & data concerns***

**European Parliament 22 January 2014**

Anna Gilmore, Professor of Public Health  
University of Bath and  
UK Centre for Tobacco and Alcohol Studies



## **Outline**

1. Accumulating evidence of ongoing tobacco industry (TI) involvement in illicit trade & in oversupply of their products (which leak into the illicit market)
2. Concerns with tobacco industry data on the illicit trade including:
  - Methodology - empty pack surveys
  - Accuracy of industry data
3. Consequent lack of reliable data on illicit

## The TI & the illicit cigarette trade

- Historically, overwhelming evidence of tobacco industry involvement in illicit trade on a global basis.
- Then from early 2000s: shift from genuine tobacco industry product to counterfeit product (China) and illicit whites (eg Jin Ling, Kaliningrad)
- But there is growing evidence that this shift is overplayed:
  - Genuine TI brands are still present in the illicit market
  - Evidence of recent TI involvement in illicit trade
  - Evidence that TI failing to control its supply chain
  - Seizure data overestimate counterfeit versus genuine product

Sources:

Pre 2000: Source - Numerous including: LeGresley et al Tob Control, 2008; 17: 389-46; Nakkash, LeG Tobacco Control, 2008; 17: 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. 2001. ICU various – eg see [http://www.icu.org.uk/press.htm](#); [http://www.icu.org.uk/press.htm](#); Gilmore McKee. Tobacco Control 2004;13:143-50; Collin et al. Tobacco Control 2004; 13 (supplII):i96-111  
Post 2000: European Commission. Action plan to fight against smuggling of cigarettes and alcohol along the EU Eastern border, COM(2011) 376 final, 24 June 2011, KPMG, Project Star Reports. Joossens, Raw, Tobacco Control 2011; 21:230-34; Joossens et al. The impact of eliminating the global illicit cigarette trade, Addiction 2010

Evidence that JTI still involved in smuggling: Organised Crime and Corruption Reporting Project <http://www.reportingproject.net>

[OCCRP Home](#) [Big Trouble at Big Tobacco](#) [Update](#) [Opinion](#) [Story Documents](#) [Additional Documents](#)

## Big Trouble at Big Tobacco

Tales of Smugglers, Mobsters, and Hackers

By OCCRP<sup>1</sup>

Reports piled up from Japan Tobacco International (JTI) investigators around the globe. Mobsters were doing business with the firm's Russian distributorship while shipping tons of illegal cigarettes into Europe. Workers felt endangered. Accused smugglers and criminals ran some of its Middle East partnerships.

And when investigators received information that 13 JTI employees or distributors may have been working directly with smugglers, a senior executive at JTI blocked an investigation, according to company e-mails and internal memos.

III had some problems:

The company's investigative team—experienced hands culled from the CIA, British police, U.S. Special Forces and elsewhere—chronicled and fought those problems for years. They went undercover, shut down smuggling routes and worked with European police to intercept shipments worth millions of Euro. The deeper they dug, the more evidence they say they uncovered against JTI's employees and its distributors.

And that, according to thousands of pages of company records, e-mails and secret recordings obtained by the Organized Crime and Corruption Reporting Project (OCCRP), along with interviews of a half-dozen past employees, created another problem for the world's third largest tobacco company.

The investigators had become too successful, they say.

JTI's own investigators say JTI and its parent Japan Tobacco did almost nothing when faced with reports their distributors smuggled tobacco through Russia, Moldova, the Balkans, Afghanistan and the Middle East. The apparently rampant smuggling occurred despite a 2007 agreement with the European Union mandating that JTI proactively investigate all claims of smuggling. The agreement prompted a public pledge by the company to adopt a zero-tolerance policy on illicit shipments. Those investigators say they were fired by management for doing their job.

This year, as Syrian president Bashar Al-Assad killed his own people and faced worldwide sanctions, JTI's Middle East business partner IBCS poured cigarettes into duty free shops, according to invoices obtained by OCCRP.



## JTI Smuggling

- “rampant smuggling”
- Investigators working within JTI say JTI “did almost nothing” about this
- Senior JTI executives blocked investigations into smuggling
- The investigators’ computers were hacked by a company paid by JTI
- The investigators were later fired.

[Source: <http://www.smugglinginvestigator.net/jti/>]

- OLAF continue to investigate JTI sales to Syria in May 2011  
(<http://online.wsj.com/news/articles/SB10000872396390444233104577595221203321922>)

## Other evidence of smuggling

- **Bulgaria:** sources point to the tobacco industry’s continued complicity in cigarette smuggling to and through Bulgaria between 2000 and 2010.

[Skafida et al. Tobacco Control 2012]

- **Imperial Tobacco’s Classic brand:** produced in Ukraine yet misleadingly classed as “illicit white”. One of the most smuggled brands in Europe (PS: over 7% illicit market in 2009)



## Overproduction

- **Ukraine:** In 2008 Philip Morris, JTI, Imperial and BAT produced and imported 30 billion cigarettes in Ukraine beyond what the country can consume, fuelling a \$2 billion black market that reaches across the EU. [10]

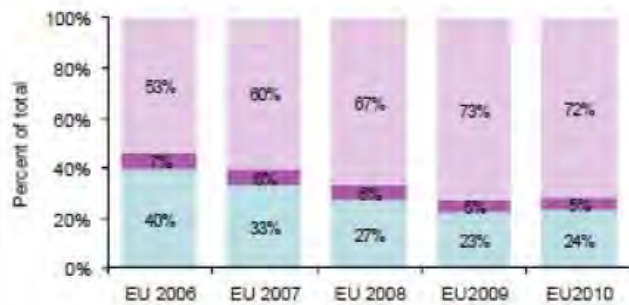
## PMI's Project Star Report

- Suggests Philip Morris International (PMI) has inadequate controls on its supply chain:
  - PMI cannot provide shipment (sales) data for the Greek islands
  - The model estimates that ¼ of illicit cigarette market in 2010 comprised PMI own brands compared to just 5% PMI counterfeit & 10% leading cheap whites

(Source: PMI Project Star Report; Gilmore et al. Towards a greater understanding of the illicit tobacco trade in Europe. Tobacco Control 2013)

## PMI's Project Star Report: 2010 Results (% EU illicit cigarette volumes)

C&C cigarette volumes by category  
2006-2010<sup>(1)</sup>



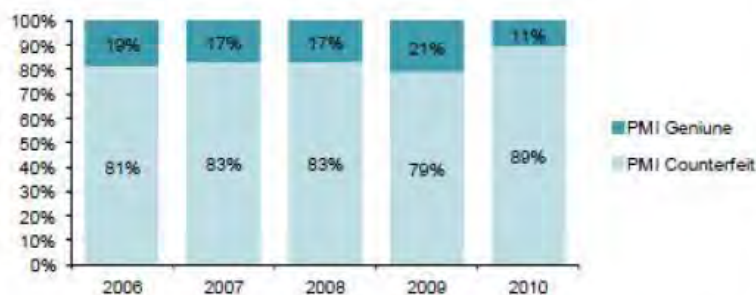
CAGR (%)	
Non-PMI C&C	
PMI counterfeit	
PMI contraband	
Total C&C	

In 2010, approx 1/4 of all EU illicit product was genuine PMI brands. 5 x more genuine than counterfeit PMI product

Source: Project Start 2010 results

## Yet seizure data give the opposite picture: seizure data are increasingly unrepresentative

Counterfeit share of cigarette seizures  
(all EU PMI seizures), 2006-2010<sup>(1)(a)(b)</sup>



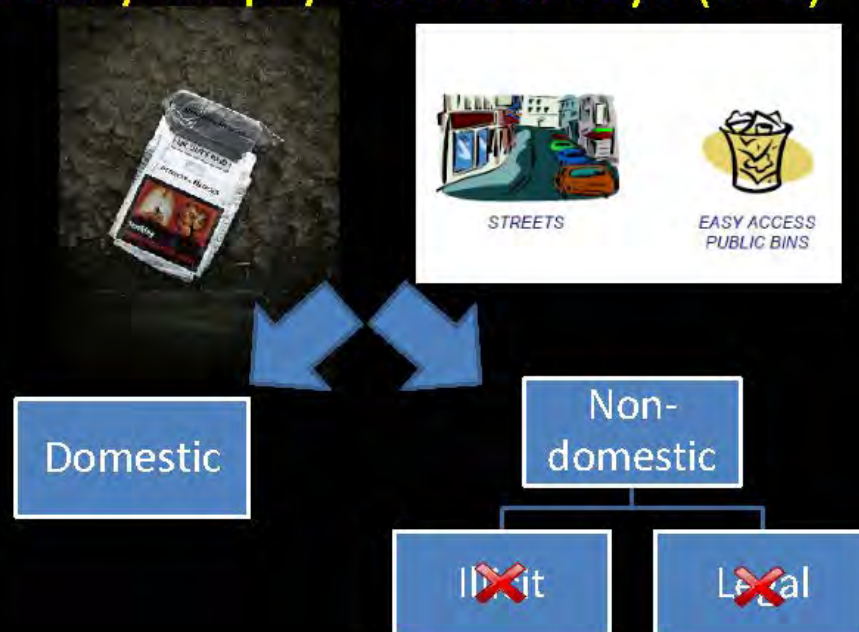
**Seizure data is weighted towards counterfeit product**

Source: Project Start 2010 results



## Examining industry data

### Industry Empty Pack Surveys (EPS)



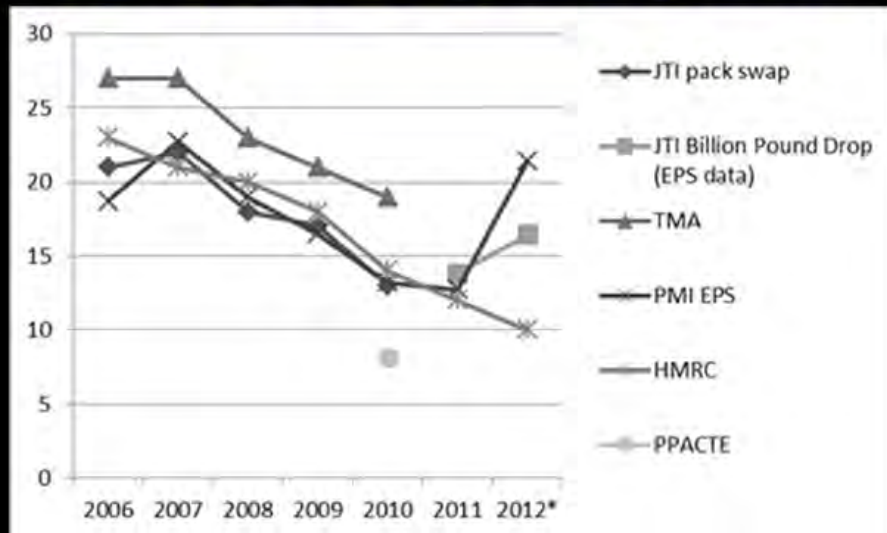
## Industry EPS

- Do NOT measure illicit
- But can provide an accurate measure of non-domestic product (tax avoidance) *if* properly conducted (Merriman 2010)
- Yet:
  - no methodological detail in most TI reports;
  - no methodological detail in press reports (eg Rowell et al in press);
  - when asked, TI has refused to provide info on methodology (eg Stoklosa 2013);
  - insufficient details in PS to determine whether methodology is adequate & reasons for concern (Gilmore et al 2013);

## Growing evidence that TI EPS designed to over-estimate non-domestic product & provide results convenient to the TI:

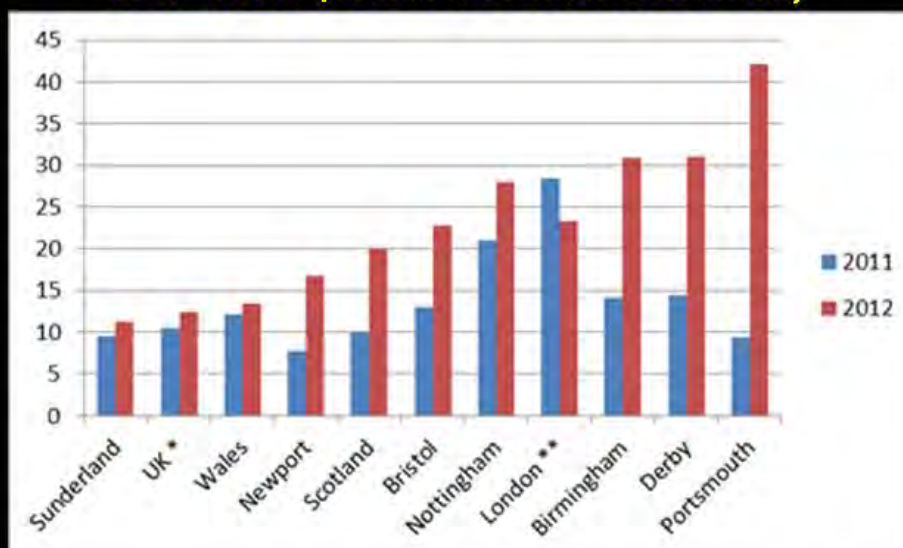
- UK TMA EPS undertaken at sports events (Merriman 2010, PS 2010);
- Poland: industry EPSs found illicit rates higher (Ciercierski 2007) & in once instance double those of independent estimates (Stoklosa 2013);
- Germany: found to systematically over-represent regions along the border and around US military bases (Adams, Effertz 2011);
- Sudden change in PS reporting between 2011 and 12 that artificially increased levels of illicit in UK in 2012 (Gilmore et al 2013).

## Published industry & independent data on UK non-domestic product



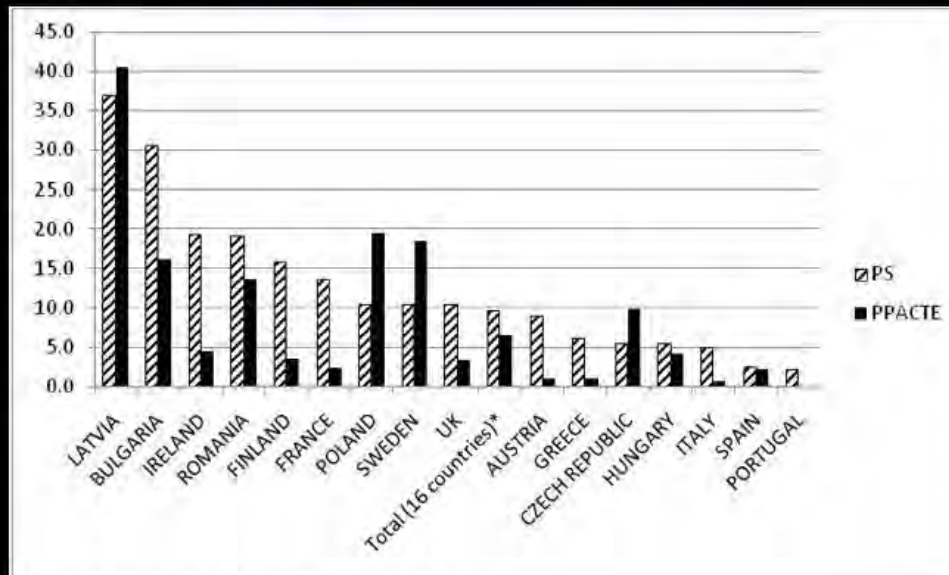
Source: Rowell, Evans-Reeves, Gilmore. Tobacco Control, in press

## Trends in “illicit” cigarettes in UK based on press articles citing industry data 2011 and 2012 (illicit as % of total consumed)



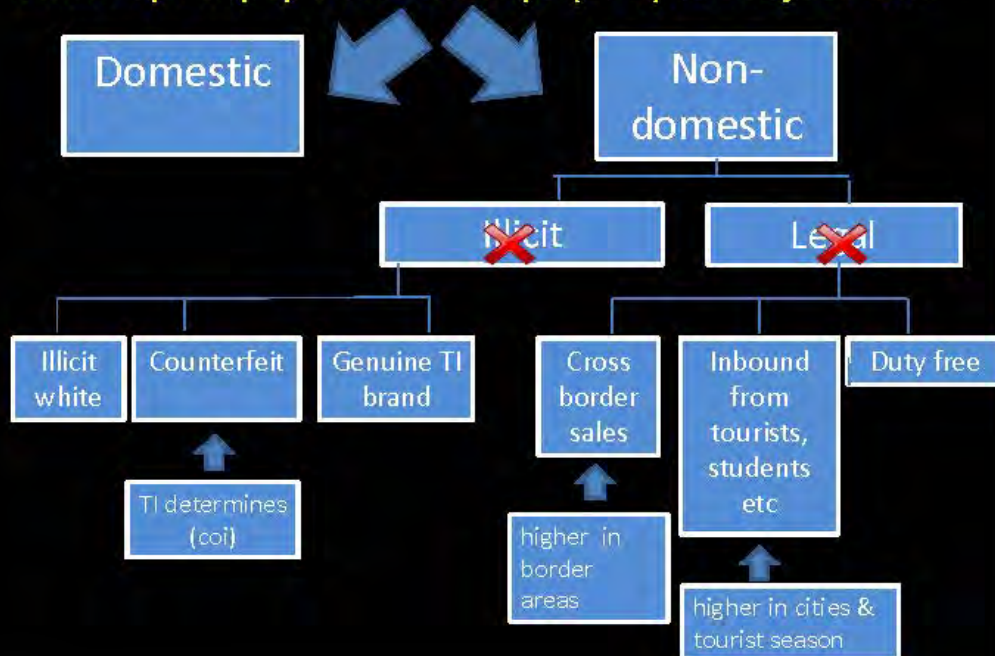
Source: Rowell, Evans-Reeves, Gilmore. Tobacco Control, in press

## Project Star & PPACTE data on illicit cigarette trade in Europe (% cigarettes identified as illicit).



Source: Gilmore et al. Tobacco Control 2013.

## Industry Empty Pack Surveys (EPS) & Project Star





## Conclusions

- Growing evidence of ongoing TI involvement in illicit trade including via oversupply of their products.
- Agreements do not appear to have deterred TI involvement in illicit.
- Industry data on illicit cannot be trusted:
  - EPS do not measure illicit
  - Growing evidence that industry using EPSs to support their lobbying position
  - Growing TI control over data on illicit & EU's apparent reliance on this data & lack of transparency is problematic.
- Seizure data also problematic - unrepresentative of the nature of the illicit market as a whole.

## Follow us...



[Tobacco Tactics Wiki](http://www.tobaccotactics.org)

[www.tobaccotactics.org](http://www.tobaccotactics.org)

Latest information on the tobacco industry, its allies  
and those promoting a pro-smoking agenda

[Tobacco Research Blog](http://blogs.bath.ac.uk/torg)

[blogs.bath.ac.uk/torg](http://blogs.bath.ac.uk/torg)

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## CONTRIBUTION BY AAMIR LATIF

As the traditional sources of income to finance the terrorist networks are being dried up due to strict government controls and sanctions, Pakistani militant groups have come up with a new way of generating finances to run their respective networks. This is tobacco smuggling, which, due to absence of proper legislation and laws, has become one of the major sources of income to run the Pakistan- and Afghanistan based militant groups.

These militant groups, which have been galvanized by Al Qaeda, but operating autonomously, do not have to do much. They simply have to provide protection to the scores of illegal and legal factories involved in producing counterfeit cigarettes of various local and international brands, and safe exit to the convoys, which smuggle these counterfeit cigarettes into different destinations.

Although, there is no recorded figures vis-à-vis total funding, the militant and criminal groups attain from tobacco/cigarette smuggling, a senior intelligence official believes that almost 15 to 20 per cent of the expenses of militant and Taliban groups are being borne out through tobacco smuggling.

Most of the illegal cigarette factories are located in those areas which are presently controlled by different militant groups.

Several small and big cigarette factories are operating in various parts of north western Khyber Pakhtunkhawa (KP) province previously known as north western frontier province (NWFP), and the restive northern tribal belt where pitched battles between security forces and pro-Taliban militants have so far claimed thousands of lives from both sides since April 2003. These factories produce thousands of counterfeit cigarettes every day as Pakistan is one of the countries where the consumption of cigarettes is increasing with every passing day.

These illegal factories have been operating in the areas of Swabi, Mardan, Noshehra, Charsadda, Kohat, Bannu, Boner, Malakund, and other adjoining areas of KP and tribal areas like Khyber agency, South Waziristan, and North Waziristan.

After poppy cultivation, tobacco smuggling has become the second major source of income for the militant groups, intelligence and security experts believe.

Taliban and other militant groups do not have to do much. They simply receive taxes on regular basis from the owners of illegal and legal cigarette factories, mostly located in several parts of KP and the tribal region, and later for the safe passage they (Taliban) provide to the convoys (smuggling).

Intelligence Source say that smugglers have to pay 10 to 20 per cent commissions on every consignment to the militant groups for protection and safe passage.

Security experts agree with the intelligence official.

Ikram Sehgal, a senior security expert thinks that the money through poppy taxation on tobacco smuggling shares around 20 per cent of the total militants' groups funding.

According to Mohammad Khosa, the head of the anti-counterfeit cell of the British American Tobacco (NAT) approximately 15 billion counterfeit sticks of different international brands are being produced annually through several illegal cigarettes factories operating in Pakistan.

Khosa says that the illegal factories have been producing 20 per cent of the total public demand for tobacco products in Pakistan.

The legitimate players have about 80% of the market and contribute nearly Rs: 40 billion to national exchequer annually. In Pakistan, illicit trade captures the rest of the 20% market. This sector has more than 55 players and more than 120 brands (including manufacturers in AJK), and contributes only Rs: 0.3 billion annually to the national exchequer.

Dr Arsalan Subuctagin, a former deputy director of Pakistan customs, and a specialist who deals with tobacco smuggling affairs thinks that the main reason behind increasing production of counterfeit cigarettes in Pakistan is, heavy taxation on the industry.

If one has to pay 87 per cent of his income to the government in the form of tax, and has to bear all the expenses, and earn profit within remaining 1 per cent, who will go for legal production?, Subuctagin said.

He too confirms that organized criminal groups have been using this business to fund themselves.

"This (business) is being mainly done in the tribal areas, which are the main routes of tobacco smuggling", he said.

Bara, a small town of Khyber agency, located merely 5 Kilometres off Peshawar, the capital of KP province, is the most famous area for production of counterfeit cigarettes. There are various stakeholders in this business

Dogra, a small village of Bara town, located 7 Kilometres off Peshawar, is known as the business headquarters of these stakeholders involved in cigarette smuggling, where two huge illegal cigarette factories, and several sprawling godowns produce and store a huge quantity of counterfeit cigarettes.

These factories are operating in the name of "One More Cigarette", which produce 555, Dunhill, Gold Leaf, Marlboro, Benson & Hedges, One More, Camel, and etc. brands.

These brands are smuggled to neighbouring Afghanistan and to the Central Asian States of Tajikistan, Uzbekistan, and Turkmenistan in the north, and to the local markets of Lahore, Karachi, and the southwestern coastal belt through trucks and containers.

The Kyber agency, which includes Bara, Landi Kotal, and Jamrud areas, are controlled by a Taliban group, led by Mangal Bagh, who meets his group's expenses through tax which he monthly receives from all the illegal and legal factories involved in different businesses.

There are six other small factories in Bara town of Khyber agency owned by different persons.

According to a senior local journalist who wished not to be named, the owners of these factories pay a sum of Rs 5 million per month (\$50,000) for his six factories to Mangal Bagh, a top militant commander in the area, who in return provides protection to his factories. This is kind of a so-called tax imposed by Mangal Bagh on the local businessmen. Mangal Bagh group comprises over 2000 trained militants.

Although, most of the militants have been ousted and pushed towards mountains by an army onslaught, however it does not hurt their "tax collection" from owners of these illegal factories.



Most of the international and local brands of cigarettes being sold in Afghanistan are made in Bara, Landi Kotal and other parts of Kyber agency, where tobacco related businesses are the major source of livelihood for the local people as the grinding poverty has forced many of the locals to work as labourer at such illegal factories.

Earlier, according to the local residents, the militant groups had fought bloody battles in 2007 over this "tax collection", and ultimately Mangal bagh group managed to establish its writ in the region.

These factory owners have strong contacts in Khost, Paktika, Paktia, Nooristan and other north-eastern provinces of Afghanistan.

Riaz Shanwari who once had acted as right-hand of a notorious drug and tobacco smugglers Haji Aub Afridi, is known as a middleman who broker deals between these factory owners and smugglers. Shanwari belongs to a powerful Afghan tribe Shanwar, which has strong roots in border areas of Pakistan and Afghanistan.

Shanwari has good connections with South African smugglers too, which is considered safe haven for Pakistani smugglers and criminals. Many smugglers have been killed on the streets of Cap town, Johannesburg and other cities of south Africa during last few years.

The illegal factories operating in southern KP districts Kohat and Bannu smuggle cigarettes to Khost, Paktika, and Paktia provinces of Afghanistan via Miramshah, the capital of North Waziristan. This area is totally in grip of Taliban who receive hefty amounts for providing safe passage to the convoys.

Smugglers have to pay 10 to 20 per cent commissions on every consignment to the militant groups for protection and safe passage.

Small units are also operating in South Waziristan area where usually local brands are prepared and smuggled to Afghanistan. This route is jointly controlled by pro-Al Qaeda Tehrik-e-Taliban Pakistan (TTP) and pro-Pakistan Taliban group of slain commander Mullah Nazir. The smugglers have to pay both separately.

Darra Adamkhel, located 35 Kilometers off Peshawar, which otherwise is well known for arms production, is also hub of production of counterfeit cigarettes. One of the most popular brand Red&White is made in Darra Adamkhel. Other brands made for Pakistan and Afghanistan are Press, Rangers, Panch Khuta (five lines), and Peela Hathi (yellow elephant) etc.

Benson and Hedges, and Marlboro are favorite brands of South African smugglers, customs sources say.

These factories produce 555 exclusively for China, which is very much in demand there. The smugglers' convoys use Silk route to smuggle 555 into China through Khunjarab border, which touches the Xinxiang province of China. Urumchi, an industrial town of China is the hub of smuggled cigarettes from Pakistan, from where they are smuggled into different parts of China.

"China is the biggest market of counterfeit cigarettes in the world. And of course smuggling of counterfeit cigarettes of all international brands from Pakistan's tribal region and the KP into China, has been continuing for last various years", Ikram Sehgal, the security expert said.

Sehgal thinks that tobacco smuggling is the easiest way of funding for militant groups, as it is not virtually considered as smuggling.

“Not only customs, or anti-narcotics force but the excise and taxation department too are not concerned about this growing phenomenon, which is not causing a huge loss to the national exchequer, but has also turned out to be a major source of income for terrorist groups”, he maintained.

Sehgal thinks that a loose control, and the connivance of border forces along Afghanistan, central Asian, and China borders, have increased the tobacco smuggling during last decade, subsequently raising the militants’ funding.

These factories procure relatively low-quality tobacco from the quota of two main cigarette companies i.e. Pakistan tobacco and Lakson tobacco and produce low quality tobacco brands, including one-touch, and Datchi (female camel), which is mainly smuggled into Afghanistan.

Sources say that these two brands are very popular in Afghanistan, and smuggled through different routes.

## PRESENTATION BY HOWARD PUGH



**EUROPOL**  
EUROPEAN LAW ENFORCEMENT AGENCY

**Howard Pugh**  
**Senior Specialist**  
**Smoke Team**

**Economic Crime Group (O23)**  
**Serious Organised Crime Business Area**  
**Europol**

**Workshop on Cigarette Smuggling 22/01/2014**

**Europol's Functions**

- EU law enforcement agency collating, analysing and disseminating criminal intelligence
- Facilitates information exchanges between law enforcement agencies
- Provides operational and strategic analysis to support intelligence building and investigations
- Provides expertise and technical support for investigations
- Remit includes serious international crime and terrorism, which affect 2 or more EU MSs



## Europol HQ, The Hague

**Analysts,  
Specialists and  
Liaison Officers**



**LB Network:**

- 145 ELOs
- 38 Countries
- 71 Agencies



## International Law Enforcement Cooperation



- 28 Member States LBs
- 10 Third Party LBs
- 12 Operational Agreements
- 20 Strategic Agreements

- Police
- Customs
- Gendarmerie
- Financial Police
- Tax and Revenue
- Border Guard
- Coast Guard
- Immigration
- Security Services

ALBANIA LB	AUSTRALIA LB  NCP	CANADA LB	COLOMBIA LB	MOLDOVA LB  NCP
ICELAND LB  NCP	NORWAY LB  NCP	SWITZERLAND LB  NCP	INTERPOL LB  NCP	U.S. AGENCIES LB



## Illicit Tobacco Trade Figures

- The illicit tobacco trade costs the EU collectively about €12.5 billion per year in lost revenue (2012 KPMG)
- Tobacco smuggling and illegal manufacturing and is a crime enabler. The huge illegal profits fund other areas of serious organised crime (Europol)
- Only about 2% of the 500 million container movements per year are inspected (UNODC)

5



## Focal Point Smoke

### Purpose:

- To support the MSs in **targeting organised crime groups** involved in the unlawful manufacturing and trafficking of tobacco products
- Potentially to soon include excise fraud (alcohol & oils)

### Aim:

- Effective targeting of OCGs through intelligence led policing
- Obtain a better understanding of the problems
- Pooling of information and intelligence
- Establish links to other investigations and crime areas
- Identify new investigations

6





## Proactive contributors to Smoke

### 26 EU Member States:

- Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Spain, Sweden and UK

### 6 Associates:

- Australia, Norway, Switzerland, US (ATF), Eurojust and Interpol (TIG)

### Interested in joining:

- OLAF and US (FDA)

7



## The Illicit Tobacco Trade

- Counterfeit cigarettes



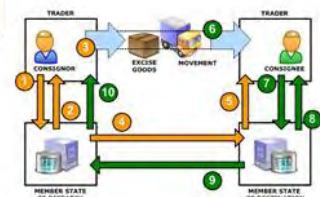
- Cheap whites cigarettes



- Illegal tobacco factories



- Excise Movement and Control System



## Op Tsar



- OCG smuggling cigarettes from UA to FR
- 7m seized plus links to 2 previous transportations
- 21-22/06/2011 2 action days and mobile office to OCU
- 150 customs, police and judicial officers across 6 MSs
- 5 arrests, 13 house searches and 2 extraditions
- Forensic analysis of technical devices by Europol
- EJ said FP Smoke provided "vital analytical support to the operation from an early stage"
- On 31/08/2013 11 suspects sentenced to 55 years
- Complete start to finish service: intelligence development, intervention coordination, prosecution assistance



## Other Areas of Work

### Mobile Office deployment

- Remote and secure access to Europol



### Universal Forensic Extraction Device

- Mobile phone analysis



### Open Source Research Project

- Multi languages identifying intelligence



### Europol Criminal Assets Bureau (ECAB)

- CARIN secretariat of financial investigators and prosecutors





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**Thank you for your attention.**

## PRESENTATION BY LESZEK BARTŁOMIEJCZYK

# TAX CHEATS?

**COMBATING ILLICIT TRADE: HOW THE LATEST TECHNOLOGY IN 'TRACK & TRACE' AND AUTHENTICATION CAN HELP WIN THE BATTLE**

**Prof. Wiesław Czyżowicz**  
Chairman of Consultative Board of Polish Customs Services  
Warsaw School of Economics,  
Wyższa Szkoła CIA i Logistyki, Warszawa

**Leszek Bartłomiejczyk**  
Director, SICPA Security Solutions Poland  
Warsaw School of Economics, PhD Student

## Illicit Trade of Tobacco at EU Eastern Border

Cigarette Smuggling Workshop      European Parliament      22 January 2014

### Agenda

- **Illicit trade phenomenon**
  - Complex nature of Illicit trade
  - Factors contributing to illicit trade
  - Characteristics of illicit trade at EU Eastern border
    - Routes of smuggling
    - Third country origins of illicit tobacco products
  - Trends in illicit trade:
    - Declines in seized cigarettes/growth of illicit tobacco
    - Increase of new form /channels of illicit trade
    - Optimisation of losses „less but more often”
  - Consequences of illicit trade
- **Ways to fight illicit trade:**
  - National and cross border Initiative
  - FCTC Illicit Trade Protocol
  - EU Tobacco Product Directive
  - Technical solutions: track & trace
    - Best practices and requirements to build effective Track & Trace solution
    - Example of practical results
- **Conclusions & recommendations**



## Illicit trade phenomenon

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### NATURE OF ILLICIT TRADE Complexity and adaptability

Illicit trade is **complex** in nature:  
Different modes **at the borders** and  
**within EU** <sup>10,11</sup>:

- **Smuggling** of genuine products
  - **False/Incorrect declaration**
  - **Counterfeit** products
  - **Illegal production** and distribution within EU
  - **Overproduction** exceeding local demand
- Illicit trade is influenced by<sup>10</sup>:
    - **Demand** and **supply** factors
    - **Lack of effectiveness of control measures**
  - Illicit trade has **global nature**
  - Various **schemes** are used **to evade taxes** <sup>11</sup>
  - Illicit Trade use not only illegal channels but also **supply chain consider safe.**

Due to complexity, **effective combating** of illicit trade requires comprehensive and global approach **at the border** and **within EU**, with **effective control measures**

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## MAIN FACTORS Contributing To Illicit Trade

### High Incentives and substantial loopholes

- **Price differences** (0,2€ Belarus, 2,5€ Eastern EU countries, above 8€ Western EU countries)
- **Complexity of rules** within EU including **definitions of excisable tobacco products, loopholes** between smuggling and rightful importation
- **Insufficient measure** to restrict **forestalling**: (creating large **overstock** released for consumption prior to tax increase that reduces Member States tax and revenue collection.)

### Supply chain control measure do not match the threat

- **Measure to control tobacco supply chain** by authorities or by economic operators are largely insufficient
- **No legal obligation** for producers to monitor their supply chain (**Tracking**)
- It makes even impossible for authorities to determine points of diversion into the illicit trade (**Tracing**)

### Challenges for enforcement authorities at EU Eastern border

- **Lack of real time trusted data** for risk management, control and investigation analysis
- **Problems with the data** provided by **economic operators** to analyse commercial supply chain movements
- Insufficient or **lack of** adequate control equipment like **X-Ray**,
- **Insufficient** or **lack of inland control unit** and **track and trace** systems
- **Corruption**
- **International cooperation** with neighbouring countries

Based on: COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT  
Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - A comprehensive EU Strategy, June 2013

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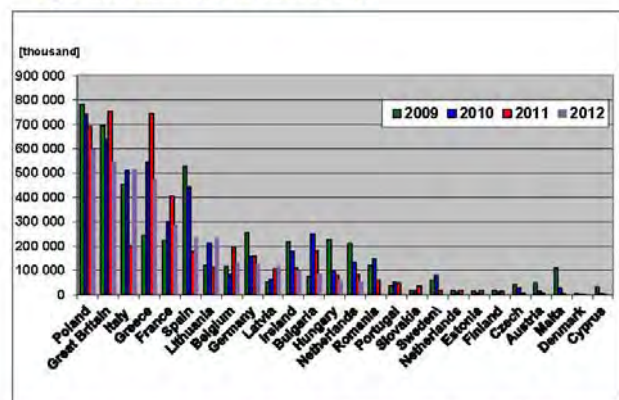
## CHARACTERISTICS OF ILLICIT TRADE at the EU Eastern Border

- “**Longest EU land border with non-EU countries** (Belarus, Russia, Ukraine, Moldova) “makes EU Countries at the EU Eastern border the States especially **impacted by smuggling**”<sup>1</sup>
- „**Large-scale smuggling** of cigarettes and alcohol into the EU takes place via its **Eastern border**”<sup>4</sup>
- “Countries at EU Eastern Border are not only **transit** countries for counterfeiting and smuggled cigarettes but also **destination target**”<sup>2</sup>
- “East-West transit through the Polish territory is the **shortest and thus most profitable** way for smugglers”<sup>1</sup>
- “Poland is the **most successful EU country in seizing** illicit cigarettes with 599 million seized cigarettes in 2012”<sup>2</sup>

Map of Europe. In red difference in price of cigarettes.



Cigarettes seizures in the UE 2009-2012



Source: Polish Customs Service<sup>4</sup> based on OLAF data

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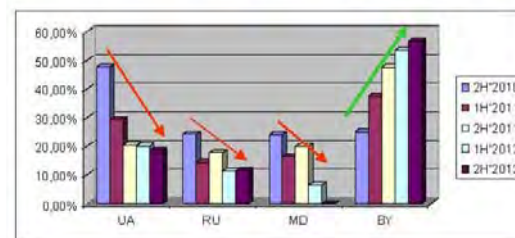
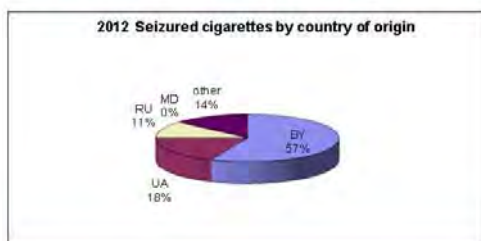
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## ROUTES AND SOURCE COUNTRIES OF SMUGGLING

### Example of Poland and Baltics States

- Main **source** are **Eastern countries** <sup>1,2,4</sup>:
  - Belarus (growing)
  - Ukraine (declining)
  - Russia Kaliningrad (declining) and St Petersburg (growing)
- China and Middle East (**UAE**) growing but not dominating
- Cigarettes from **Belarus dominate illicit cigarettes market**
  - Belarus Government strategy aiming at **permanent growth** in the **production** of tobacco products in this country
  - Flows from Belarus are largely comprised of **Grodno** Tobacco brands such as Fest, Minsk and Nz with retail price of 0,2 €
- Transit countries, routes :
  - Change from **Lithuania to Belarus**
    - In 2008 80% of cigarettes seized by the Customs Office in Poland were from Lithuania, 20% from Belorussia <sup>5</sup>
    - By 2010 it changed: **60% from Belarus**, 40% from Lithuania <sup>5</sup>
  - South Channel**: New seizures in West Poland indicate growth of importance of new smuggling channel via **South countries**.
  - Sea Ports**: from **Middle East and China**



Source of data for graphs: Polish Customs Service

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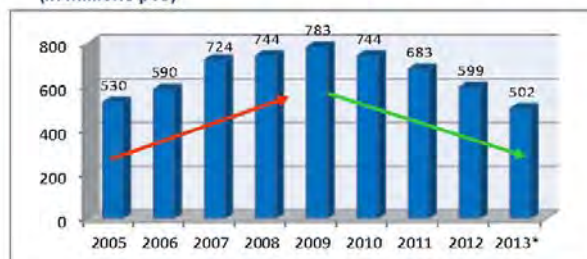
## TRENDS IN ILLICIT TRADE AT EU EASTERN BORDER

### Decline in seized cigarettes substituted by other form of illicit trade

#### TREND 1: Decline in seized of smuggled cigarettes

- Example: **Poland**:  
Data confirms that actions undertaken by the Polish Customs Service after Polish accession to EU make smuggling of cigarettes more difficult. Since 2009 **trend of seized cigarettes is declining**.
- Example: **Estonia**  
**36% decline** (17 413 060 in 2012, 11 159 975 in 2013)

Quantities of cigarettes seized in Poland in 2005-2012 (in millions pcs)

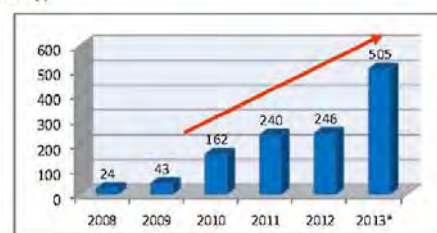


Source: Polish Customs Service

#### TREND 2: Decrease in smuggled cigarettes tends to be substituted:

- Meaningful **Increase of domestic illegal production using dried tobacco** (usually untaxed) Highly **increasing trend** of seized **tobacco** (inverse to declining trend for cigarettes)
- Smugglers have sought alternative smuggle routes, prefer to take routes in their opinion **less tightly controlled by Customs** which go through Balkan states.

Tobacco seizures in Poland in tons (\*2013- preliminary)



Source: Polish Customs Service

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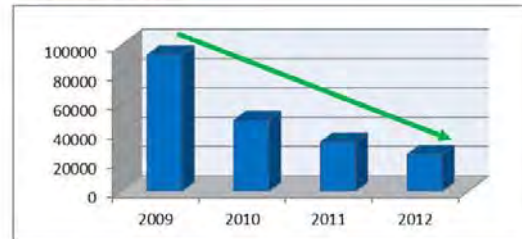
## TRENDS IN ILLICIT TRADE AT EU EASTERN BORDER

### Use of legal channels replaces well controlled traditional ones

#### TREND 3: Customs Services succeeds in decreasing smuggling in rail transport

- Result of use of modern **X-Ray scanners** for scanning wagons
- Thorough controls of passengers trains crossing borders

Cigarettes disclosure in rail transport 2009 -2012  
(in thousand pcs)

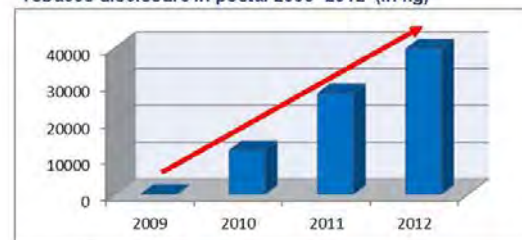


Source: Polish Customs Service<sup>6</sup>

#### TREND 4 : Growing use of available legal channels:

- Growth of tobacco send by **Postal Services**, Internet
- **Legal channels** are used to distribute illegal products

Tobacco disclosure in postal 2009 -2012 (in kg)



Source: Polish Customs Service<sup>6</sup>

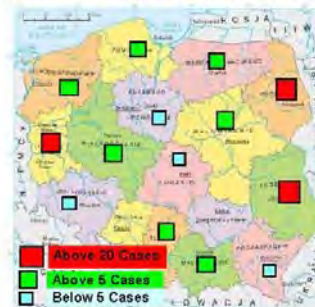
## TRENDS IN ILLICIT TRADE AT EU EASTERN BORDER

### Fragmentation and wide spread of illicit trade to limit losses

#### TREND 5 : Illicit trade wide spreads inside country

- Seizure far from external Eastern border
- May indicate growth of illegal production inside country or EU.

Examples of seizures above 500.000 sticks<sup>7</sup>



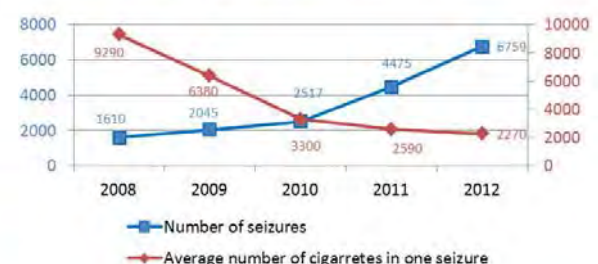
Source: Polish Customs Service

#### TREND 6 : „Less but more often”

- More incidents but with less volume to decrease risk of lost profit by illicit trade organisers<sup>6</sup>

Effective combating illicit trade requires activities **within country** and **cooperation abroad** to support on-border control

Seizure of cigarettes on bazaars 2008-2011



Source: Polish Customs Service<sup>6</sup>



## CONSEQUENCES of Illicit Trade

### Negative effects of illicit trade:

#### Financial

- Polish **budgetary losses** from unpaid excise and VAT caused by illicit trade of tobacco (over **8 billion sticks per year**, an equivalent of 1.000 truckloads) are estimated at ca **zlotys 3.3 bn per year**<sup>1</sup>

#### Public Health

- increased **risk to health of the society** and high cost of tobacco related illness treatment.

#### Local economy

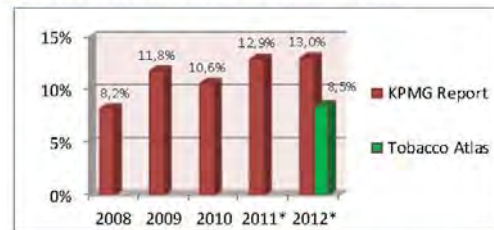
- Harms legitimate business** interests at both manufacturing and retail level.
- Licit producers have to compete** not only amongst themselves but also **with illegal cheaper products**

#### Public order and safety

- Illicit trade is „almost **exclusively the domain of organised crime groups**”<sup>4</sup>
  - concentration of **criminal groups** in certain areas (e.g. around border check points).
  - Illicit trade** of tobacco in regions on Eastern Polish border is **above 50%** (Lubelskie, Białopodlaskie)<sup>1</sup>
  - ability for criminal groups to influence multiple areas of State activity and **reinvest profit** from tobacco illicit trade **in other crimes**

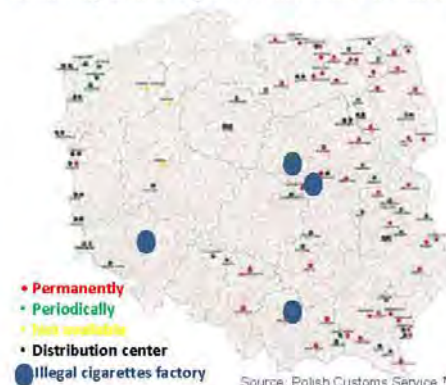
Algirdas Semeta, anti-fraud Commissioner (9.10.2013):  
"Every year, public **budgets lose around €10 billion** a year in the EU alone due to the illegal tobacco trade. Moreover, **tobacco smuggling undermines health policies**, and helps to fund even **more sinister crimes**"

Illicit trade in Tobacco in Poland 2008-2012 in%



Source: PCS based on KPMG reports, accepted by Polish Customs Services for years 2008-2010\*, \*unconfirmed for 2011-2012 (**issue of legally imported cigarettes counted as illegal**, please see example discrepancy between **KPMG data** and **Tobacco World Atlas 2012** <sup>14</sup>)

### Availability of illicit cigarettes on bazaars in Poland



## Ways to fight illicit trade



## WAYS TO FIGHT ILLICIT TRADE

### Recommendation for solutions and activities

- **International crime** is organized on a **global scale**, so **strategies to combat** smuggling of tobacco (and other) products should also have a **global/international dimension**.
- Multilateral Treaties and Draft of European Legislation:
  - WHO **Framework Convention on Tobacco Control (FCTC)**
  - WHO – FCTC **Protocol to Eliminate Illicit Trade in Tobacco Products**
  - EU Proposal of **Tobacco Directive** by the European Commission to the European Parliament and to the Council
- National and cross-national **cooperation**
- Technical Solutions:
  - **Track & Trace System**



ASIA PACIFIC



AMÉRICAS



EUROPE



MIDDLE EAST, AFRICA

Algirdas Semeta, anti-fraud Commissioner (09.10.2013):  
 "The EU pours huge resources into stamping out **contraband and counterfeit cigarettes**. But, it is not a problem we can eliminate on our own. The **international nature** of this problem **demand an international response**. The **EU must throw its full weight behind the implementation of the WHO Protocol**, and help stamp out this pernicious activity across the global"

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## NATIONAL INITIATIVES AND CROSS BORDER COOPERATION

### to fight illicit trade at the EU external Eastern Border

- **National Initiative:**
  - Strengthen national regulation to **reduce anti-smuggling** and legal tax free import for further sale
    - Example: Estonia as of 1st Dec'13 limited number of cigarettes that can be brought duty-free to country to 2 times 40 pcs per month per traveller.
  - Combating growing illicit trade caused by **untaxed raw tobacco**:
    - Example: Poland as of 1st Jan'13 issued excise tax on tobacco leaves
  - **Campaign to gain public support** for fighting illicit trade and to decrease consumption of illicit goods
  - **Discouraging actions** :
    - Permanent monitoring of bazaars
    - Monitoring of Internet and postal parcels
- **Cross border cooperation:**
  - Automatic **car plate and containers codes recognition system** implemented on Russia and Belarus borders as well as on EE-LT-LV borders by 3 Baltic States: Latvia, Lithuania, Estonia, allowing observation of car and container movements
  - Joint operation :



Source: Estonian Tax and Customs Department<sup>9</sup>

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## Global Efforts To Combat Illicit Trade in Tobacco Products – FCTC

2005, United Nations WHO

Framework Convention on Tobacco Control



Most comprehensive and advanced institutional and legal, as well as organizational approach

176 Parties, 168 states including EU member states committed to control tobacco

Sets forth binding measures aiming at the reduction of the supply and demand of tobacco products worldwide incl. by eliminating illicit trade

2012, Protocol to Eliminate Illicit Trade in Tobacco Products

October 2012,  
January 2014

Adopted by over 140 parties, including EU Member States  
Signed by 54 countries and European Union  
(will enter into force after 40th ratification)



Secretary General of World Customs Organization named FCTC Protocol :  
„key instrument in fighting tobacco smuggling and dismantling criminal rings”  
and strongly encourage all WCO Members to make best use of it:

tracking and tracing

- to secure the distribution chain
- and assist in the investigation of illicit trade

secure identification markings

- unique, secure and non-removable, on all unit packets, packages or any outside packaging

set of information

- manufacturing date, facility and machine, product description, intended market of retail sale,...
- on imported, produced for domestic market or for export

controllee - controller separation of duties

- “Obligations assigned to a Party shall not be performed by or delegated to the tobacco industry”.

European Union signed the Protocol on 20 December 2013

\* Source: WCO, „WCO and WHO strengthen cooperation to fight illicit tobacco trade” Brussels 2013

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## EUROPEAN UNION Tobacco Product Directive

2013, European Union Tobacco Product Directive



EU regulation concerning manufacture, presentation and sale of tobacco and related products

Successor of Directive 2001/37/EC adopted on 5 June 2001

Negotiation position voted by EU Parliament on 08.10.2003

Art. 14 Traceability and security features

Explicitly taking into consideration „global standards of tracking, tracing and authentication of consumer goods and the corresponding requirements set by the WHO Protocol on Illicit Trade of Tobacco”

tracking and tracing

- with the aim to trace the products through the whole supply chain.
- to ensure integrity
- for tobacco products destined or placed on the Union market

unique identifier

- unique, secure and irremovable, on all unit packets, packages or any outside transport packaging

set of information

- manufacturing date and place, facility and machine, time or shift, product description, intended market of retail sale; intended and actual shipment route including all warehouses used, the shipment date, shipment destination, consignee and point of departure; where applicable, the importer into the Union; the identity of all purchasers; invoice; order number and payment records
- All AEOs have to be registered and transmit any movement data

Security Features

- In addition to secure identifier
- carry a visible and invisible, tamper proof security feature of at least 1 cm<sup>2</sup>,
- irremovably printed or affixed

Independence and separation of duties

- The roles assigned for tracking and tracing shall be performed by economic entities with no legal or commercial link to the tobacco industry

However the compromise text issued by Council on 17 Dec 2013 following the trilogue does **not** exclude the tobacco industry from a central role in tracking and tracing tobacco products. It also **exclude** „secure” from unique identifier. This is in **clear contradiction** with the letter and spirit of both the FCTC (art.5.3) and the FCTC Protocol (Art. 8 para 2 and 12) which the EU has signed.

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Findings:

## Best Practices And Requirements To Build Effective Track & Trace Solution

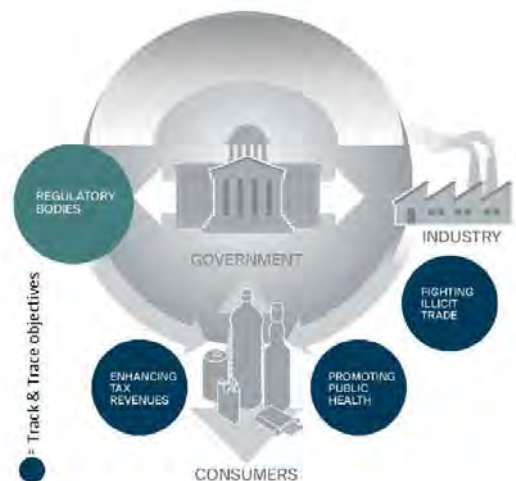
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### COMMON EXPECTATIONS of Track & Trace and Authentication

- **Ministry of Finance/Customs:**  
Enhancing tax revenues by facilitating recovery of rightful taxes
- **Ministry of Healthcare:** Promoting public health by detecting counterfeit tax-unpaid consumer products in circulation
- **Producers:** Fighting illicit trade and strengthening fair competition and local economy by providing unparalleled level of product security and enabling visibility
- **Customers:** Access to easy to authenticate products with controlled (by government) origin and distribution



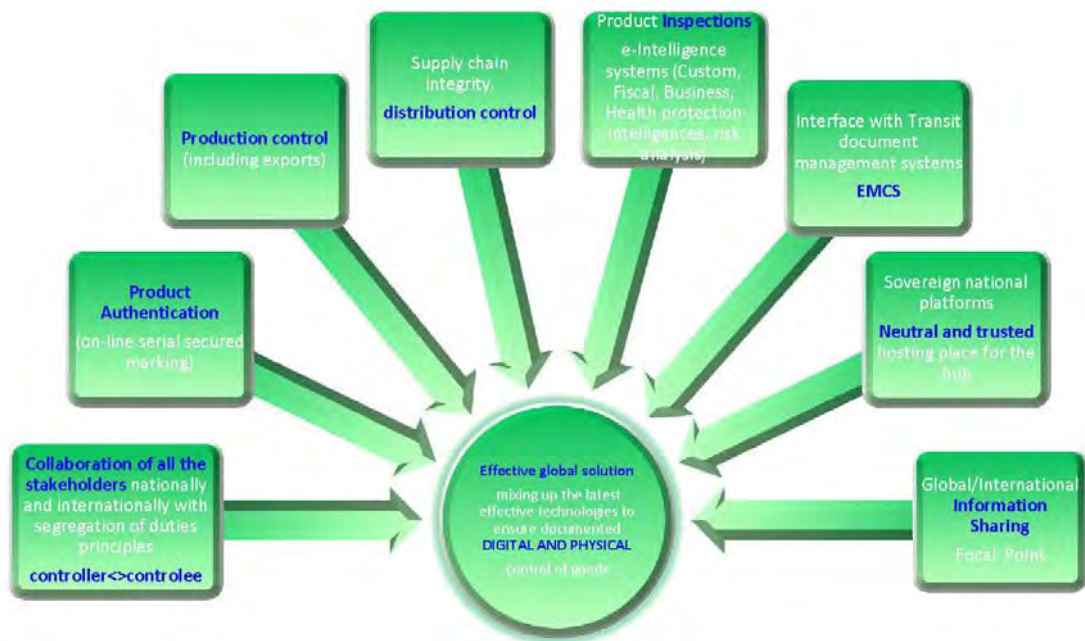
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## IDENTIFIED BEST PRACTICES AND REQUIREMENTS to build effective Track & Trace System



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## ELEMENTS of Effective Track & Trace System



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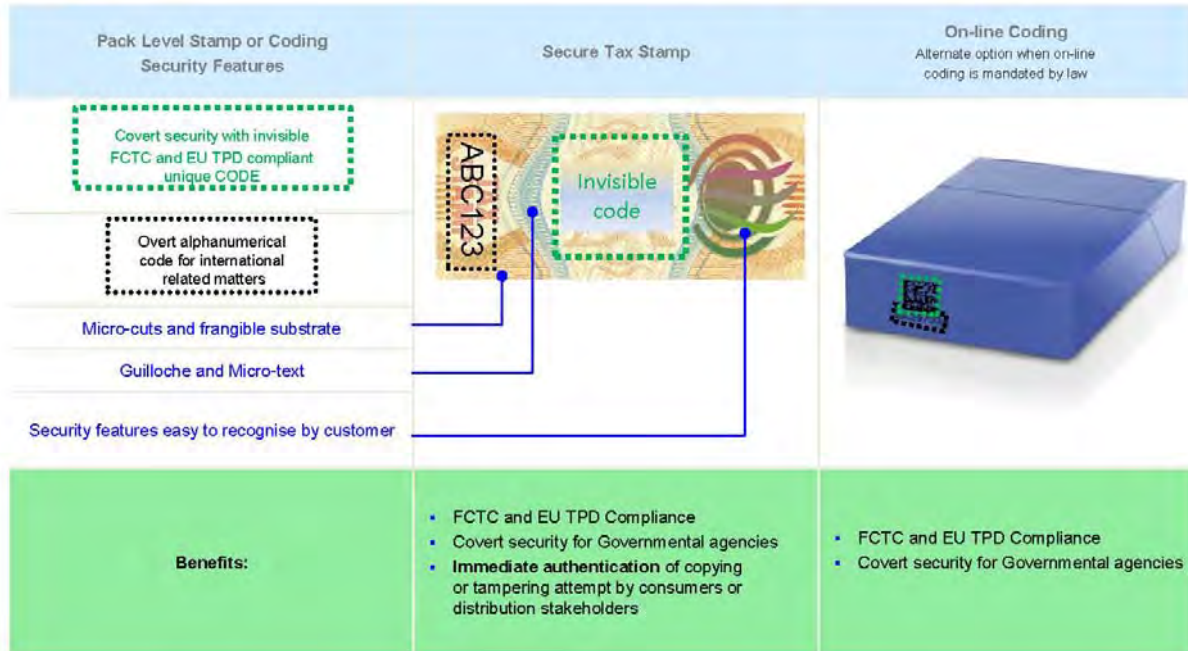
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**1**  
SECURE  
MARKING

## Effective Track &Trace: SERIAL SECURED MARKING

**BEST PRACTICE:**  
Combining **covert** and **overt**  
**security features**

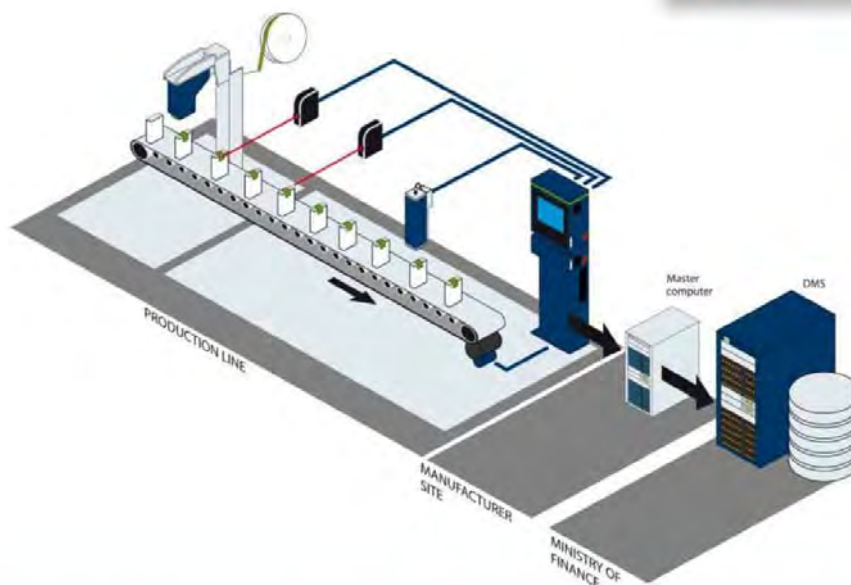


**2**  
PRODUCTION  
CONTROL

## Effective Track &Trace: PRODUCTION CONTROL

**BEST PRACTICES:**

- Trustworthy and independent **real time control on all production lines** with real time data transmission to Ministry of Finance
- Codes activation on production lines**



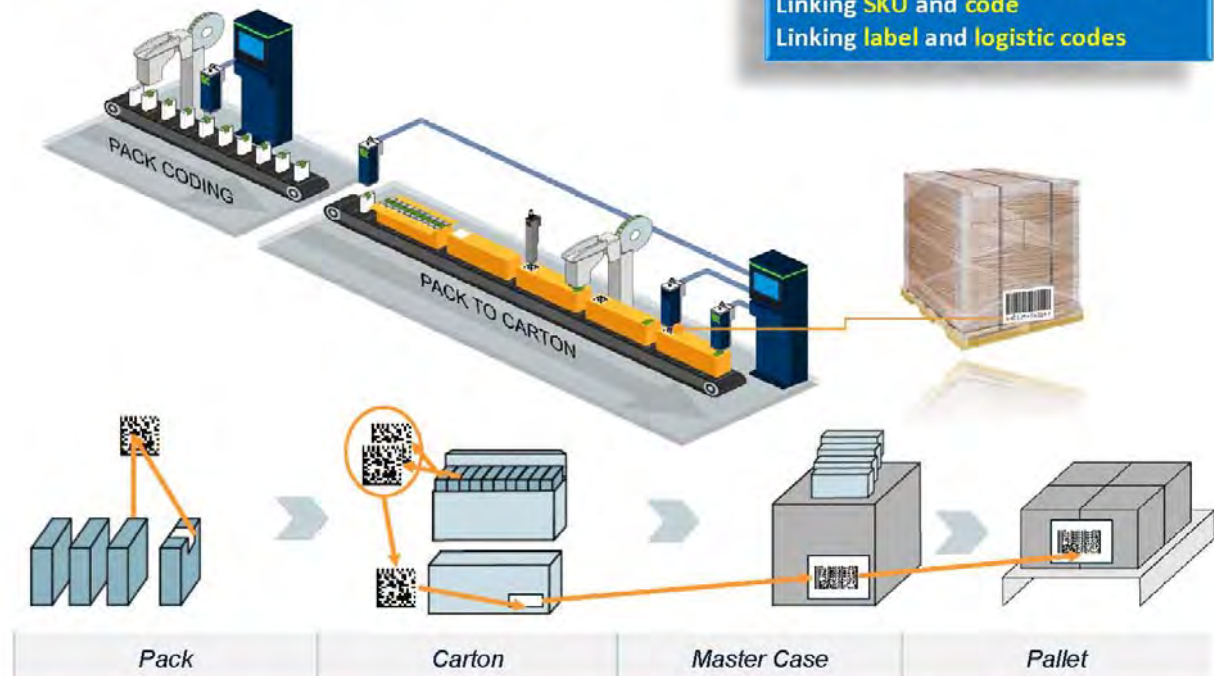


**3**  
DISTRIBUTION CONTROL

## Effective Track & Trace: ITEM TO CARTON AGGREGATION In the FCTC/EU TPD environment

### BEST PRACTICE:

Trustworthy and independent **real time control of aggregation** on all production lines with real time data transmission to Ministry of Finance  
Linking **SKU** and **code**  
Linking **label** and **logistic codes**



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**3**  
DISTRIBUTION CONTROL

## Effective Track & Trace: DISTRIBUTION CONTROL

### Supply Chain



### BEST PRACTICE:

**Integration** of Track & Trace and EMCS (in EU) = Physical control of declared goods movement



= Consolidation / analysis of electronic data with field data, to trigger actions and controls.

\* = EU member states

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## Effective Track & Trace: AUDIT SYSTEM for objective field checks

*MOBILE*  
field audit device  
dedicated to  
enforcement inspectors



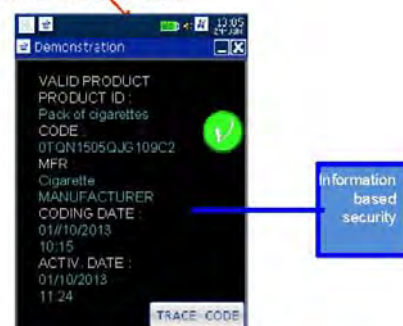
### BEST PRACTICES:

**One push-button device for**

- Immediate and unequivocal authentication of Fiscal Marks
- Confirmation of **genuine** of the product,
- Fulfilment of **excise obligation**,
- **Verification of tracing info**
- Upload information for **reporting** of audit results,
- With **anty corruption/ objective** feature

Step 1: Validation that product is genuine

Step 2: Retrieval and validation of all product specific data from DMS



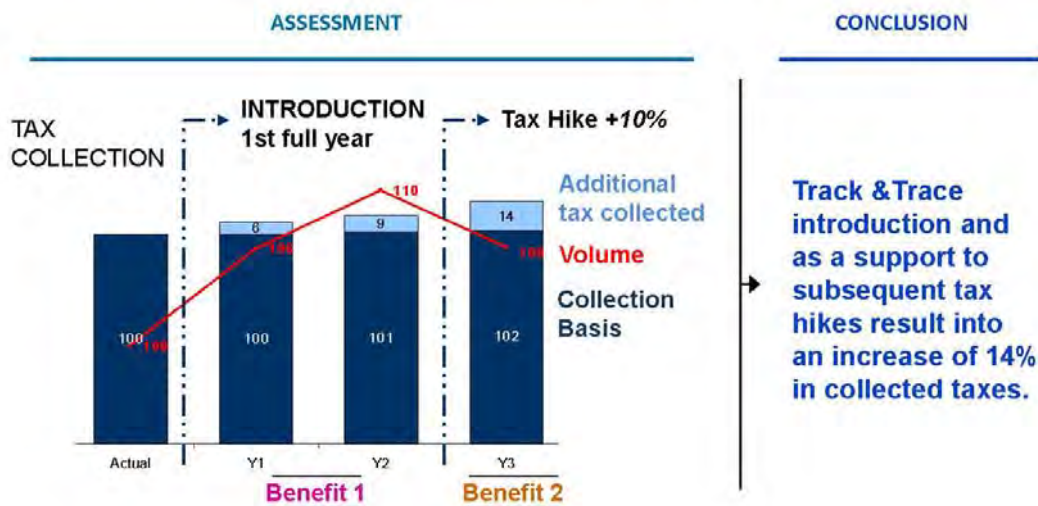
## Key Findings

### Theoretical And Practical Results



## MODELING: Track & Trace Possible Benefits

### Benefits following Introduction and subsequent Tax hikes



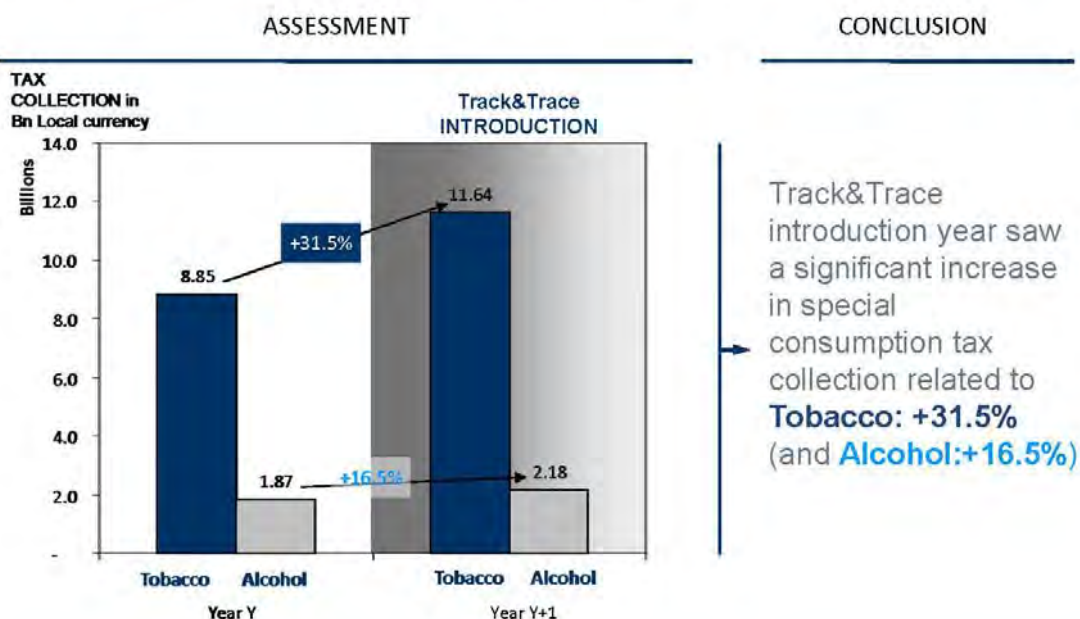
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## LIVE PROJECT EXAMPLE: Benefit in Country A

### Benefit of Track & Trace following its introduction



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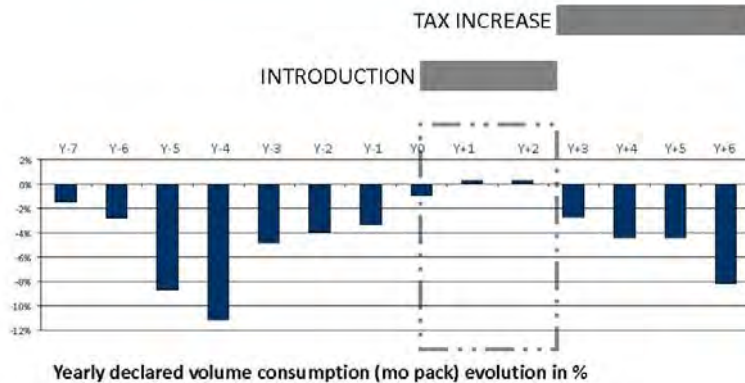
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## LIVE PROJECT EXAMPLE: Benefit in the Country B

Benefit of the Track & Trace program following its introduction in Year 0

### ASSESSMENT

### CONCLUSION



-In the years following its introduction, Track&Trace allowed the **stabilization of declared consumption volumes** despite an historical downtrend

- The enforcement authority recognized a **above 30% tax evasion reduction** following Track&Trace introduction

## EXAMPLE OF TRACK & TRACE SYSTEM: Achievements Records

### BRAZIL SCORPIOS



“[...] there were 13 cigarette manufacturers operating in Brazil. As soon as SCORPIOS went online, enforcement personnel discovered that 8 of these companies were operating illegally [...] the system has significantly improved Brazil's ability to regulate its tobacco market: revenue losses with small manufacturers reduced 33% under the program”

Source : Receita Federal Do Brazil, Jul 2012

### CALIFORNIA (USA)



“By regulating the tobacco market in California[...], we have substantially reduced cigarette smuggling in California, taken tons of illegal cigarettes off our streets, levelled the playing field for legitimate California businesses and generated \$153 million in new tax revenue for the state”

Source : Jérôme E. Horton, Board of Equalization, California State, 2010

### TURKEY CIGARETTES



“With the implementation of the Labelled Products Inspection System, the revenues earned from the Special Consumption Tax have significantly increased[...] from the tax in 2007 and 2008 from small producers and mass producers in the Tobacco and Alcohol markets”

Source : Turkey Ministry of Finance, Revenue office, 2010



## 73% of EU Citizens support introducing of security features to fight smuggling and counterfeit even if it increases price of product

Q022 Would you be in favour of or opposed to any of the following measures?  
Assumes: In favour – evolution compared with EBFZ 3 Oct. 2008

		Introducing security features on the packs of cigarettes that limit sales of smuggled or counterfeit products, even if this means a few more cents more expensive	Banning advertising of tobacco products at points of sale/shops	Limiting tobacco that make tobacco products more attractive	Banning the sales of tobacco products via the Internet	Keeping tobacco products out of sight in shop points of sale	Banning covers, boxes and promotional material from packets of tobacco products	Banning the sales of tobacco products through vending machines	Increasing taxes on tobacco products								
EU27	70%	+1	73%	64%	+1	65%	+2	60%	+2	58%	+3	57%	+3	54%	+2	53%	+3
Finland	58%	-3	58%	48%	=	49%	+1	49%	+3	49%	+3	37%	+3	34%	+3	17%	-4
Netherlands	83%	+3	83%	71%	+2	70%	+2	69%	+2	65%	+2	64%	+2	62%	+1	57%	-4
BE	81%	=	83%	67%	+3	74%	+8	72%	+5	67%	+8	62%	+8	61%	+6	60%	+3
RO	72%	-8	76%	65%	-2	46%	-11	53%	-3	51%	+6	44%	-7	58%	-5	52%	-2
CZ	77%	+2	73%	67%	+2	47%	-2	63%	+2	62%	+1	49%	+1	52%	-3	54%	-5
DK	61%	+6	71%	63%	=	66%	-2	43%	-4	48%	-1	49%	-1	44%	-1	57%	-1
DE	72%	+1	72%	69%	-3	64%	-1	66%	-1	46%	-2	49%	-3	43%	-4	46%	-5
EE	73%	+2	71%	68%	+6	62%	+2	67%	+11	65%	+13	62%	-11	67%	+10	37%	+5
IE	68%	+4	82%	84%	=	82%	+2	85%	+9	86%	+5	88%	+4	73%	+9	65%	-1
PL	87%	+4	81%	66%	-8	67%	-2	65%	-8	66%	-5	64%	-2	67%	-6	38%	-14
ES	74%	-3	76%	58%	+1	60%	+2	62%	+8	61%	+5	55%	+6	42%	+5	46%	-7
FR	73%	+5	76%	61%	+3	71%	+2	62%	+2	51%	+5	57%	+4	59%	+3	45%	-3
IT	78%	+2	73%	69%	+1	66%	-2	71%	-1	66%	+2	66%	+2	62%	=	64%	-1
CY	94%	=	89%	78%	-5	85%	+2	82%	=	77%	-2	75%	-5	78%	+2	63%	-3
LV	86%	+2	92%	63%	+1	67%	+3	57%	+4	64%	=	56%	+3	56%	+3	41%	-7
LT	78%	+4	80%	69%	+1	65%	+8	59%	+7	57%	+2	62%	+10	55%	+8	52%	-5
LU	72%	+12	73%	68%	-4	66%	+1	59%	+5	43%	+4	49%	-5	46%	=	57%	=
HU	78%	+1	77%	70%	=	66%	+3	73%	+3	67%	-1	62%	+5	66%	+2	33%	-1
MT	85%	-1	74%	78%	+7	65%	+3	64%	+8	66%	+6	62%	+1	55%	+7	34%	-4
NL	76%	+8	97%	51%	+1	50%	+5	47%	=	46%	+3	39%	+3	36%	-3	55%	+2
AT	62%	-1	67%	49%	+3	52%	+1	59%	+5	49%	+2	49%	-1	37%	+2	46%	-1
PT	78%	+3	73%	65%	=	51%	1	63%	+6	59%	+4	52%	+3	58%	+7	48%	3
RO	74%	+2	83%	60%	=	52%	+3	54%	+3	53%	1	50%	+2	52%	=	55%	1
SI	69%	+12	77%	64%	+2	55%	+9	60%	+9	59%	+5	50%	+10	51%	+8	54%	-1
SK	86%	+7	77%	80%	+8	68%	+7	77%	+11	71%	+7	71%	+11	72%	+5	63%	+1
FI	77%	+13	83%	69%	-1	71%	+4	73%	+3	69%	+5	60%	+6	58%	+3	71%	+1
SE	70%	+1	78%	72%	+8	56%	+6	58%	+10	67%	+13	52%	+11	47%	+2	52%	+5
GR	86%	+3	73%	69%	+4	67%	+4	63%	+2	69%	+2	66%	+5	67%	+6	36%	-4

Highest percentage per country: 94% (CY)  
Lowest percentage per item: 41% (ES)

Source: European Commission, Special Eurobarometers 385, ATTITUDES OF EUROPEANS TOWARDS TOBACCO Report, May 2012, TNS Opinion & Social

## Recommendations for consideration

## Recommendation for consideration

<b>FCTC Protocol ratification</b>	Fast <b>ratification</b> and <b>implementation of FCTC Protocol</b> by EU Member States <b>EU Campaign</b> to actively <b>support and encourage neighbouring countries</b> to do the same
<b>EU Tobacco Directive</b>	Need to <b>ensure</b> that is <b>correctly aligned</b> to the provisions of the <b>FCTC</b> and its <b>Protocol</b> to avoid future legal challenge or ambiguity.
<b>Tracking and Tracing</b>	Encourage EU Member States to start building <b>tracking and tracing systems</b> to monitor production and trade from production line to final point of sale Entirely government-controlled and independent from producers ( <b>controlee-controller separation</b> )
<b>Secure marking of legitimate products</b>	<b>Mark securely legal products</b> to allow citizens to distinguish between licit and illicit products
<b>Strengthen effectiveness of Customs Services at EU Eastern Border</b>	Strengthen effectiveness of Customs Services by enabling access to <b>transparent and public data on illegal trade but also legal production</b> of tobacco products in EU countries Increase <b>international cooperation</b> <b>Special EU Fund</b> to support Customs needs (equipment procurement and maintenance) including <b>financial support for new X-ray scanners</b> for wagons and trucks (partially covered by Hercules III)

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**Questions?  
Remarks?  
Suggestions?**

**THANK YOU FOR  
YOUR ATTENTION**

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## **PRESENTATION BY LUK JOOSSENS, HANA ROSS AND MICHAŁ STOKŁOSA**

DIRECTORATE GENERAL FOR INTERNAL POLICIES  
POLICY DEPARTMENT D: BUDGETARY AFFAIRS



# **EU Policy and Illicit Tobacco Trade: Assessing the Impacts**

Luk Joossens<sup>1,2</sup>, Hana Ross<sup>3</sup>, Michał Stokłosa<sup>3</sup>

<sup>1</sup>Association of European Cancer Leagues (ECL);

<sup>2</sup>Belgian Foundation against Cancer

<sup>3</sup>Economic and Health Policy Research, American Cancer Society

Presented by Luk Joossens

1

## **We consider three EU policies:**

- 1) EC Strategy and Action Plan to tackle illicit trade in tobacco products
- 2) Revised Tobacco Products Directive
- 3) Agreements between European Community, individual Member States, and four major tobacco companies

2

## 1) ANALYSIS OF EUROPEAN COMMISSION STRATEGY TO TACKLE THE ILLICIT TRADE IN TOBACCO PRODUCTS

3

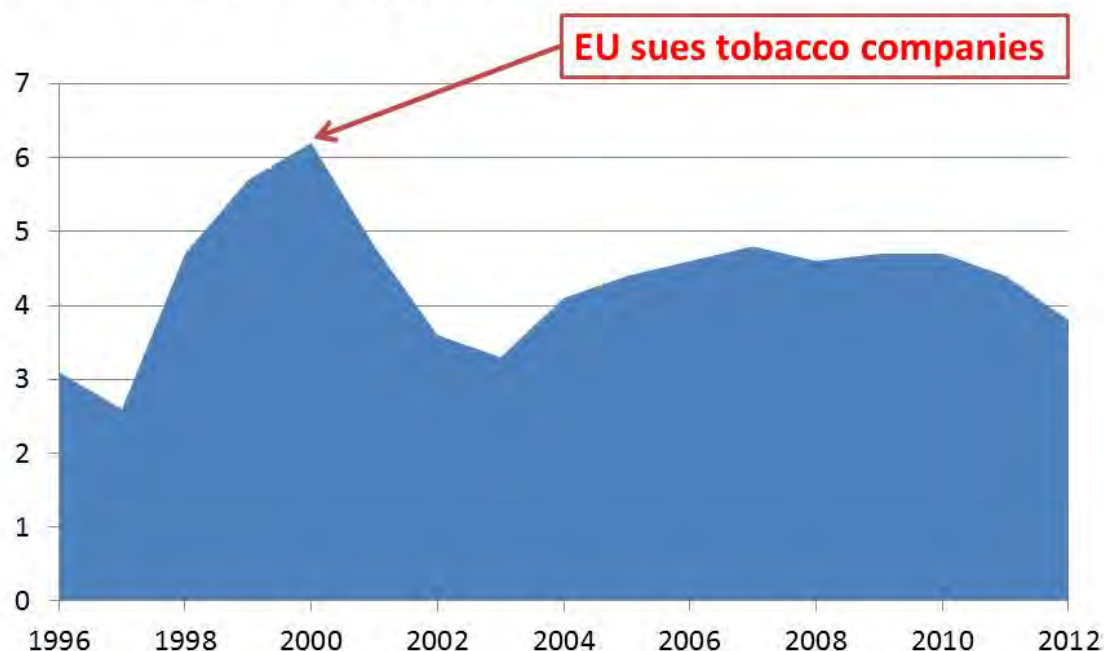
### Current Problem: Lack of reliable data

- **KPMG Project Star data** cannot be used
  - Report commissioned to meet specific terms of reference only known to Philip Morris International and KPMG
  - Data shown to be unreliable (Gilmore et al, 2013)
- **Seizure data** cannot be used to estimate illicit trade levels
  - However, this data can indicate trends in illicit trade

4



## Billions of cigarettes seized in the EU



## Implementation of FCTC Protocol

Global tracking and tracing system might not function without EU technical and financial support to FCTC Protocol implementation



Source: sfgate.com

## **No Measures Against Illicit Manufacturing**

- Commission acknowledges that illegal tobacco manufacturing in the EU is a growing problem
- The Strategy and Action plan do not propose any measures to control and prevent illegal diversion of raw tobacco, filters, or papers

## **Too Few OLAF EU Liaison Officers**

- OLAF has only one EU liaison officer
  - Works in Kiev
- By comparison, the UK has 28 overseas intelligence officers
  - Officers helped prevent €815 million revenue loss between 2011 and 2012

## **2) IMPACT ASSESSMENT OF THE REVISED TOBACCO PRODUCTS DIRECTIVE ON CIGARETTE SMUGGLING IN THE EUROPEAN UNION**

9

### **Imperial Tobacco and the 2001 Tobacco Products Directive**

- Imperial claimed the 2001 Directive would cause massive job loss because export markets would not accept lower tar and nicotine cigarettes
  - This did not happen

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## Imperial stoked post-TPD Smuggling

- Exported massive quantities of cigarettes to 'tiny' Latvia, Kaliningrad, Moldova, Afghanistan and Andorra
  - 65% of Imperial's exported Regal and Superkings brands were smuggled back to the EU

11

## Most reports on the impact of the revised TPD on illicit trade are paid for by cigarette manufacturers





## The Effect of the Tobacco Products Directive According to Merrill Lynch

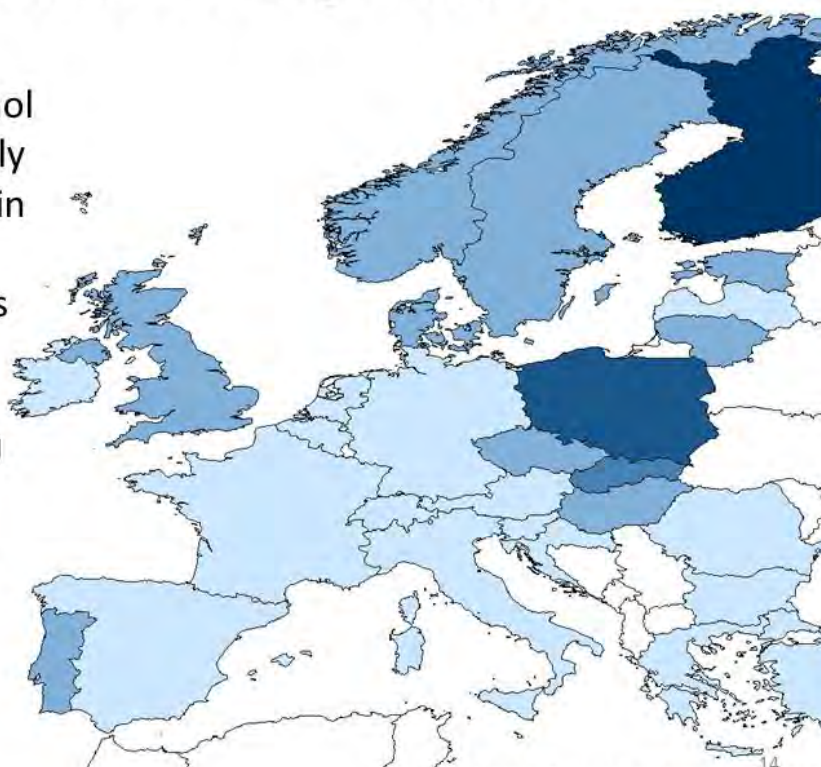
-9 October 2013

“Menthol cigarettes to be phased out over 8 years. Menthol accounts for 4% of EU volumes. We expect most volumes will simply transfer to non-menthol cigarettes, likely the same brand, so we see minimal earnings.”

### Regulation of Ingredients

- The ban on menthol flavor will have only a **minimal** impact in countries where menthol cigarettes are not popular, which is the **majority** of the EU

Menthol market share



Source: Euromonitor International, 2013



## Those who smoke menthol cigarettes are less likely to use illicit cigarettes

- A typical smoker of menthol cigarettes in Poland is a young, well-educated female who lives in a city.
- A typical smoker of illicit cigarettes in Poland is an older, less-educated male living in a rural area.
- Their purchasing habits and places are also different

A typical place of purchase of menthol (left) and illicit (right) cigarettes



Source: [www.kolporter.com.pl](http://www.kolporter.com.pl)



Source: [www.konstancin24.eu](http://www.konstancin24.eu)

15

## Economic Impact

- Even in the **worst-case scenario** of large-scale tobacco industry involvement in supplying illicit cigarettes to the EU
- Both the share of illicit menthol cigarettes in the total EU cigarette market and the associated excise tax **revenue loss would remain at minimum levels**

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### **3) ANALYSIS OF AGREEMENTS BETWEEN THE EU AND MAJOR TOBACCO COMPANIES**

17

## **Lawsuits Against the Industry**

- An early 2000's lawsuit was filed against PMI and JTI, accusing these companies of organizing illicit cigarette trade
- Suits dropped in 2004 and 2007, against PMI and JTI, respectively

18

## Agreements with the Four Major Tobacco Companies

- PMI, JTI suits dropped reached in return for an enforceable and legally binding agreement
- Cooperation agreements, without settlement, were concluded BAT and Imperial in 2010
- Key feature of these agreements are payments:
  - **Base payments** (fixed amounts paid over time)
  - **Seizure-based payments**



## Questionable Effectiveness of the Agreements

Imperial Tobacco Ukraine produces the Classic brand which is one of the most smuggled cigarette brands in the EU





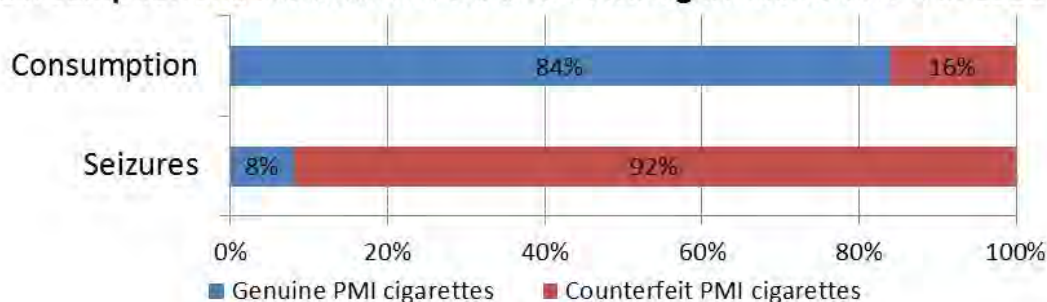
## Seizure-based payments

The industry has an incentive to classify seized cigarettes as counterfeit because no seizure payments are made when seized cigarettes are counterfeit.

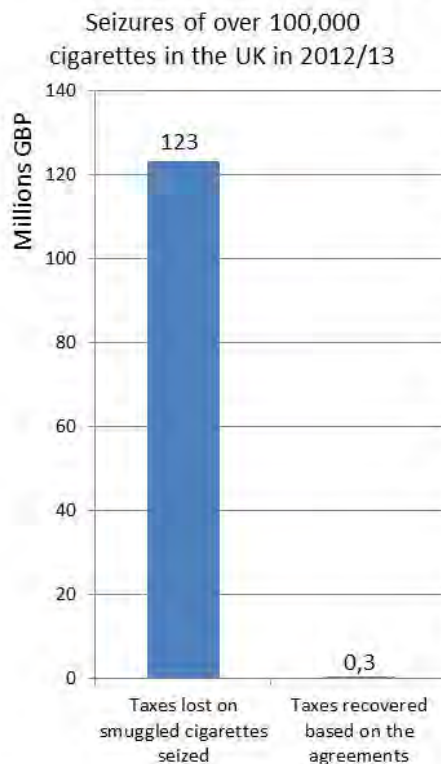
### 16% versus 92%

- On Page 53, 16% of contraband PMI cigarette consumption is counterfeit (Project Star empty pack surveys)
- On Page 56, 92% of contraband PMI cigarette seizures are counterfeit

Consumption and seizures of contraband PMI cigarettes in the EU in 2011



## Seizure-Based Payments Are Tiny



Recovered value of taxes and duties from seizure-based payments is tiny.

Especially, compared to the lost tax revenue from large cigarette smuggling seizures.

In 2012 in the UK, the ratio was less than 0,3

## Member Use of Industry Payments

- Earmark payments to fight cigarette smuggling
  - Estonia, Poland, and Slovakia
- Direct payments to the general budget
  - Belgium, Finland, Germany, Slovenia and the UK
- Used payments to purchase technical equipment for authorities who combat illicit cigarette trade, including customs, police, and border guards.
  - Czech Republic and Poland



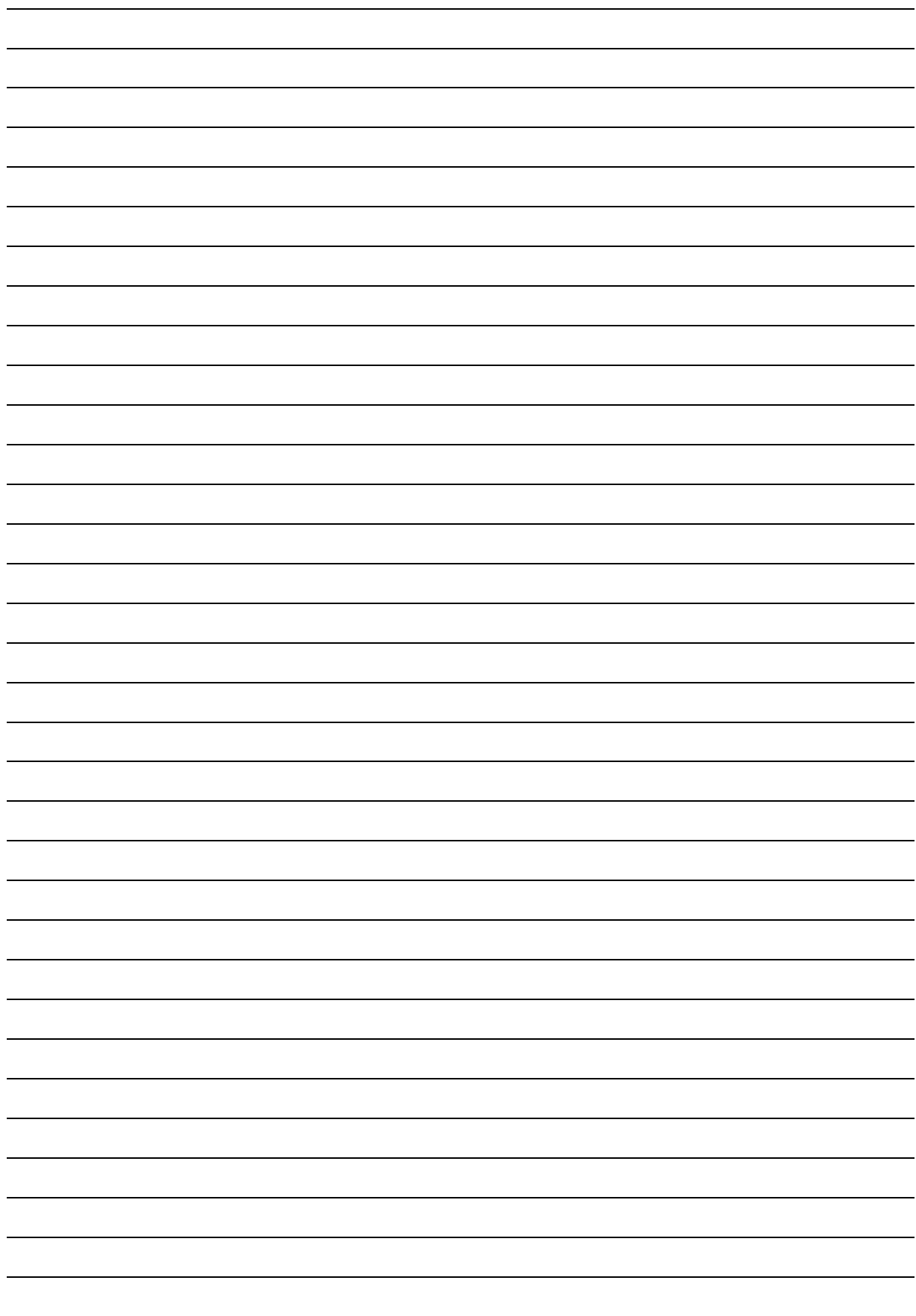
## Agreements Presented as Corporate Social Responsibility

- Payments from agreements with PMI and JTI are presented to the public as industry **philanthropy** rather than as settlement money
- Payments are being **described** in press as “**sponsorship**” and “**assistance**” from a tobacco industry who is “**vividly interested** in combating cigarette smuggling”



Source: Imperial Tobacco

[illegible]





## DIRECTORATE-GENERAL FOR INTERNAL POLICIES

# POLICY DEPARTMENT BUDGETARY AFFAIRS **D**

## Role

Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

## Policy Areas

-  Budgets
-  Budgetary Control

## Documents

Visit the European Parliament website: <http://www.europarl.europa.eu/studies>

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