

Illicit Tobacco: What is the Tobacco Industry Trying to Do?

Introduction

1. The illicit trade in tobacco remains a serious problem for the UK. According to HM Revenue & Customs, in 2013/14 an estimated 10% of cigarettes and 39% of hand rolled tobacco consumed in the UK were illicit. The estimated lost tax revenue was £2.1 billion.¹ This represents a small rise on the estimates for 2012/13, after a long period where more effective enforcement action had reduced the level of illicit trade from its peak in 2000/01, when HMRC estimated the proportion of illicit cigarettes in the UK market at 21% and hand rolled tobacco at 63%. As well as depriving the exchequer of tax revenue, illicit tobacco also damages public health, particularly because increases in tobacco taxation are known to be a key means of reducing consumption and encouraging smokers to quit.²
2. Illicit cigarettes can be broken down into three broad categories:

Genuine brands that are first shipped to other countries (where either lower taxes are paid, or taxes are not paid at all) and then smuggled back into the UK

Overseas brands, including what are often called “cheap whites”, that are manufactured overseas, have no legitimate market in the UK and are routinely smuggled

Counterfeit cigarettes.
3. Starting in 2000, HM Customs and Excise, and its successor bodies HM Revenue and Customs and Border Force, have implemented detailed strategies to tackle the illicit tobacco trade. The most recent was published in March 2015.³ Spending on tackling illicit trade is highly cost effective. Paragraph 1.4 of the 2011 strategy stated that there has been “£917 million additional investment to tackle organised crime, tax evasion and avoidance through the government’s 2010 Spending Review”.⁴ Of this £25 million was re-invested in work on the illicit tobacco trade.

Tobacco Industry: Using Illicit Trade to Fight tobacco Control Policy

4. In the UK, as in other countries, the tobacco industry routinely both exaggerates the extent of illicit trade and misrepresents the nature of the illicit market. KPMG produces “Project Star” reports on illicit trade in the EU for Philip Morris International. The KPMG estimate of the illicit trade in cigarettes in the UK in 2012 was 16.4% of the total market: HMRC figures for 2012/13 show a level of 9%^{5 6} Industry material on illicit trade focusses on counterfeit products and cheap whites and routinely underplays the issue of legitimate products being smuggled back into the UK market. The tobacco industry wants to use the threat of illicit trade to:
 - Block or delay tobacco control policies, such as the tobacco tax escalator and the introduction of standardised (“plain”) packaging

¹ [HMRC Tobacco Tax Gap Estimates 2013/14](#)

² Article 6 of the [WHO Framework Convention on Tobacco Control](#), to which the UK is a Party, states that “the Parties recognise that price and tax measures are an effective and important means of reducing tobacco consumption”.

³ [Tackling illicit tobacco: from leaf to light](#): HMRC and Border Force strategy to tackle tobacco smuggling

⁴ [Tackling tobacco smuggling: building on our success](#): HMRC and Border Force, April 2011

⁵ [Project Star final report 2012, page 107](#): published 16th April 2013, PMI website

⁶ [HMRC Tobacco Tax Gap Estimates 2012-13](#)

- Create relationships with Government, local authorities and law enforcement agencies to get round the Framework Convention on Tobacco Control, under which Parties including the UK are obliged to prevent tobacco industry involvement with Government over public health policy.⁷

Tobacco Industry: Complicity in Illicit Trade

5. In fact, the large increase in the level of illicit trade during the 1990s was at least partly due to a vast expansion in British cigarettes being sold overseas in bulk to countries like Afghanistan, Moldova, Latvia and Russia and then smuggled back to the UK. The major tobacco manufacturers were strongly implicated in this form of illicit trade. During an evidence session on illicit trade held by the UK Parliament's Public Accounts Committee, in June 2002, George Osborne MP, then a member of the Committee made the following remarks to witnesses from Imperial Tobacco:

"One comes to the conclusion that you are either crooks or you are stupid, and you do not look very stupid. How can you possibly have sold cigarettes to Latvia, Kaliningrad, Afghanistan and Moldova in the expectation that those were just going to be used by the indigenous population or exported legitimately to neighbouring countries, and not in the expectation they would be smuggled? You must know - you only have to read a newspaper every day, a member of the public could tell you – that these are places which are linked to organised crime, that the drugs trade passes through all of these countries, that prostitution passes through all these countries. Did you not know that?"⁸

6. In 2000 the European Commission and Member States began legal action against the tobacco industry in the United States alleging that the major manufacturers had engaged in 'an ongoing global scheme to smuggle cigarettes, obstruct government oversight of the tobacco industry fix prices, bribe foreign public officials, and conduct illegal trade with terrorist groups and state sponsors of terrorism.'⁹ Without admitting liability, between 2004 and 2010 the four major tobacco multinationals, Philip Morris International (PMI), Japan Tobacco International (JTI), British American Tobacco (BAT) and Imperial Tobacco Ltd all signed legally binding anti-smuggling agreements with the EU paying billions of dollars in total to the EU and Member States. Agreements require them to put measures in place to prevent smuggling of their cigarettes, limit sales to volumes commensurate with legitimate market demand and to pay additional amounts if their cigarettes are subsequently found to be smuggled.¹⁰ However, the EU agreements have been strongly criticized as insufficiently strong to deter the industry from continuing complicity in illicit trade, and in particular as under-representing the proportion of illicit trade that is made up of genuine products that have been diverted into illicit channels.¹¹
7. In November 2013 the Public Accounts Committee accused tobacco multinationals of deliberately oversupplying European markets, with the tobacco smuggled back into the UK¹⁴. Committee Chair Margaret Hodge said: *"The supply of some brands of hand-rolling tobacco to some countries in 2011 exceeded legitimate demand by 240 per cent. HMRC must be more assertive with these manufactures. So far it has not fined a single one of them."*¹² The PAC reported that *"HMRC has not yet found the right balance in its enforcement action, which can range from prosecutions of organised criminal gangs to imposing fines or referring offenders to licensing authorities for those involved in local, small-scale*

⁷ Article 5.3 of the the [WHO Framework Convention on Tobacco Control](#) states that: *"In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and their vested interests of the tobacco industry in accordance with national law"*.

⁸ [Public Account Committee minutes of evidence 19 June 2002](#)

⁹ [Anti-racketeering legal action against tobacco companies](#): 4/11/2002

¹⁰ [Cigarette smuggling](#): OLAF (the EU anti-fraud office)

¹¹ [End European agreements with tobacco industry designed to curb smuggling, urge experts](#): Tobacco Control, 28/5/2015

¹² [Tobacco companies help fuel black market in Britain say MPs](#): 10/10/2002

operations".¹³ In November 2014, British American Tobacco was fined £650,000 by HMRC for deliberate over-supply of cigarettes to Belgium.¹⁴

8. A 2011 presentation by HMRC estimated, based on what are usually large seizures, that the proportion of illicit cigarettes in the UK market in 2009 that were genuine at only 6%.¹⁵ However, trading standards officers across nine English regions recently took part in "Operation Henry", a programme of search and seizures of illicit tobacco co-ordinated through the Trade Standards Institute. Between May and November 2014, more than 2.5 million cigarettes were seized together with other tobacco products including hand-rolled tobacco, raw tobacco, and shisha tobacco.¹⁶ These seizures included:

1,800,000 genuine non-UK duty paid cigarettes
615,000 illicit white cigarettes
123,000 counterfeit cigarettes
512 kilos of genuine non-UK duty paid hand rolling tobacco
753 kilos of raw tobacco
77 kilos of shisha.

9. The figures strongly suggest that HMRC data may seriously underestimate the proportion of the illicit market that is genuine cigarettes produced by major manufacturers. One possible reason for this may be that HMRC relies for some of its operational intelligence on the tobacco companies, who have a strong interest in reporting counterfeit products, and no reason to report illicit diversion of their own products.

Tobacco Industry: Using Illicit Trade to Build Relations with Governments and Local Authorities

10. Around the world, the tobacco industry has tried to use the issue of illicit trade to build relationships with Governments, local authorities and enforcement agencies, in breach of Article 5.3 of the FCTC and its accompanying guidelines. For example, in 2011 INTERPOL accepted a \$23.5 million donation from Philip Morris International, and has announced that it will be working with the industry's Digital Coding and Tracking Association to use the industry's "Codentify" system (see below) through the INTERPOL Global Register.¹⁷
11. The Trading Standards Institute, in partnership with Public Health England, ASH and others, have produced guidance for local authorities on how they should interact with the tobacco industry. The guidance states that:

"A popular tobacco industry 'route in' to the delivery of tobacco control is their assertion that, as brand holders, they are experts in tackling the illegal tobacco trade. In fact, their role is limited. The only aspect of tackling illegal tobacco that the tobacco industry can reasonably take part in is when the products concerned are counterfeit."

12. The tobacco industry has used retired senior police officers to raise public concern about illicit trade and dispense industry messages about standardised packaging and other tobacco control policies. illicit

¹³ [Public Accounts Committee - Twenty-Third Report HM Revenue and Customs: Progress in tackling tobacco smuggling](#), 4th September 2013.

¹⁴ [BAT in line of fire after smuggling fine](#): The Times, 14.11.2014

¹⁵ [HMRC. Presentation to Anti-Illicit Tobacco Seminar. 31 January 2011](#)

¹⁶ [Crackdown seizes more than 2.5 million illegal cigarettes](#): Chartered Trading Standards Institute 28/1/2015

¹⁷ [Philip Morris International Provides 15 Million Euro Contribution to INTERPOL to Fight Trafficking in Illicit Goods](#): 21.6.2012

trade. For example, former Scotland Yard detective chief inspector Will O'Reilly has been working on illicit trade for Philip Morris International, and has been widely quoted in the media.¹⁸

13. Phillip Morris has licensed its "Codentify" coding system, for no fee, to the other three major manufacturers. Codentify prints alphanumeric codes on cigarette packs, and the industry wants Governments to use this system to meet their obligations under the Illicit Trade Protocol.¹⁹ However, although the industry has been secretive about the details of the system, it does not appear to provide all the required information under either the Protocol, or the revised EU Tobacco Products Directive. The security of the system is also under question: for example, over whether use of the codes by enforcement agencies would become known to the industry, potentially providing inappropriate access to information about ongoing criminal investigations. Codentify may also not provide adequate safeguards against re-use of legitimate codes on diverted products.

What Should the UK Government Do About Illicit Tobacco?

14. Action on Smoking and Health strongly supports the latest HMRC and Border Force strategy to fight illicit trade. ASH also wants the UK Government to:
 - Sign and ratify the WHO Illicit Trade Protocol, as soon as possible
 - Introduce all the supply chain controls mandated under the Protocol and revised Tobacco Products Directive as soon as possible, including an effective and secure tracking and tracing system for tobacco products
 - Take a lead in developing international mutual assistance and legal co-operation as mandated under the Protocol
 - Protect the HMRC and Border Force budgets for tackling illicit tobacco in the next Comprehensive Spending Review
 - Protect local authority budgets for trading standards enforcement work at a local, and provide direct budget incentives to local authorities and regional partnerships to undertake effective action to interdict the supply of illicit tobacco and to reduce public demand for illicit tobacco
 - Introduce a positive licensing scheme for tobacco wholesalers and retailers, with licenses suspended or withdrawn in cases of involvement with illicit trade
 - Undertake a joint review with the Trading Standards Institute and other enforcement experts into the collection of data on illicit trade, and in particular on whether current data accurately assesses the proportion of illicit tobacco accounted for by diverted genuine products
 - Ensure that HMRC and the Border Agency works with the Trading Standards Institute and other representative local government bodies as appropriate, to help develop a joint strategy on regional and local partnership work on illicit trade, to ensure that this is pursued more systematically across the country.

¹⁸ http://www.tobaccotactics.org/index.php/Will_O%E2%80%99Reilly

¹⁹ The [Illicit Trade Protocol](#) is a subsidiary treaty under the FCTC, which includes various supply chain controls which Parties must introduce to control illicit trade, including a Tracking and Tracing system for tobacco products (under Article 8)