CONFRONTING ILLICIT TOBACCO TRADE:

WORLD BANK GROUP

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

CONCLUSION

TECHNICAL REPORT OF THE WORLD BANK GROUP
GLOBAL TOBACCO CONTROL PROGRAM.

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I. Overview

The preceding chapters of this book have presented a series of case studies addressing illicit trade in tobacco products in over 30 countries, including strategies and measures to address it. The country case studies describe the impact of tax administration (including customs) and, in most cases, of price and tax differences on illicit trade. Collectively, these case studies provide a strong platform for evaluating good and, in some cases, bad practices in addressing illicit trade in tobacco products. The chapters address both tax evasion (i.e., illicit tobacco trade) and tax avoidance (i.e., legal loopholes to avoid tobacco taxes). These studies demonstrate a wide variety in the salience of illicit tobacco trade, country strategies, capacities, and degrees of success in confronting this challenge.

This concluding chapter summarizes good practices and recommendations that emerge from the country cases. It also draws on guidance from the WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products (the Protocol), from the IMF Chapter in this volume, and from the recent World Bank report, *Tobacco Tax Reform: At the Crossroads of Health and Development*. The essence of these good practices and recommendations, as discussed below, can be summarized in the following three points:

» To reduce illicit trade in tobacco products, it is both crucial and feasible for all countries to strengthen tax (including customs) administration and enforcement. There is growing experience and agreement on the package of steps needed to do so, the main elements of which are described in the Protocol.

» Tobacco taxes play only a minor role in illicit trade, although several country cases found that the tobacco industry used exaggerated estimates of illicit trade to argue against tobacco tax increases. Significantly, in every case study where there was a significant tax or price increase, there was a resultant increase in government revenue and (where data was available) a decrease in smoking prevalence. As a result, countries should not hesitate to increase tobacco taxes and improve their tax structures, even while at an early stage of efforts to improve tax administration. Even at relatively high levels of tobacco illicit trade, the overwhelming majority of smokers will still be buying on the official market and paying full taxes, while some smokers will quit (or non-smokers will not initiate smoking) as a result of a tobacco tax reform.

» The strengthening of tax administration and tobacco tax reform – significant and sustained increases and restructuring of tobacco taxes — should be viewed as complements rather than substitutes. They reinforce each other in helping countries to reduce preventable morbidity and mortality and in increasing public revenues.

II. The importance of reducing illicit trade in tobacco products

The case studies make it clear that reducing illicit trade in tobacco products is important whether viewed from the perspective of public health, public finance, the rule of law, governance, or equity. As previously noted, illicit trade in tobacco products contributes to numerous health, economic, and governance challenges, of which the following are most salient:

» **Illicit tobacco kills**. The fundamental reason to confront illicit trade in tobacco products involves its public health impact. All tobacco products are dangerous to human health, including those produced and sold in strict legality. However, illicit tobacco harms individual and population health in additional ways. From a public health perspective, illicit trade weakens the effect of tobacco excise taxes on tobacco consumption - and consequently on preventable morbidity and mortality - by increasing the affordability, attractiveness, and/or availability of tobacco products.

» **Youth and the poor are most impacted.** Illicit cigarettes generally sell for considerably less than their tax-paid equivalents, as evidenced by the case studies presented in this book. They inflict the greatest harm to the most price-sensitive population group, reducing prices to and so encouraging consumption by, in particular, young people and those with low incomes. The availability of inexpensive illicit cigarettes increases the likelihood of young people developing addiction (particularly where illicit imports "glamorize" smoking through aspirational brands). It also encourages the poorest quintiles of the population to continue smoking, rather than choose to quit, even when tobacco taxes and the price of legal cigarettes rise. The poor tend to have higher tobacco consumption levels and consequently are disproportionately impacted by tobacco-related diseases and premature deaths, placing them at higher risk of being pushed into extreme poverty due to costs of treatment and/or loss of income when an income-earning smoker develops a tobacco-related disease. As a result, illicit trade in tobacco products exacerbates equity gaps.

» **Confronting illicit trade in tobacco products supports improved governance.** Tobacco illicit trade, by definition, reduces revenues that would otherwise be paid to government that could be invested in tobacco control and other priority programs that benefit the population. It also negatively impacts public welfare in other ways. For instance, illicit trade in tobacco is not only inconsistent with the rule of law, but often depends on and can contribute to weakened governance (e.g., through corruption and the presence of organized criminal networks). In contrast, confronting this issue can yield broader benefits for governance - tools and capacities developed to address illicit trade in tobacco products can strengthen overall tax administration, compliance, and enforcement (including for other products subject to excise taxes, such as alcohol and fuel). This subject is addressed in the Kenya, Georgia, and Ecuador chapters of this report. Controlling illicit trade in tobacco products and enhanced overall governance are mutually reinforcing.

» **Uncontrolled illicit trade in tobacco provides opportunities for the tobacco industry to misinform public opinion and unduly influence public policy.** As emphasized in this report's country case studies and other recent analyses[1], the tobacco industry routinely uses inflated estimates of the impact of tobacco taxes on illicit trade to campaign against tobacco tax increases and misinform public opinion. By accurately measuring and better controlling illicit trade in tobacco, governments reduce industry's ability to distort policy priorities supporting improved public health, tax administration, and governance. For example, as emphasized in the Colombia chapter, an initial study to quantify the true volume of illicit cigarette trade in the country (notably, the first of its kind not to be sponsored by tobacco companies) was essential to galvanizing support for increased tobacco taxation.

III. Strategic steps to reduce illicit trade in tobacco products

How are countries effectively confronting tobacco illicit trade? The following strategic steps emerge from the case studies, with respect to key lessons from countries that are successfully addressing illicit trade in tobacco products.

» **Diagnose the different forms of illicit trade in tobacco products:** The cases studies show that illicit trade overwhelmingly involves cigarettes, rather than other tobacco products. Cigarette illicit trade takes variety of forms, varying in type and severity by country: smuggling across borders; declaring products as for export (and thus not subject to domestic tax) and then selling them on the domestic market; using fake tax stamps; selling undeclared production (e.g. an undisclosed third production shift); producing counterfeits of legitimate brands; producing low-cost unbranded cigarettes destined for illicit markets (so called "illicit whites"); using Free Zones to leak cigarettes to the domestic market; and selling tobacco products via Internet, phone, or mail[2]. Each form of tax evasion has somewhat different implications for needed improvements in tax administration and enforcement.

» **Understand the causes and drivers of illicit trade in tobacco products:** The case studies confirm findings from the literature that tobacco illicit trade stems from a wide range of causes. These include weaknesses in governance and the regulatory framework, corruption, insufficient capacity of enforcement and judiciary systems, the existence of informal distribution and of organized crime networks, having a border with another country suffering from similar problems; and expected profitability of tobacco illicit trade. Tobacco taxes are one of the factors affecting expected profitability, along with costs of procurement, distribution and the chances and consequences of getting caught – which is largely dependent on tax administration. However, the sub-regional case study on South Africa, Lesotho and Botswana shows that price differences had little to no detectable impact on illicit cross-border trade of tobacco products. In fact, countries or sub-regions with relatively low tobacco prices such as Malaysia or the Caribbean tend to have higher, rather than lower, shares of illicit trade.

The country cases strongly confirm that the most important determinant in illicit trade of tobacco products is tax administration. Countries as different in levels of economic and institutional development as the United Kingdom (UK), Kenya, and Georgia have all successfully improved the effectiveness of their tobacco tax administration and, by doing so, reduced tobacco illicit trade while increasing tobacco tax rates and tobacco tax revenues. Addressing illicit trade and raising tobacco taxes should be viewed as mutually reinforcing and complementary actions. Even at relatively high levels of illicit trade, the overwhelming majority of consumers purchase on the official tax-paid market. Some of that overwhelming majority of smokers will be reducing their consumption or quitting following a tax increase, while wealthier and less price sensitive smokers will be contributing to increased government revenues.

» **Strengthen country data, analysis, planning, and implementation oversight:** Consistent with Articles 7 and 9 of the Protocol, the UK, Australia, and Ireland case studies visibly demonstrate the importance of reliable data. The process should start with mapping of the supply and demand for tobacco products; what is known about illicit trade in tobacco products; the modus operandi of actors involved in or facilitating illicit trade; the capacity, commitment, and accountability (including corruption) of government agencies; and resultant effectiveness of tax/customs administration. Anti-illicit trade strategies need to be informed and when needed adjusted based on the ongoing data collection - as the UK, Kenya, and Australia (with its Black Economy Taskforce), have done. Actors involved in the illicit trade of tobacco products are continuously assessing their sales and profits and adapting their tactics accordingly. Consequently, agencies responsible for controlling/preventing tobacco illicit trade must take a similarly adaptable, rigorous, and focused approach.

In addition, having access to high quality local market data, including smoking prevalence and intensity, is essential. Countries that regularly generate their own reliable estimates (e.g., UK, Australia, Ireland) use them also to fine-tune their strategies. Unfortunately, independent estimates of the size of illicit markets are scarce, particularly in low- and middle-income countries, and industry estimates (as discussed below) are unreliable. As a result, it is important that countries develop independent estimates of tobacco illicit trade using good-practice methods. These methods, described in a 2015 Guide[3], if applied correctly and adjusted for the local circumstances, can generate reliable estimates of the size of illicit markets relatively quickly and at reasonable costs. Developing such independent estimates requires strengthening country capacity, which could be augmented by technical assistance available, including from multilateral donors and other development partners.

Importantly, not having data regarding the size of the illicit market is not an excuse for inaction. The absence of such a reliable estimate has not stopped Kenya, Georgia, or the Philippines, for example, from moving ahead in controlling illicit trade in tobacco products. In all countries, it is important to evaluate the measures already in place and determine what works, what does not, and why. Country strategies to reduce illicit trade in tobacco products should establish policies, legislation, and regulations appropriate for specific country contexts.

It is critical to note that having a strong strategy on paper is important but not sufficient, unless such plans can be operationalized. This includes the strengthening of capacity, incentives, and accountability needed for effective implementation.[4] The case studies of Bangladesh, the Southern African Customs Union (SACU), and the UK, at quite different levels of development, all emphasize the importance of capacity development. Similarly, Colombia adopted an Anti-Smuggling Act that both provides the legal framework for controlling illicit trade and the tools for implementing extended law enforcement activities in border areas. Likewise, the Kenya case study highlights the fact that deterring tobacco illicit trade requires not just setting, but enforcing criminal penalties, including incarceration and severe financial penalties for correspondingly serious offenses.

» **Avoid reliance on the tobacco industry:** The role of the tobacco industry poses a challenge to countries seeking to address illicit trade, since the tobacco industry is often linked to illicit trade in tobacco products, either directly or indirectly.[5] The UK and Ireland case studies emphasize the need to fulfill obligations under Article 5.3 of the FCTC to prevent the tobacco industry from influencing public policy.[6] One approach, as described in the UK case study, is to publicly expose the industry involvement in illicit trade. As the literature indicates, tobacco industry documents provide compelling evidence that the supply of international brands via illegal channels has been an important component of their market entry strategy in Africa, Latin America and in Asian countries.[7,8] As the experience of SACU, Chile, the Organization of Eastern Caribbean States (OECS) and South Africa illustrates, the industry's economic power provides them substantial influence in many countries. In Colombia, for example, the main regulatory authority is required to report to the tobacco industry, allowing it to influence budget allocations and decisions related to controlling tobacco illicit trade in violation of Article 5.3 of the FCTC.

The case studies, including Colombia, Australia, Georgia, and Malaysia, also confirm prior findings that the tobacco industry regularly overstates levels and changes in tobacco illicit trade to oppose tobacco tax reforms. For example, in Colombia, an impartial estimate of the market share of illicit trade was only 7 percent, while the tobacco industry estimated that share at 18 percent.[9] In Australia, an industry-funded study estimated the illicit market at 14 percent[10] of the total market, while the Australian Taxation Office calculated that share to be only 5.6 percent.[11] This issue of exaggerating the illicit market share applies whether the tobacco industry is reporting data to governments or to firms that aggregate and publish data.

The Georgia and Uruguay case studies show that when the government responds to industry pressure and reduces taxes due to fears regarding tobacco illicit trade, the result is a decline in revenues and an increase in consumption, while the true drivers of illicit trade in tobacco products remain unaddressed. Canada had a similar, well-documented, experience in the 1990s, when the government reduced tobacco tax in response to tobacco illicit trade concerns[12]. This tax reduction led to lower cigarette prices, higher smoking rates, especially among youth,[13] and lower tax revenue. After assessing the impact of its 1994 tobacco tax cut on prevalence and revenues, the Canadian government restored taxes to their pre-1994 level.[14] In addition, it sued the tobacco industry for manipulating illicit trade to influence the lowering of the cigarette tax rate.[15, 16]

» Build inclusive, political coalitions against illicit trade in tobacco products: Strong and successfully implemented country strategies require enlisting support and finding champions at top levels of ministries and governments, as demonstrated in Georgia, the Philippines and the UK. Another crucial element of gaining political support is to build alliances with key stakeholders in civil society, including NGOs, think tanks, and the media, as emphasized in the Kenya and the UK case studies.

NGOs in Georgia, Turkey, Columbia, and Bangladesh also have played major roles in support of addressing tobacco illicit trade and in implementing tobacco tax reforms, including exposing efforts by the tobacco industry to counter tobacco control programs. In Bangladesh, for example, young people have torn down billboards that were illegally advertising tobacco. The Philippines and Kenya introduced apps for the public to verify the authenticity of cigarette packs, while the UK ran a public awareness campaign explaining how purchasing illegal cigarettes harms the country and local communities. Involving the public in addressing illicit trade both supports enforcement and reduces the demand for illegal products. Issues of political economy also affect enforcement – the Mexico and Kenya case studies highlight the importance of the electoral cycle and the overall national security context on the effectiveness of tax administration and enforcement.

- **Work across sectoral silos:** The Colombia, Chile and Kenya case studies identified lack of integration across sectors at the national and subnational levels as the major obstacle in controlling illicit trade of tobacco products. These analyses, in conjunction with the Bangladesh, Australia and Mexico case studies, emphasize that success in adopting and implementing strong programs to combat illicit trade and implement tobacco tax reform requires active and coordinated support from numerous ministries/government agencies. Coordination is particularly important in integrating tobacco illicit trade control into strategies for tobacco tax reform and overall tobacco control programs.

  Bangladesh, for example, closely coordinates its tobacco control efforts through five ministries at both the national and the district levels: Health (the lead agency in the FCTC and overall tobacco control); Finance (responsible for tax policy and administration); Home Affairs (responsible for police and border control); Agriculture (regarding tobacco cultivation); and the Cabinet Office (to provide high level political support). As detailed in the Bangladesh case study, its national taskforce also includes, among others, the Ministry of Commerce (on regulating trade and licensing); the Ministry of Justice (on enforcing the law and prosecuting offenders); and the Ministry of Education (on convincing vulnerable young people not to initiate smoking behavior /develop an addiction to tobacco).

- **Address illicit trade as an integral part of tobacco tax reform and overall tobacco control:** Country cases, including those of the Philippines, the UK and Ireland, clearly demonstrate the complementary nature of addressing tobacco illicit trade and implementing tobacco tax reform. The key elements of tobacco tax reform have recently been summarized in the World Bank publication *Tobacco Tax Reform: At the Crossroads of Health and Development*[17] and are summarized below:

  - **Go big, go fast.** Tax strategies should focus on health gains first, then on fiscal benefits. This means going for big tobacco excise tax rate increases starting early in the process.
  - **Attack affordability (i.e., if tobacco taxes increase tobacco prices faster than inflation and growth in per capita income).** Tobacco taxes only reduce tobacco consumption if they reduce cigarette affordability.
  - **Change expectations.** Communication with the public is also critical. Governments must make sure consumers know that cigarette prices will keep going up.
  - **Tax by quantity.** Tobacco tax rates should be simplified and based on the quantity of cigarettes, not their price.
  - **"Soft earmarks" can win support.** Although earmarking tax revenues through legislation is criticized by fiscal experts as contributing to rigidities, fragmentation, and eventual distortions in public expenditure, "soft" earmarking of funds (for example, linking increased taxes to increased health spending) has helped generate grassroots support for the tax hikes.

- **Regional collaboration can boost results.** Momentum for ambitious tobacco tax reform can be enhanced, and cross-border threats like cigarette smuggling minimized, when countries work together in a regional structure.
- **Build broad alliances.** Country leaders face sharp resistance to tax rate increases and other tobacco control measures from the tobacco industry. Countering these pressures requires reliable data and economic analysis, multi-sectoral policy development, and strong partnerships among key stakeholders at the local, national, and international levels.

The pace and phasing of these tax reform principles will, of course, depend on specific country circumstances. Following these principles of tobacco tax reform, combined with addressing tax avoidance and tax evasion, will improve public health, increase tax revenues and support economic growth. The largest beneficiaries of health and income gains will be former smokers and their families, as well as those who might otherwise have initiated smoking.[18]

More broadly, confronting illicit trade in tobacco products should be an integral part of a country's overall approach to tobacco control, which includes the steps called for in WHO's "MPOWER" strategy (banning smoking in public places, banning advertising and promotion of tobacco products, offering help to those who want to quit, as well as, of course, tobacco tax reform). The UK and Ireland case studies illustrate the importance of integrating tax and non-tax MPOWER steps in responding to tobacco illicit trade.

» **Encourage and draw on regional and global cooperation/partnerships:** As recommended in the Protocol (Articles 20 – 31) and the FCTC, countries also should support and draw on regional and sub-regional, as well as global, partnership arrangements to address illicit trade and to implement tobacco tax reform. This can help, for example, in reducing substantial disparities in tobacco taxes in neighboring countries by pulling countries up to a common higher tax level. It also can improve coordination of cross-border and regional efforts to reduce tobacco illicit trade.. As shown in the European Union (EU) case study, the EU sets the gold standard in using regional agreements to establish high minimum standards for tobacco taxes and to address illicit trade in tobacco products. Its regulations have an impact not only on EU member states, but also on candidate countries and on countries with Association Agreements such as Georgia. Georgia, for example, has worked closely with Turkey to stop the use of its territory for transit of untaxed cigarettes. In addition, Georgia has a memorandum of understanding with the UK Customs office to share intelligence regarding large-scale smuggling operations.

However, it should be noted that not all regional agreements are uniformly positive. The case study of the OECS countries and Trinidad and Tobago, for example, shows a negative informal 'neighborhood' effect, where all countries have low tobacco taxes (except for Barbados), lag behind the implementation of the MPOWER recommendations on tax reforms, and have implemented very few measures to control tobacco illicit trade. Also, the Senegal case study points to the damaging impact on tobacco tax reform of the maximum tobacco tax rate established by the West African Economic and Monetary Union (WAEMU). In contrast, West Africa's other regional economic grouping, the Economic Community of West African States (ECOWAS), has recently drastically reformed its tobacco tax directives by changing its "maximum" tax rule to a "minimum" one, so that, like the EU, it does not restrain countries from implementing higher tax rates.

At the global level, the most effective way a country can benefit from and contribute to promoting international collaboration is to join the Protocol, discussed below. Only four of the countries covered by case studies have done so, as of yet - Ecuador, Senegal, the UK and Uruguay. Ratifying the Protocol has advantages that go beyond information sharing and coordination of enforcement efforts, including access to technical assistance in implementing the Protocol and establishing track and trace systems.

» **Draw on the Protocol and Guidelines for implementing the FCTC:** Authorities seeking to strengthen tax administration can utilize two important sources of good practice that derive from Section 15 of the FCTC, "Illicit Trade in Tobacco Products." The first is the WHO's FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (or the Protocol). It is a new treaty derived from the FCTC that has been ratified by 46 countries and the European Union and that entered into force on September 25, 2018, as detailed in the chapter of this book. The case studies consistently refer to the Protocol, recommending adhering to its principles and citing specific Articles, even where countries have not yet ratified it. As an international treaty, the Protocol also can help generate domestic political support for implementing its measures. Additionally, countries that have ratified the Protocol will have access to resources to help them assess their illicit markets and develop their strategies to address illicit trade in tobacco products. The Protocol outlines three main approaches to reduce and prevent tobacco illicit trade: (i) Controlling the supply chain of tobacco products (Articles 6-13); (ii) Addressing unlawful conduct and criminal offenses through enforcement (Articles 14-19); and (iii) Promoting international cooperation through information sharing, mutual administrative and legal assistance, and extradition (Articles 20-31).

The second key source of policy guidance and good practice is constituted by the Guidelines for Implementation of Article 6, on *Price and Tax Measures* of the FCTC (issued in 2014). These guidelines also cover Article 15, on *Illicit Trade in Tobacco Products*. One of its guiding principles is the need for efficient and effective administration of tobacco tax systems, including addressing illicit trade in tobacco products. Section 4 of the Guidelines, which focuses specifically on tax administration, is closely aligned with the articles of the Protocol. It addresses a common practice of tax avoidance called "forestalling" (i.e., stocking up tax stamps or tax-paid excess inventories in the distribution system in advance of a tax increase). Forestalling has been reported in several case studies (including Georgia and the Philippines). Section 6 of the Guidelines is devoted to tax-free/duty-free sales - topics raised, for example, in Uruguay, the Philippines, and Chile case studies as a potential source of tax evasion or avoidance. Section 7 of the Guidelines emphasizes and provides guidance on international cooperation.

Box 1 summarizes the above strategic steps to reduce illicit trade in tobacco products.

BOX 1: SUMMARY OF STRATEGIC STEPS TO REDUCE ILLICIT TRADE IN TOBACCO PRODUCTS

- Diagnose the different forms of illicit trade in tobacco products
- Understand the causes and drivers of illicit trade in tobacco products
- Strengthen country data, analysis, planning, and implementation processes
- Avoid reliance on the tobacco industry
- Build inclusive, political coalitions against illicit trade in tobacco products
- Work across sectoral silos
- Address illicit trade as an integral part of tobacco tax reform and overall tobacco control
- Encourage and draw on regional and global cooperation/partnerships
- Draw on the Protocol and Guidelines for implementing the FCTC

IV. Specific actions to confront illicit trade in tobacco products

The discussion above provided broad, strategic directions for enhancing progress in controlling/preventing illicit trade in tobacco products. *However, what specific actions can decision makers prioritize to rapidly achieve gains?* Findings from the country case studies suggest the following specific actions (which are consistent with the IMF guidance presented in Chapter 22).

- *Require licensing for the full tobacco supply chain, as required by Article 6 of the Protocol*. At present there is licensing at least for all manufacturers, importers, exporters, and distributors in almost all country cases. What is needed is for each country to assess its capacity to require licensing for rest of the supply chain, particularly retail. As noted in the Canada case study, the best example of using licensing to control the supply chain is in the province of Quebec, where the entire supply chain is licensed including tobacco growers, transporters, manufacturers, those who store raw tobacco and/or final products, importers, wholesalers, retailers, as well as those in possession of manufacturing equipment. Tobacco importers are licensed in Malaysia, and the Philippines requires suppliers of raw materials to the production process, including those providing tobacco papers and filter components, to be licensed. The Australia case study highlights the importance of licensing tobacco manufacturing equipment to prevent the use of second-hand equipment for unlicensed and untaxed production. The UK has recently implemented a similar measure.

» *Require use of secure excise tax stamps and other product markings to facilitate enforcement and tax collection, as required by Article 8 of Protocol.* These markings should possess multiple layers of security (as implemented in Kenya, Georgia, and the Philippines, for example); they should not be removable (not the case in Indonesia where the stamps are being reused illegally); and they should be destroyed when the pack is opened (also to prevent reuse). The absence of secure excise marking in SACU countries, Chile or Mexico weakens the ability of the tax authorities to collect taxes.

» *Establish effective track-and-trace systems to follow tobacco products through the supply chain from production or import to sale to consumers (Article 8 of the Protocol)*. Secure excise stamps are crucial but not sufficient to prevent tax evasion if there is no downstream verification that cigarettes have tax stamps and that they are authentic. Georgia, Kenya, and the Philippines, for example, already possess tight monitoring of production and import using unique IDs and excise stamps. These efforts could be readily developed into full-fledged track-and-trace systems throughout the supply chain with relatively small investments. A track-and-trace system would help address, for example, the challenge posed by under-declared domestic cigarette production or production declared for export but then sold on the domestic market.

The Mexican and Chilean case studies identify the absence of a track-and-trace system as the major obstacle to controlling illicit trade in tobacco products, as does the SACU study. The Ecuador case study, documented how its Internal Revenue Service implemented a tax track-and-trace system — "SIMAR" for domestically produced cigarettes, alcoholic beverages, and beer. As the first track-and-trace to comply with the Protocol to Eliminate Illicit Trade in Tobacco Products, SIMAR has become a benchmark for other countries in the region as they begin to tackle these issues.

» *Establish effective enforcement teams equipped with automated reporting devices, to reduce human discretion in tobacco tax administration (Articles 8 and 19 of the Protocol)*. This feature played a major role in improving the level of enforcement in Kenya and Georgia. However, the Kenya case also underlines the importance of enforcement agents with the power to carry out inspections at any time and at any point in the supply chain, to seize illicit products on the spot, and to bring immediate charges against offenders.

» *Obtain detection equipment and use it effectively at customs posts (Articles 14 and 19 of the Protocol)*. Most countries already have access to detection equipment, although not necessarily in adequate quantity. Potential governance challenges, with respect to the use of this equipment, can be further reduced by separating the roles of generating and interpreting scans (as noted in the Kenya case study).

- *Develop a risk profile to target inspections (Articles 10, 14 and 19 of the Protocol)*. The Chile case highlights the use of a risk analysis tool for targeting suspicious cargos and to generate customs alerts.
- *Set relatively low duty-free allowances (Article 13 of the Protocol and Article 6.2 of the FCTC) for tobacco product purchases*, both in terms of amounts (e.g. only two packs, as in Australia) and frequency (e.g. only once every 30 days as in Georgia). Chile shows how the lack of restrictions on frequency led to substantial but legal small-scale tax avoidance.
- *Regulate or ban trade in tobacco products in free trade and other special economic zones (Article 12 of the Protocol)*. The Chile case study illustrates how the relative freedom from regulation in these zones can make them gateways for domestic sale of untaxed tobacco products. In contrast, Colombia and Malaysia both established a strict regulatory framework for free trade zones to prevent this challenge.
- *Set and enforce significant financial penalties and penal provisions for illicit trade in tobacco products (Articles 15, 16 and 17 of the Protocol)*. Seizures, financial penalties, and other punishment severe enough to be a deterrent (unlike some of those reported in the Kenya case study) are important. Criminal prosecutions are particularly important as deterrents. The UK case study, for example, reported that in its successful efforts to sharply reduce illicit trade, there were an average of about 250 criminal convictions per year from 2014-2016. Colombian officials also realized the importance of punishment as a deterrent when Colombia substantially boosted penalties for those involved in smuggling.
- *Provide for secure and environmentally friendly destruction of seized cigarettes, carried out by the regulatory authorities and not by the tobacco industry (Article 18 of the Protocol)*. In Mexico, customs officials destroy seized cigarettes, while in the Philippines approval and presence of a Bureau of Internal Revenue representative is required. In contrast to this guidance, in South Africa an industry-representative body is responsible for the destruction of illicit goods.
- *Educate the public on the impact of tobacco illicit trade*. Getting the public involved supports enforcement and reduces the demand for illegal products. As noted in the case studies, the Philippines and Kenya introduced apps for the public to verify the authenticity of cigarette packs, while the UK ran a public awareness campaign explaining how purchasing illegal cigarettes harms the country and local communities.

The specific actions noted above do not cover Articles 7 (due diligence), 9 (record keeping) and 15 (liability) of the Protocol, since the country case studies generally did not call attention to these Articles. However, the Australia chapter stresses the importance of due diligence and record keeping, and the Canada chapter addressed record keeping. Since these Articles relate to the obligations of the industry, they are highly relevant to the implementation of the FCTC and the Protocol, in order to help create a strict regulatory environment for the tobacco industry and to protect public policies from commercial and other vested interests of the tobacco industry (in accordance with national law as specified in Article 5.3 of the FCTC).

Box 2 summarizes the above strategic steps to reduce illicit trade in tobacco products.

BOX 2: SUMMARY OF SPECIFIC ACTIONS TO CONFRONT ILLICIT TRADE IN TOBACCO PRODUCTS

» Require licensing for the full tobacco supply chain, as required by Article 6 of the Protocol.

» Require use of secure excise tax stamps and other product markings to facilitate enforcement and tax collection, as required by Article 8 of Protocol.

» Establish effective track-and-trace systems to follow tobacco products through the supply chain from production or import to sale to consumers (Article 8 of the Protocol).

» Establish effective enforcement teams equipped with automated reporting devices, to reduce human discretion in tobacco tax administration (Articles 8 and 19 of the Protocol).

» Obtain detection equipment and use it effectively at customs posts (Articles 14 and 19 of the Protocol).

» Develop a risk profile to target inspections (Articles 10, 14 and 19 of the Protocol).

» Set relatively low duty-free allowances (Article 13 of the Protocol and Article 6.2 of the FCTC) for tobacco product purchases, both in terms of amounts and frequency.

» Regulate or ban trade in tobacco products in free trade and other special economic zones (Article 12 of the Protocol).

» Set and enforce significant financial penalties and penal provisions for illicit trade in tobacco products (Articles 15, 16 and 17 of the Protocol).

» Provide for secure and environmentally friendly destruction of seized cigarettes, carried out by the regulatory authorities and not by the tobacco industry (Article 18 of the Protocol).

» Educate the public on the impact of tobacco illicit trade.

V. Final remarks

Complementing and supporting the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, the case studies presented in this book illustrate how countries have confronted illicit trade in tobacco products, in addition to summarizing the progress achieved, and the lessons learned. The case studies presented in this work demonstrate the importance - and feasibility - of addressing illicit trade in tobacco products as an integral part of tobacco tax reform and comprehensive tobacco control.

Endnotes

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https://www.who.int/en/news-room/detail/19-07-2017-who-report-finds-dramatic-increase-in-life-saving-tobacco-control-policies-in-last-decade

[iii] Combatting illicit trade in tobacco products: Commissioner Andriukaitis' Statement on the EU's adoption of an EU-wide track and trace system. European Commission Press Release, December 15, 2017.
http://europa.eu/rapid/press-release_STATEMENT-17-5269_en.htm

[iv] How to design and enforce tobacco excises? International Monetary Fund, October 2016
https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2016/12/31/How-to-Design-and-Enforce-Tobacco-Excises-44352

[v] World Bank Group: "Global Tobacco Control: A Development Priority for the World Bank Group", Preface of WHO Global Tobacco Report 2015.
http://www.who.int/tobacco/global_report/2015/timevansandworldbankforeword.pdf?ua=1

"To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation." [i]

– Dr. Vera Luiza da Costa e Silva
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

"Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences." [ii]

– Dr. Tedros Adhanom Ghebreyesus, Director-General
World Health Organization

"Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade. [iii]

– Commissioner Vytenis Andriukaitis
Health and Food Safety / European Commission

"Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions." [vi]

– Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)
Fiscal Affairs Department / International Monetary Fund

"Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year." [v]

–Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)
Health, Nutrition and Population Global Practice / World Bank Group