

Illicit Tobacco Trade

**Illegal Profits
and Public Peril**

CAMPAIGN FOR TOBACCO-FREE KIDS OCTOBER 2008

Understanding Illicit Trade

Global Losers

**Tobacco Company
Involvement In Illicit Trade**

Combating Illicit Trade

I. INTRODUCTION

Hundreds of billions of cigarettes are “vanishing” each year from legal trade channels into an underworld market,¹ and the counterfeiting of cigarettes is growing steadily, all at an enormous cost to public health and nations’ economies.

From China to the United Kingdom, and from Canada to Brazil, this outlaw trade spans the globe. The illicit trade of tobacco products is so pervasive that it was estimated at 10.7 percent of worldwide sales in 2006, or 600 billion cigarettes,² and cigarettes are believed to be the most illegally trafficked legal product in the world.³

The human impact is grave. Smuggling, whether of genuine or counterfeit brands, delivers cigarettes that are cheaper to buy. Because cheaper cigarettes lure youth and other new customers, they boost sales and consumption and make it harder for smokers to quit. As a result, illicit trade adds steadily to health care costs, worker productivity losses and the growing global death toll from tobacco use: 5.4 million lives a year, projected to rise to 8 million by 2030.⁴

The economic harm is also severe. The smuggling of genuine cigarettes steals as much as an estimated US \$40 billion to US \$50 billion a year from governments in tax revenue,⁵ with counterfeit trafficking stealing billions more.⁶ In addition, public health strategies are undermined; honest businesses suffer from unfair competition; and public safety is threatened when illegal profits support organized crime and even terrorist networks.⁷

To save lives and billions of dollars, strong international efforts are needed to eliminate illicit tobacco trade. One effort has begun. Parties to the Framework Convention on Tobacco Control (FCTC), an international treaty that took effect in 2005, are working to negotiate a treaty devoted to ending illicit trade.

This paper will give an introduction to illicit tobacco trade; discuss its causes and impact; and explore ways to combat it.

II. UNDERSTANDING ILLICIT TRADE

There are many faces to illicit tobacco trade, including large-scale smuggling, counterfeiting and bootlegging:

- In Canada, a disturbingly high number of teenagers are smoking contraband tobacco, judging from a study of the origins of thousands of cigarette butts taken from public grounds around high schools.⁸ Canada’s contraband problem also is estimated to cost government treasuries as much as \$4 million in lost tax revenues each day.⁹ The cigarettes come

GLOSSARY

Illicit tobacco trade is a prohibited practice or activity that involves production, shipping, distribution, receipt, purchase or sale of products. The major types of illicit trade include:

Large-scale smuggling. This often involves criminal organizations and refers to transporting, distributing and selling huge volumes of cigarettes, typically avoiding taxes. It often involves diversion from legal trade channels of entire container loads, each carrying about 10 million cigarettes. Because the market value of the cigarettes is high when compared to costs for transporting them, large-scale smugglers can realize a huge profit.

Typically the tobacco is bought by unofficial traders while it is **in transit** from its country of origin to its official destination, when customs duties, excise and value-added taxes have been suspended temporarily in a system to facilitate trade.

Bootlegging. This refers to smuggling by individuals or small groups of lesser quantities of cigarettes, usually for shorter distances. Often the cigarettes are bought in low-tax jurisdictions and re-sold across government borders in higher-tax regions in quantities that exceed customs limits.

When a tobacco product is made in violation of the law—whether it’s a statute relating to taxation or to licensing—it is called **illegal manufacturing**. One kind of illegal manufacturing is **counterfeiting**, the making of a fake tobacco product that carries a trademark without agreement from the trademark’s owner. This is the fastest-growing category of illicit trade.

Another type of illegal manufacturing is the production of otherwise legal brands in their regular factories after hours, or off the books, for illicit trade purposes.

When a tobacco product is smuggled, it’s called **contraband**.

Cigarette packaging: A cigarette pack frequently contains 20 cigarettes, cartons have 10 packs or 200 cigarettes, and master cases 50 cartons or 10,000 cigarettes. A shipping container generally has 475,000 packs or almost 10 million cigarettes.

from illegal factories on aboriginal reserves and from China.¹⁰

- China is home to one-third of the globe’s current smokers.¹¹ It also appears to be perhaps the source of more counterfeit cigarettes than any other nation.¹² Fake cigarettes from China are estimated at levels as high as 190 billion a year.¹³
- When authorities acting on a tip checked out a funeral cortege heading from a Ukrainian village to Romania, they found bootlegged cigarette cartons and packs hidden inside the coffin and concealed with foodstuffs.¹⁴ The deathly cargo came from a nation where one in four cigarettes produced is exported illegally¹⁵ and where cigarette prices are low.

Large-Scale Smuggling as a Lucrative Practice

Whether carried out by speed boat or container ship, cargo plane or lorry, 70 percent of illicit tobacco trade involves large-scale smuggling¹⁶—the transporting, distributing and selling of huge volumes of genuine or counterfeit cigarettes, avoiding taxes and duties.

Large-scale smuggling, often carried out by organized criminal groups, is highly lucrative. Raymond Kelly, former head of the U.S. Customs Service, reported that “profits from cigarette smuggling rival those of narcotic trafficking.”¹⁷

An explanation lies in the fact that cigarettes, based on their size and weight, are quite expensive compared to most other goods, making them ideal for high-profit-per-load smuggling. For example, a standard pack of cigarettes weighs only about an ounce (or 30 grams), and a carton of ten packs weighs significantly less than a pound. The popular Western brand Marlboro ranges in retail sales from €3.16 per pack (United States)¹⁸ to €8.63 (Norway).¹⁹

On the other hand, it is possible to get cigarettes for smuggling at much lower prices. First, counterfeit brands are cheaper to make. Second, smugglers can get bona fide cigarettes at factory cost by diverting them from legal trade channels before duties or taxes are applied. Third, smugglers can buy cigarettes legally in a low-price country to smuggle into a higher-priced country for illegal resale, evading import duties or taxes normally charged by a destination country. (Table 1 shows the large price disparities in place across countries.) In the low-price countries of Ukraine and Russia, for example, the average prices of a Marlboro pack are €0.67 and €0.97, respectively.²⁰ Smugglers may generate a profit of £2 per pack or £1 million for a container load of (almost 10 million) cigarettes sold on the street in the United Kingdom at half its UK retail price.²¹

Table 1: Cigarette Prices in Selected Markets²²

Market	Average price of a pack of 20 cigarettes	Carton (10 packs)	Shipping container (47,500 cartons or 475,000 packs)
Value (in U.S. Dollars)			
Ukraine	0.44	4.40	\$209,000
Russian Federation	0.68	6.80	\$323,000
India	0.78	7.80	\$370,500
China	0.84	8.40	\$399,000
Brazil	1.58	15.80	\$750,500
Uruguay	1.92	19.20	\$912,000
Romania	2.06	20.60	\$978,500
Japan	2.58	25.80	\$1,225,500
USA	4.10	41.00	\$1,947,500
Canada	6.34	63.40	\$3,011,500
Singapore	6.88	68.80	\$3,268,000
United Kingdom	8.24	82.40	\$3,914,000

Source: Euromonitor International

Currently, smugglers confront relatively low risks to realize high profits. Due to the current lack of international cooperation to fight smuggling, it is almost impossible for authorities to track the movement²³ of cigarettes over international boundaries and through the hands of numerous smugglers. Benefits currently outweigh risks for those who are prosecuted;²⁴ many countries don’t treat these offenses as a serious crime.²⁵

The potential huge profits at stake aren’t the only cause of cigarette smuggling. Countries with the highest cigarette tax rates or duties don’t necessarily have the highest levels of cigarette smuggling.²⁶ In Thailand, for example, tobacco taxes are some of the highest in the region, but smuggling is fairly low; most Thai smokers prefer mid-price and economy brands to the premium brand cigarettes chiefly offered by illicit trade.²⁷

Other key factors determining illicit trade rates include existing smuggling routes and black markets for other products in the country, the presence of organized crime, government policies toward cigarette smuggling, corruption, and even the marketing strategies chosen for a country by the major cigarette companies.^{28,29} (See Section IV, Tobacco Company Involvement in Illicit Trade.) Many of these factors are more commonly found in low- and middle-income countries.³⁰

To move cigarettes from legal trade channels into the black market, a smuggling route can cover thousands of miles. One pathway for smuggling American cigarette brands into Italy began with container loads exported to Antwerp, Belgium under the “transit” system of temporary suspension of taxes on goods headed for a third country. Next the cigarettes were rapidly exported and imported again

through many locations, ultimately transferring them to illegal channels in a city known for lax surveillance, such as Bar or Zelenika in Montenegro. Finally speedboats ferried cases of the cigarettes by night across the Adriatic to Italy, where they were sold in the streets of Naples and Bari.³¹

A different magnitude of smuggling across borders, sometimes by individuals or small crime gangs, is typically called small-scale smuggling or bootlegging. It is estimated to make up 15 percent of illicit trade.³² Often bootlegging involves smuggling genuine cigarettes purchased in low-tax jurisdictions to higher-tax jurisdictions for resale, in quantities that exceed customs limits.

Counterfeit Cigarette Manufacturing Expands

Boosted by new technology, the making of counterfeit cigarettes is the fastest-growing category of illicit tobacco trade.³³ It is simple to produce look-alike packaging, with sophisticated and less expensive computer scanners and printers. The counterfeiting of cigarettes is estimated to make up about 15 percent of illicit trade³⁴ when combined with other types of illegal cigarette manufacturing (for example, the manufacturing of otherwise legal brands after legal hours).

Counterfeiting poses a major challenge in some regions. As smuggling of genuine cigarettes has been reduced in the European Union, for example, the counterfeiting problem has grown.³⁵ Contraband cigarettes result in an annual revenue loss in the European Union of about €6 billion, and 65 percent of those cigarettes seized are counterfeit.³⁶

The journey of counterfeit cigarettes made in China and later seized in the West reflects the determination and resourcefulness of their traffickers. Here is a how an illegal counterfeiting pathway can work:

From rural areas where they are hard to detect, Chinese counterfeiters often operate clandestinely.³⁷ Decentralizing operations in these rural areas helps traffickers evade authorities: in one location, cigarettes are made; in another, cigarette packages are produced; and in a third, the cigarettes are hand-packed into the packages.

After containers of these knockoffs enter shipping channels, they make their way to such gateway ports as Los Angeles, poised to bring their handlers high profits. In 2003, it was reported that a container load of counterfeit cigarettes from China could bring smugglers a profit of US \$1 million to \$2 million, even after taking into account the cost of the cigarettes, their shipping and any necessary bribes in China.³⁸ The cost of importing the fakes from China: US \$120,000.

In addition to China, other sources of counterfeit cigarettes include Iran, United Arab Emirates, Romania, Russia, North Korea, Uruguay and Paraguay.^{39,40}

Biggest Markets for Illicit Trade

The consumers of the greatest volume of illicit cigarettes are China, Russia and Brazil (Table 2).⁴¹ Because China is believed to be a major supplier, many of the illicit cigarettes smoked there are probably made inside the country.⁴²

Table 2: The 24 Biggest Markets for Illicit Cigarettes 2006⁴³

Market	Illicit cigarettes consumed (million sticks)	% of duty paid market
Russian Federation	76,092.0	20.0
China	68,950.0	3.5*
Brazil	37,965.8	38.0
India	20,905.5	21.5
USA	19,465.3	5.1
United Kingdom	18,672.0	36.6
Philippines	18,519.8	19.4
Germany	15,555.3	16.5
Turkey	15,380.1	14.1
Indonesia	13,063.8	8.5
Greece	12,447.0	37.0
Poland	11,735.3	16.2
Vietnam	11,000.0	13.6
France	6,915.7	12.4
Canada	5,096.0	13.8
Argentina	5,012.5	12.6
Czech Republic	5,000.0	21.3
Romania	4,761.0	16.7
Japan	4,635.4	1.7
Saudi Arabia	3,988.0	22.6
Malaysia	3,435.3	20.0
South Africa	3,375.0	15.4
Morocco	3,000.0	22.4
Austria	2,700.0	19.9

* Illicit trade estimates vary for China. This estimate is from Euromonitor International. The Framework Convention Alliance estimates that China's illicit trade could be as high as 8%.

Source: Euromonitor International

Countries where illicit cigarettes make up the highest share of the total market include Albania, Bosnia and Herzegovina, Hong Kong, Brazil, Greece, United Kingdom, Macedonia, Uzbekistan and Iran (Table 3).⁴⁴ The nations that consume the greatest volume of illicit cigarettes are not necessarily top-ranking when countries are compared by illicit share of their total market; China and the United States, for example, rank high in the former grouping but lower in the latter.

Table 3: Illicit Share of Total Cigarettes Market – 24 Selected Markets 2006⁴⁵

Market	% of duty paid market 2006
Albania	45.0
Bosnia and Herzegovina	40.0
Hong Kong, China	39.1
Brazil	38.0
Greece	37.0
United Kingdom	36.6
Macedonia	33.0
Uzbekistan	30.0
Iran	25.0
Saudi Arabia	22.6
Morocco	22.4
Czech Republic	21.3
Norway	20.4
Malaysia	20.0
Russian Federation	20.0
Austria	19.9
Singapore	19.8
Philippines	19.4
Argentina	18.0
Finland	17.6
Venezuela	17.6
Netherlands	17.4
Pakistan	17.0
South Africa	15.4

Source: Euromonitor International

When geographic regions are compared for illicit cigarettes as a high percentage of the market, the leading regions are Latin America, 21.4 percent; Eastern Europe, 15.7 percent; and Western Europe, 12.3 percent.⁴⁶

Other Practices Used to Evade Taxes

In addition to smuggling and counterfeiting, some other practices evade taxes and deliver cheaper cigarettes as a result. These practices boost tobacco use, harm public health and help deplete national treasuries. They include Internet sales and cross-border shopping.

Internet sales of cigarettes are growing. In the United States alone, more than 770 websites were selling cigarettes to smokers in 2006, with about half of the websites located outside the United States.⁴⁷ That was up from about 40 domestic Internet sellers of cigarettes to buyers in the United States in early 2000.

Many cigarettes sold by Internet retailers are illicit be-

cause taxes are not paid, whether by retailers or smokers.⁴⁸ The Internet sellers also provide a useful sales outlet for smuggled or counterfeit cigarettes, and few of them safeguard against illegal purchases by underage smokers.^{49,50} With the growth of online trading websites, it has become possible for ordinary people owning computers to become tobacco smugglers from their homes.⁵¹

Citizens of one country may cross a border to buy cigarettes in an adjoining, lower-tax jurisdiction and pay required local taxes, or they may buy cigarettes when visiting the neighboring country for another reason. Returning home, the individual smoker often supplies family, friend or co-workers with cheaper cigarettes. This practice is called cross-border shopping.

In the small, lower-tax nation of Luxembourg, the portion of total cigarette sales resulting from cross-border shopping was once reported at up to 85 percent.⁵²

III. GLOBAL LOSERS

The big losers in the face of illicit tobacco trade are public health, government treasuries, national and local economies, public safety and security and honest businesses. The only winners are the smugglers and other illicit trade profiteers, which have included major cigarette companies.

Harm to Public Health from Cigarette Smuggling and Tax Evasion

One of the foremost ways that illicit trade causes harm worldwide is by making cigarettes more available and affordable. The availability of cheaper cigarettes boosts their sales and consumption⁵³ and adds to the devastating global toll of disease and death caused by smoking.

Smuggled cigarettes, whether genuine or counterfeit, are sold free from import duties and taxes, and counterfeit brands start with much lower manufacturing costs. These cigarettes can be sold at much cheaper prices than cigarettes made and sold legally.

Youths are among those most likely to be affected by availability of lower-priced, smuggled cigarettes.⁵⁴ Studies show that young people are more responsive to the price of cigarettes than older people.⁵⁵ Others who are more responsive to price changes are less educated people and lower-income people.^{56,57}

By making cigarettes more available and affordable, illicit trade increases the prevalence of smoking and tobacco consumption most among the poor and in low or middle-

income countries.⁵⁸ In these countries the WHO forecasts a mushrooming tobacco death toll: of the 8 million annual deaths projected from tobacco use in 2030, 80 percent will be in the developing world.⁵⁹

Illicit trade can also sabotage high tobacco taxation policy. Raising cigarette taxes—and prices—is considered the most effective way to reduce tobacco consumption and get smokers to quit.⁶⁰ Price increases have been shown to discourage young people from starting, to increase the number of smokers who quit and to reduce the number of former smokers who start again.⁶¹

For years, cigarette companies have exploited fear about smuggling to lobby policymakers worldwide against raising tobacco taxes, often blocking or delaying new cigarette tax increases or reducing their size.⁶² Despite the companies' claims, numerous countries have raised tobacco taxes effectively and enjoyed large revenue increases without experiencing a dramatic rise in smuggling.^{63,64}

Harm to National Treasuries and Economies from Illicit Trade

In addition to its harmful impact on public health, illicit trade takes a fiscal and economic toll.

In lost customs and tax revenues worldwide, illicit trade costs the world's governments an estimated US \$40 billion to US \$50 billion a year.⁶⁵ That staggering cost of tax evasion exceeds the gross domestic product of two-thirds of the countries in the world.⁶⁶

Even countries that provide a source of cheap cigarettes smuggled into other nations suffer from illicit trade. When a source country keeps tobacco tax rates low in order to maintain its role as a low-cost provider for contraband traffickers, it loses large sums of potential government revenue.

Illicit trade also affects national economies indirectly. Keeping cigarette prices low keeps smoking levels higher, which translates into higher health care costs for governments, households and businesses.

In the United States, health care costs tied to tobacco use have been estimated at close to US \$100 billion a year, in Germany almost US \$7 billion and in Australia, US \$1 billion.^{67,68} For high-income countries, the World Bank estimates that between 6 percent and 15 percent of total health-care costs can be attributed to smoking.⁶⁹ In low-income countries, these health care costs are often borne by families.

Tobacco use also imposes high productivity costs as smokers are sicker and absent from work more often. About half of all smokers die from a smoking related disease in

middle age, during prime working years.

Total costs—including direct health care costs plus indirect economic burden from productivity loss, absenteeism, and other socio-economic costs—are high: For example, Bangladesh, US \$424 million; Canada, US \$12.89 billion; New Zealand, US \$17.03 billion; Republic of Korea, US \$3.33 billion;⁷⁰ and USA, more than \$194 billion.⁷¹

Threats to Public Safety and Security from Contraband Tobacco Trade

Law and order are threatened globally by illicit trade in tobacco, whether through the ruthlessness of criminal organizations, the financing of terrorist groups or the corruption of public officials. Here are some examples:

- In the Balkans, violence and death have erupted in a center of cigarette smuggling. High-profile killings tied to illicit tobacco networks have taken the lives of intelligence officers, politicians, criminals and a journalist—who was gunned down after his newspaper published a series on smuggling conducted by underworld kingpins.⁷²
- A leader of a multi-million dollar cigarette smuggling operation in the United States was convicted of providing aid to a terrorist organization, the Lebanese group Hezbollah, and was sentenced to 155 years in prison in 2003.⁷³
- Paraguay, an international hub for cigarette smuggling, is marked by “weak border controls, extensive corruption and money-laundering activity,” according to the U.S. Central Intelligence Agency's World Factbook.⁷⁴

Increasingly, law enforcement authorities have identified cigarette smuggling as appealing to criminal networks. The possibility of realizing huge profits has drawn organized crime groups to smuggling.⁷⁵

Some smugglers have ties to terrorist groups. Investigators have found “that traffickers in the United States and the United Kingdom are providing material support to the Hezbollah and the Real IRA (RIRA), among other terrorist groups. In addition, law enforcement research indicates that groups tied to al Qaeda, Hamas, PKK (the Kurdish Workers Party), and Islamic Jihad (both Egyptian and Palestinian) are involved in the illicit trafficking of cigarettes.”⁷⁶

IV. TOBACCO COMPANY INVOLVEMENT IN ILLICIT TRADE

There is extensive evidence that major cigarette companies have been complicit in illicit trade. Evidence ranges from court cases to documents produced by the companies as a result of a wave of lawsuits, and it indicates that in addition to fostering and supporting smuggling of their own brands, companies have overseen and directed actions of middlemen in smuggling routes taken by some of their cigarettes.⁷⁷

Cigarette company executives have routinely denied allegations they had a hand in illicit trade. They insisted they sold cigarettes legally to distributors, wholesalers and exporters with no control over the next steps. But a different story has emerged from legal proceedings and internal industry document disclosures.

Court Cases and Binding Agreements

In 1998, a RJR Nabisco subsidiary, Northern Brands International, pleaded guilty to federal charges in a “round-tripping” smuggling scheme. Canadian-produced cigarettes were exported to the United States and clandestinely re-routed back across the St. Lawrence River to avoid cigarette taxes in Canada. It was the first time a U.S. tobacco company was convicted of complicity in international cigarette smuggling.⁷⁸ The affiliate’s former president, who also pleaded guilty to charges in the case, told 60 Minutes II that RJR set up the affiliate expressly for smuggling cigarettes back into Canada.⁷⁹

In 2004, in order to avoid a European Union lawsuit, Philip Morris International (PMI) entered into a legally binding agreement to put in place a series of anti-cigarette smuggling measures. PMI did not admit liability. Three years later, Japan Tobacco International (JTI) reached a similar accord with the EU. PMI and JTI are two of the largest transnational tobacco companies (TTCs).

In 2008, Imperial Tobacco Canada Ltd. and Rothmans, Benson & Hedges pleaded guilty to aiding cigarette smugglers in the late 1980s and early 1990s. They admitted they had known that cigarettes shipped to the United States were smuggled back to Canada for cheap re-sale. The companies are to pay fines and penalties of more than \$1.1 billion.

After the settlement, there was another reminder of the high profits that can be gained through cigarette smuggling. A former executive with a holding company that once owned Imperial Tobacco described the Canadian settlement terms as involving “chump change” compared to what the company earned from breaking the law.⁸⁰ His slang phrase meant he considered the settlement a bargain that made the illegal acts worthwhile.

Internal Tobacco Industry Documents

Once-secret corporate documents written in tobacco executives’ own words show the value of smuggling to the major cigarette companies and the parts they have played in it. The economic incentives for tobacco companies are many: smuggled cigarettes have helped the companies expand sales, make inroads in markets they cannot enter legally, increase their market share in competition with rivals, keep cigarette prices down generally or win legal import status or production in another country.⁸¹ The following two examples are based on case studies using internal documents.

After the fall of the **Soviet Union** in 1991, TTCs sought to exploit emerging markets in the former Soviet states. The region represented not only a huge population but it also shared a border with China, a market considered the top prize; it had a large young population and posed the opportunity to expand sales to women.⁸² Smuggling, referred to by the acronym GT for general trade, was an important strategy detailed in a British American Tobacco (BAT) memo about establishing brands in the former Soviet Union:

- “GT will flourish”
- “GT Market will formalize in 1993 and continue through the Plan”
- “Powerful International Brands will drive and benefit from the GT Market”; and
- “Establishment of brand image and consumer franchise are pre-requisites for success in GT.”⁸³

China, with 350 million smokers, is the largest cigarette market in the world.⁸⁴ For BAT, penetrating the Chinese market from Hong Kong through smuggling was seen as the “key to the future” for the company’s taking the lead in the global tobacco industry,⁸⁵ according to internal documents. By 1990, Chinese government data showed all legal imports at 10.5 billion cigarettes, whereas BAT records reflected its exports to China of more than 20.3 billion cigarettes.⁸⁶ Presumably smuggling accounted for most or all of the difference. In fact, by the early 1990s, smuggling into China represented “the largest BATCo [British American Tobacco Company] market.”⁸⁷

Among the internal documents disclosed, indirect references or code words for smuggling are common. However, when the trade journal World Tobacco published the following conclusion, it openly acknowledged the importance of smuggling:

“Although sales of contraband cigarettes have affected the level of income that governments world-wide derive from tobacco sales, smuggling has also helped to promote some of the world’s leading brands in markets which had remained closed to foreign imports and where demand for Western cigarettes has continued to grow.”

Company Ties to Crime Groups Alleged

Cigarette makers often have blamed smuggling on organized crime. But some tobacco companies have had their own connections to crime groups, according to journalists' reports and racketeering lawsuits brought by the European Union and by governors of Colombia.

In one investigation of cigarette smuggling, journalists wrote that "company officials at BAT, Philip Morris, and R.J. Reynolds have worked closely with companies and individuals directly connected to organized crime in Hong Kong, Canada, Colombia, Italy, and the United States."⁸⁹ Separately, the Colombian governors' lawsuit accused Philip Morris of knowingly selling cigarettes to reputed narcotics traffickers. Cocaine profits could be used to buy cigarettes, which in turn could be sold quickly with a large profit and provide an appearance of legitimacy.⁹⁰

V. COMBATING ILLICIT TRADE

Strategies to reduce illicit trade have ranged from government investigations and litigation to use of high-tech devices for tracking cigarette packages, making smuggling easier to detect. At the international level, countries are working to write a comprehensive action plan in a treaty to supplement the Framework Convention on Tobacco Control (FCTC).

Investigations and Litigation

Investigations of cigarette smuggling and the threat of lawsuits apparently had a positive impact in Italy, Spain and the United Kingdom.

The European Community brought civil suits in the United States against a number of tobacco companies in 2000, alleging "an ongoing global scheme to smuggle cigarettes." Investigations in the late 1990s preceded the lawsuits.

In the agreements subsequently reached with the EC, Philip Morris International (PMI) and Japan Tobacco International (JTI) pledged to pay up to \$1 billion over 12 years and \$400 million over 15 years, respectively, for anti-contraband and anti-counterfeit initiatives. If authorities seize more of their smuggled cigarettes, the companies must make further payments. All European Union member states except the United Kingdom signed both agreements.⁹¹

In Italy and Spain, cigarette smuggling has declined dramatically, from about 15 percent to 1 to 2 percent,⁹² over the last decade. There was increased intelligence gathering, customs activity in border regions and international

cooperation,⁹³ and supply of U.S.-made cigarettes into illegal markets was reduced substantially. The smuggling investigations and the EC lawsuit were among multiple measures that resulted in cutting off the supply chain of American cigarettes into Spain's illegal market.⁹⁴

In the United Kingdom, where tobacco smuggling became a serious problem about a decade ago, it has declined from around 21 percent to 13 percent.⁹⁵ That reduction came after Parliament investigated and cast a public spotlight on tobacco export practices, and the UK government launched an anti-smuggling enforcement plan. It included heightened penalties, more customs officers, more prominent fiscal marks on cigarette packs and a public awareness campaign.⁹⁶

A different approach to smuggling involves a non-binding "memorandum of understanding" that some cigarette companies have signed with governments. It is clear that these voluntary agreements are not always proving effective.⁹⁷

UK-based Gallaher was among the first to sign such an agreement, in 2002. It included Gallaher pledges for information sharing with the UK and for refusing to sell cigarettes when a final destination is in doubt. Nonetheless, because of smuggling of Gallaher cigarettes into the UK, the UK Treasury has lost more than £1 billion in revenue since 2000.⁹⁸

The JTI and PMI agreements involve only two of the large cigarette companies, and it is too early to tell whether steps the companies are taking will succeed with global impact.

Digital Tax Stamps

The high-tech era offers new weapons to fight illicit trade.

One of them is the digital tax stamp. It uses invisible ink and features a unique, hidden code with data for each cigarette pack, making it harder for criminals to produce fakes. The encrypted data allows enforcement officials to scan packs of cigarettes wherever they find them, to distinguish real tax stamps from fakes, to identify the company that applied the stamp and initially sold the cigarettes, and to get other information for tracking, tracing, and enforcement.⁹⁹ (*Tracking* refers to monitoring a product's path. Tracing involves pinpointing where it was diverted from legal channels.)

In the most populous American state, California, a high-tech tax stamping system was implemented in 2005. By June 2007, the California tax collection agency announced that annual cigarette tax evasion had declined by 37 percent due to increased enforcement and the new tax stamps, gaining the state \$110 million annually in additional cigarette tax revenue.¹⁰⁰ Seizures of counterfeit products de-

clined. The cost of the California system has been calculated at about \$9 million per year—sharply less than the benefits.¹⁰¹

Brazil, facing the greatest problem with contraband in Latin America,¹⁰² has responded by requiring licensing of all cigarette manufacturers and implementing a national monitoring system. It includes equipment to automatically count cigarettes made on every production line and use of high-tech, encrypted tax stamps to identify each individual cigarette pack.¹⁰³ Tobacco companies bear the costs of introducing the system, which have been assessed at 1.7 US cents per cigarette pack.¹⁰⁴

There is a disadvantage: beyond Brazil's borders, law enforcement officials can't read the encrypted tax-stamp codes unless they get scanners from Brazilian authorities.¹⁰⁵

Barcodes

Another technology the tobacco sector is applying relies on barcodes, which are familiar to buyers of various consumer goods.

Under PMI's agreement with the EC, the company is required to control future smuggling through various steps. Since 2004, it has labeled 200 million master cases (each with 10,000 cigarettes) with unique barcodes that can be scanned by machines before the cigarettes are sold to the first buyers in the distribution chain.¹⁰⁶

In addition, PMI is required to continue research on technology for improving coding on cartons and packs. This year it has introduced tracking of cartons in Russia and Ukraine. Under PMI's program, the teartape on a carton—the small plastic tape used to tear open the cellophane wrapping—carries a more sophisticated barcode called a data matrix code. It is scanned at a production line and entered into a database. Philip Morris is trying out the labeling of individual packs with unique codes¹⁰⁷ in Germany and Peru.

A more expensive technology is radio-frequency identification, or RFID. When a cigarette pack carries a microchip, authorities using hand-held electronic devices can tell whether a pack is fake or real and whether duty is paid on it. RFID "smart tags"—they are microchips attached to antennas—cost US 15 to 20 cents a tag, and RFID readers cost between US \$100 and \$1,000.¹⁰⁸

BAT products have carried since May 2005 a taggant—a chemical element added to the ink—on the teartape. The taggant can be recognized by a scanner, and BAT can tell whether a product is genuine or counterfeit.¹⁰⁹

An International Treaty and its Illicit Trade Protocol

Despite progress in some countries and the application of new technologies, a more aggressive approach by the world's governments is needed to halt illicit trade.

One hundred sixty nations have ratified the World Health Organization's Framework Convention on Tobacco Control (FCTC), a treaty that went into effect February 27, 2005. Among its provisions, the treaty commits parties to eliminate the illicit trade of tobacco products.

Broad obligations under the treaty¹¹⁰ include marking all units and packages of tobacco products to help countries detect their origins; considering a tracking and tracing system; passing stronger laws against illicit trade; and ensuring destruction of confiscated tobacco-manufacturing equipment.

Parties to the FCTC agreed in 2007 to negotiate a supplementary treaty for curbing illicit trade, called a protocol. Negotiations started in 2008 and could be completed by 2010.

VI. CONCLUSION

Illicit tobacco trade contributes to massive harm to public health and economies worldwide and threatens public safety. This clandestine trade deprives treasuries of enormous revenues and adds to the devastating global death toll from tobacco use, now estimated at 5.4 million people a year and rising.

If the global tobacco epidemic is to be addressed effectively, then worldwide illicit trade demands a strong international response, tailored to help bring improved public health and greater economic security.

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