

THE CONTEXT OF TOBACCO AND ILLICIT TRADE

Tobacco is the largest avoidable health threat in the EU:

- The cause of nearly 700.000 premature deaths per year;
- Half of all smokers die an average of 14 years younger than non-smokers;
- The addictive and harmful characteristics of tobacco clearly set it apart from other commodities on the market.

Nearly 10% of the global cigarette trade is illicit; this is significantly higher in low and middle-income countries, reaching up to 50% and above.

Consequences of illicit tobacco trade:

1. Poses severe risks to public health:

- Increased accessibility, affordability and consumption of tobacco product;
- Higher chance of attracting vulnerable groups especially young;
- Increased burden on healthcare systems

2. Supports organised crime:

- Tobacco is one of the most smuggled commodities in the world (1).
- Profits from illicit trade fund other criminal activities,
- Feeds terrorism and international and local crime including money laundering, bribery, fraud (2).

3. Inflicts significant economic harm and loss in government revenue:

- Illicit tobacco trade (ITT) evades revenue collection globally estimated at minimum US\$39 billion(3) to \$50 billion and is

estimated to account for 9,5% to 12% of all cigarette consumption worldwide or 570–680 billion cigarettes.(4)(5)
 b. EU estimates based on seizure figures indicate more than €10 billion losses of revenue annually with large-scale smuggling as the major and increasing problem (from 8,3% in 2006 to 10,4% in 2011). (6)

4. Destroys fair trade.

Destroys the licit market and fair competition by deterring the economic competitiveness of legitimate traders and brands.(7)

5. Have negative ecological consequences.

Destroys the environment by generating uncontrolled waste.

THE MISCONDUCT OF THE TOBACCO INDUSTRY

The illicit trade

Illicit activities are undertaken not only by the illicit players, but also by players considered as legitimate.

Four major international tobacco companies have been accused of direct and indirect involvement with illicit trade including smuggling:

- Claims made by the European Union against the tobacco industry resulted in settlements (PMI 2004, JTI 2007, ITL and BAT 2010) with the European Union.
- Since 2004, tobacco companies have paid billions of dollars in fines and payments to settle cigarette smuggling litigation in Europe (\$2,4B) and Canada.(8)
- Still complicity is suspected when companies export billions of cigarettes to countries or hubs that do not have a demand for such large volumes. Just in 2014, BAT was fined £650,000 by HMRC for over-supplying its own product to Belgium. (9)

The Tobacco Industry Strategies to Diminish Controlling Policies

WHO highlights that despite the above accusations and settlements, the tobacco industry portrays itself as a key partner in combating illicit trade and is constantly using different strategies to oppose international efforts to implement independent tobacco controlling policies like the EU Tobacco Products Directive (2014/40/EU) or the WHO Framework Convention on Tobacco Control and its Illicit Trade Protocol:

- 1.Total opposition. At the onset of a legislative proposal, the tobacco industry uses every argument possible to oppose new legislation including threats of closing factories, firing employees and warnings of decrease in tobacco tax revenues.
- 2.Next, the tobacco industry delays approval and weakens policy language to ensure minimal restrictions on its business.
- 3.While forced to accept the new legislation, the tobacco industry presents itself as a necessary implementation “partner” to governments, showcasing its obligatory commitments as an example of good will with the goal to further delay the implementation, keep control in its own hands and revert government control to secondary targets. It offers governments its own solution CODENTIFY - free of charge - as the only complete solution to illicit trade.

In general, the tobacco industry fights to keep the control of information on its real production volume, export data and the real market proportion related to illicit trade.

Currently, after the European Commission decision to not extend the PMI settlement agreement beyond July 2016, the tobacco industry is actively seeking 'engagement' with governments and its agencies for 'collaboration to fight illicit trade' based on government-tobacco industry agreements.

According to the WHO FCTC governments cannot use tools that are owned by the tobacco industry. However, the tobacco industry is so determined to keep control of information on production volume and tobacco trade that it decided to transfer the rights to its own internal controlling system CODENTIFY to the newly created "independent" company INEXTO for 1 Swiss Franc, despite claimed cost of 400 million Euros for creating such a system of.

Can INEXTO independence to be trusted?

How CODENTIFY become independent:

- 2004 Philip Morris Intl settlement with EU with OBLIGATION to create system of marking its products with serial codes.
- 2005 Philip Morris Products developed and PATENT CODENTIFY
- 2010, PMI licensed the system, at no cost, to its three main competitors – BAT, JTI, IT
- 2011, PMI, BAT, JTI, IT formed the Digital Coding and Tracking Association (DCTA) that promotes CODENTIFY to governments
- 2016, DCTA transferred Codentify to newly created INEXTO, affiliate of French Impala as "fully independent from any tobacco company",

INEXTO is just the next step in evolution of created by PMI CODENTIFY.

TRACK AND TRACE AS AN EFFECTIVE TOOL TO PREVENT TOBACCO ILLICIT TRADE

EU, WHO and WCO recognise track and trace as a [key tool to effectively control the supply chain and prevent illicit trade.](#)

Track and trace systems are already and successfully used to control tobacco production and trade in several countries in the world. They are shown to significantly increase tax collection, create new legal businesses, improve public health and consequently decrease smoking prevalence.

Track and trace systems of tobacco products will become obligatory in the EU by 20 May 2019 due to the implementation of Art. 15 and 16 of the Tobacco Products Directive (2014/40/EU) (10). They are also due for implementation globally based on Art. 8 of the WHO FCTC Illicit Trade Protocol. (11)

Consequences of illicit tobacco trade:

Track and trace or tracking and tracing (T&T), is a process of determining [the current and past locations, the time and status](#) and other information [of a unique item](#). More specifically (12) :

• **Tracking** is the concept of marking products with a unique identifier so they can be monitored at each step of the process from the point of production up to the point of sale, creating a time and location history for every step.

• **Tracing** is the ability to identify the past or current location of an item. Where an item is intercepted, tracing allows for verifying the product's route back to its origin and retrieving a specific product's time and location history.

In short, a track and trace system can [in real time](#) monitor production, movement and trade and [determine the history](#) of tobacco products that are properly marked by a [secure and unique identifier](#).

An immanent part of a track and trace system is security. Security features are needed to ensure that the right product is monitored and that its identifier remains unchanged and non-manipulated during the movement of a product along the whole supply chain. A lack of proper security features may result in an original identifier being replicated to legitimate an illicit product. Security features are also needed to recognise whether a product is genuine or falsified.

Why tobacco track and trace is important and beneficial

Due to its unique ability to monitor production and movements of tobacco goods, T&T systems can help Member States [fight illicit trade](#), [increase tax collections](#) and [create better fair-trade conditions](#) for compliant producers, importers and traders. Finally and most importantly, they [save thousands of lives](#) and provide a better protection of [the health of EU citizens](#) and of the [environment](#).



Benefits for fighting illicit trade

Studies (13)(14), indicate that tracking and tracing can enhance capabilities among Member States both in combating illicit trade and in enhancing the collection of customs, duties and taxes:

1. [Eliminates under and mis-declaration](#) of production and trade volumes.
2. [Detects diversion of goods](#) including re-entering of exported goods and round-tripping.

Specifically, the tracking function can be used to monitor flows of legally produced products in real time, and thus to protect against diversion into the illicit market. Tracing can help identify the history of movements of marked products, allowing authorities to investigate where, when and by whom products are diverted into the illegal market.

3. [Detects carousel frauds and ghost exports](#).

Abilities to monitor real movement and identification of unit products can assist in eliminating both in-transit and trans-shipping offences (when original products disappear from local markets or in transit countries), origin offences (when goods are combined or the presentation is physically changed to conceal the true origin) and drawback frauds (such as fictitious/ghost export, incorrect quantities, substitutions of products).

4. [Supports Member States' tax revenue forecasting](#) and planning and provides real time trusted data and visibility of trade.

Critics of T&T systems argue that T&T may be useless, because only legally produced goods can be marked, leaving the illegally produced goods unmarked and out of the control of T&T.

It is true that due to the nature of illicit trade, governments cannot mark illicit products. However by marking all legal products, automatically all illegal products can be recognised by not having government ID marks. This may significantly increase visibility and eventually detection of illicit products and criminals.

Secondly, regarding the ID mark, T&T can be used as a guard to verify if a product is eligible for trading in a legal supply chain, automatically isolating noncompliant illicit products from the legal market.

If T&T covers the full supply chain including points of sales, it will enable protection of customers from involuntary purchase of illicit or counterfeit products.



Benefits for tax collection

There are two obvious benefits in securing tax collection:

1. [Initial increase in tax collection](#)

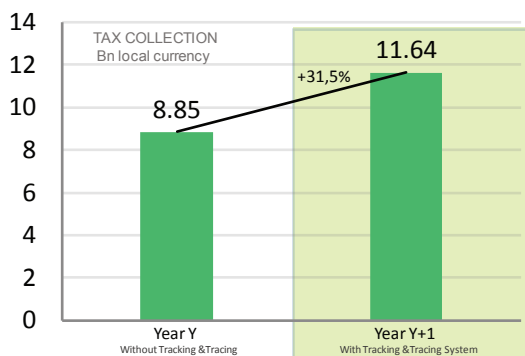
- a. Observed in the first period after introduction of tracking and tracing system due to capture of under-declared and miss-declared production and trade volume that leads to proportional increase in tax collection.
- b. The business case of Turkey demonstrates that tax collection on tobacco products can increase by 31,5% in the first year after introduction of T&T.(15)

2. [Protecting tax income after increasing excise taxes](#) or implementing more restricted policies

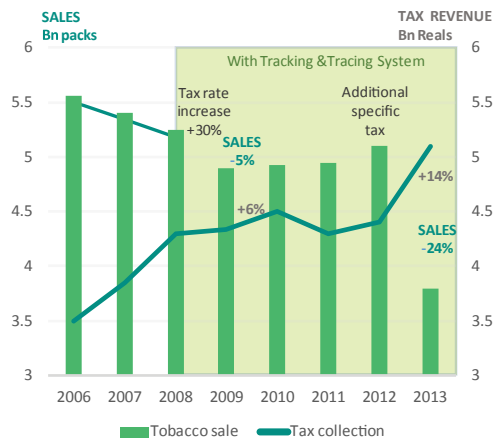
- a. Collecting appropriate taxes is usually a challenge after taxes or duty levels have increased. Firstly, higher prices reduce the volume of demand; secondly increased taxation is an incentive for under-declaration, which may decrease tax collection.

- b. A T&T system can help to secure collection of appropriate taxes by reducing under declaration and can restrict forestalling (creating a large overstock released to the market prior to tax increases, which reduces tax and revenue collection).

- c. In Brazil, after T&T implementation in 2008, the government significantly increased the tax rate by +30%, which resulted in a 5% decline in market volume while tax collection increased by 6%. Similarly, after changing the tax structure and adding a specific tax to the ad valorem tax in 2012, tax collection increased by 15,9% in 2013 despite a 23,9% drop in tobacco sales.



Significant increase in tax collection after introducing of track and trace in Turkey in 2009.



Brazil case: increase of tax collection after 30% tax rate increasing



Benefits for public health

According to WHO, increasing the price of tobacco through [higher taxes is the single most effective measure to encourage tobacco users to quit and prevent children from starting to smoke.](#)

In that way, tobacco track and trace, which supports increased tax collection can contribute to:

1. Decreasing smoking prevalence;
2. Decreasing the percentage of children and young people starting smoking and;
3. Protecting the customer from involuntary purchases of illegal products by implementing validation of the authenticity of products.



Benefits for fair trade

1. T&T can help to isolate and protect legitimate compliant businesses and customers from illicit products and criminal organizations.
2. Better control of the market and elimination of illicit trade can create fair and same competitive conditions for all players and boost the economy.

3. It was observed that a number of legally registered entities significantly grew after implementing T&T due to a better competitive environment.



Benefits for ecology and the environment

1. Every year more than one trillion cigarette butts contaminate our soils, rivers and seas.
2. Thanks to the ability to identify unit products and determine the origin of each product, T&T can support waste management systems in making producers and importers of tobacco products responsible for collecting litter and rubbish generated by them.

3. This may reduce the volume of waste, support recycling and eventually protect our environment.

Recommendations for effective tobacco track and trace

Full supply chain protection

1. Member States and EU citizens will achieve the greatest benefits if T&T [covers the full supply chain](#) from the producers of raw materials to retailers.
2. All partial solutions, which could be considered as steps in the right direction, may still not protect the customer from involuntary purchase of illicit products.
3. Covering the full supply chain can be achieved by:
 - a. Automatic control of production and marking of all products in the beginning of the supply chain.
 - b. Including fiscal cash registers as the ultimate controlling element of T&T and enable them to read and authenticate tracking IDs. This will result in all products within legal point of sales being automatically controlled and their purchase being automatically reported, which leads to securing the legal supply chain by eliminating sale of illegal (fake or untaxed) products from the legal market.

Secure marking of all legal tobacco products

1. Member States shall ensure that all unit packets and [outside packages](#) of tobacco products are marked [with unique and secure identifiers](#).
(16)(17)
2. Such marking shall be performed [automatically on production lines, independently from producers](#) and [controlled by the government](#) or an authorised entity.
3. The unique identifier as a key element to identify a product must not only be [unique](#), but also [secured in itself](#), otherwise the identifier, crucial for data integrity, can be replicated and used to legitimate illicit or fake products on the market.

Separation controlee-controller duties

1. To ensure its full efficiency and transparency T&T [shall guarantee separation of controlee-controller duties](#).
2. Member states shall not accept constant attempts from the tobacco industry to be a necessary “partner” in implementation of T&T. Instead, the tobacco industry shall be treated as subject to control.
3. Member States shall reject any solution created by the tobacco industry like CODENTIFY (currently INEXTO), even if such solutions are proposed by “independent” third parties or a state-owned entity.
4. Independently from the tobacco industry, governments shall:
 - a. [Automatically monitor production](#) and sources at [manufacture sites](#), including
 - i. [Authentication](#): Secure, unique marking of each unit of products and packaging;
 - ii. [Volume Control](#): Automating recognition of product type and produced volumes according to fiscal/customs categories,
 - iii. [Aggregation](#) control of product packaging
 - iv. Identify intended and real market,
 - v. Share information in real time.
 - b. Along the distribution chain:
 - i. [Control all](#) critical events and share information in real time.
 - ii. Trade volume reconciliation in real time.
 - c. In all retail points:
 - i. [Validation](#) of authenticity and origin of all units of tobacco products.
 - ii. Reconciliation of trade volume.

Cross checking and interoperability with other control system

1. To increase effectiveness, data from the T&T system shall be crosschecked with other control systems already implemented by Member States, like EMCS, road transport control, VAT, etc.
2. System intersection allows for export control and can help fight anti-carousel fraud.

Founded in 1997, The European Network for Smoking and Tobacco Prevention (ENSP) is an international organisation based in Brussels and consists of more than 50 organisations across 36 countries active in tobacco control. ENSP aims to develop strategically coordinated actions in tobacco control by sharing information and experience on research, prevention and treatment; as well as running common EU-wide joint projects with the objective to end tobacco in Europe. www.ensp.org

(1) (Interpol, Office of Legal Affairs, 2014)Foreword

(2)(Financial Action Task Force/OECD, 2012)

(3)(Euromonitor International, 2013)

(4)(Euromonitor International, 2013) “570 billion stick market in 2013 with estimated value of US\$39 billion.”

(5)(Interpol, Office of Legal Affairs, 2014) p.1 11.6% (657 billion cigarettes)

(6)(European Commission, 2012)

(7)(WCO World Customs Organisation, 2015)

(8)(Joossens, Smuggling the Tobacco Industry and Plain Packs, 2012)

(9) The Times. Fines for tobacco companies ‘fail to rein in black market’ November 27 2014. Available from:

<https://www.thetimes.co.uk/article/fines-for-tobacco-companies-fail-to-rein-in-black-market-nrd9ndpv9qb>

(10)Directive 2014/40/EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulation and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC, further: EU TPD or Directive.

(11)WHO Framework Convention on Tobacco Control, Protocol to eliminate illicit trade in tobacco products, 2012, further: FCTC ITP or Protocol.

(12)Source:(Eurogroup Consulting and Sovereign Border Solutions, 2015) p.64

(13)(Chaloupka, Edwards, Ross i al., 2015)

(14)(Analysis and Feasibility Assessment Regarding EU systems for Tracking and Tracing of Tobacco Products and for Security Features, 2015, p. 36)

(15)Source: (Ross, 2015) following Turkish Ministry of Finance

(16)Ibid.Art.15.1

(17)Ibid.Art.15.1