

# Fighting Illicit Tobacco Trade



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INTERNATIONAL

June 2020

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# Crime-free, Smoke-free

## Fighting Illicit Trade: An Imperative for Delivering a Smoke-Free Future

PMI is leading a transformation in the tobacco industry to create a smoke-free future, and ultimately replace cigarettes with smoke-free products to the benefit of adults who would otherwise continue to smoke, society, the company and its shareholders. To succeed in our mission to unsmoke the world, it is imperative to eradicate illicit trade wherever it exists.

Today, tobacco is one of the most common illegally traded goods in the world, with as much as ten percent of global cigarette consumption sourced from the black market, according to the WHO.<sup>1</sup>

Illicit trade makes cheap, unregulated tobacco products easily accessible, undermining efforts to reduce smoking prevalence and protect youth from smoking. In order to make better alternatives available to the millions of adults who would otherwise continue to smoke, we must also ensure that there are no illegal actors sustaining a black market for cigarettes.

Smoke-free products can be a much better choice than continuing to smoke, provided that they are scientifically substantiated, manufactured using the appropriate safety and quality controls, and marketed responsibly. It is therefore important to protect consumers from fakes and prevent the counterfeiting of our products.

In a future where better alternatives replace cigarettes for those who would otherwise continue to smoke, there is no place for illegal operators fueling the black market with illicit products.

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1. WHO: <https://www.who.int/news-room/fact-sheets/detail/tobacco>



## A Complex Issue Requiring Collaboration, Dialogue and a Commonsense Approach

No one government or single industry can address this complex problem on its own. Tackling illicit trade requires **collaboration and public-private partnerships**, making full use of existing expertise, information sharing, innovative solutions and evolving technologies.

Public actors, the private sector and civil society alike all have a role to play.

**Effective regulation** is fundamental to achieving real progress against illicit trade, and governments have a key role to play in ensuring more effective **enforcement** of laws and penalties. This is why we **strongly support the objectives and principles of the WHO Framework Convention on Tobacco Control (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products**, and we are delighted to see a growing number of countries joining this international treaty.

**Civil society** can help consumers better understand the direct and indirect consequences of illicit trade and join forces with the private and public sector to find and implement impactful solutions.

On our end, as a legitimate tobacco company, we **invest significantly in supply chain controls** through preventive and protective measures, implement track-and-trace solutions in line with strict regulatory requirements and apply comprehensive due diligence of customers and suppliers. To protect our consumers and brands from

counterfeiters, we apply innovative and sophisticated **authentication and security technologies** to all our products, and we take **legal action to protect our brands**.

We also **collaborate with law enforcement agencies** to analyze seized products, share intelligence on emerging smuggling routes and trends shaping the black market, and train officials on the innovative authentication and security features we use to protect our products.

To foster cross-sector and public-private collaboration, we support — through PMI IMPACT — a wide range of organizations that fight illegal trade and related crimes through research, awareness-raising, development of technical solutions, funding of equipment, training and communication initiatives.

**Public-private partnerships based on an inclusive, commonsense approach by governments, the private sector, and civil society — in the implementation of appropriate regulation, knowledge sharing and beyond — are vital to help combat illicit trade.**

In this document, we outline several strategies for tackling the illicit tobacco problem. These include tougher enforcement of laws in free zones, effective licensing regimes, enhanced tracking and tracing systems, strong know-your-customer guidelines, and strict labeling requirements. We also illustrate the ways stakeholders can unite efforts.

To find out more about the fight against illicit trade, visit <https://www.stopillegal.com/>

# Understanding Illicit Tobacco Trade

Illicit tobacco trade affects not only our industry but also governments, society and ordinary people. It misleads consumers, deprives public authorities of tax revenue and funds organized crime and terrorism.

In 2019 the World Health Organization (WHO) estimated that one in every ten cigarettes and tobacco products consumed globally is illicit.<sup>2</sup> Euromonitor estimated that in 2017, the volume of duty-not-paid cigarettes consumed globally was 456 billion sticks, with an estimated tax revenue loss for governments of around USD 40 billion.<sup>3</sup>



## A Worldwide Scourge

*The problem is truly global in scope, sparing no region or country.*

### Latin America and Canada

It was estimated in 2018 that 22% of total cigarette volume or 52.5 billion cigarettes consumed in Latin America & Canada Region were potentially illicit. This represents USD 6 billion in aggregated tax revenues loss for the governments of the 19 countries included in the study. Most of these illicit cigarettes are “Illicit Whites” or “Cheap Whites” –tobacco products that are generally legally produced in a market and smuggled into another market where they have limited or no legal distribution.<sup>4</sup>



2. WHO, <https://www.who.int/news-room/fact-sheets/detail/tobacco>

3. Euromonitor International, <https://www.euromonitor.com/illicit-trade-in-tobacco-products/report> - based on an assessment covering 100 markets representing 95% of global tobacco consumption

4. KPMG, Project EOS, A study of illicit cigarette consumption in selected markets from Latin America and Canada, 2019.

## Eastern Europe

In Eastern Europe illicit cigarette consumption rose from 0.6% to 6.8% of total consumption from 2015 to 2018, representing over 20bn cigarettes in 2018. Had these cigarettes been sold legally, an additional USD \$950 million (RUB 68 billion) would have been collected in 2018.<sup>6</sup>

## Asia

Illicit cigarette incidence was estimated at 14.6% across 16 countries in 2017, equivalent to 115.9 billion illegal cigarettes. This means 1 in 7 cigarettes consumed in Asia were illicit in 2017. Governments lost USD 5.8 billion in tax revenue due to the illicit cigarette consumption.<sup>5</sup>

## The European Union

And within the European Union, in 2018 about 8.6% of total consumption of cigarettes in Europe was illicit, according to annual research by KPMG. This represents 43.6 billion cigarettes a year and \$10 billion in lost tax revenues.<sup>7</sup>

5. Oxford Economics, *Asia Illicit Tobacco Indicator 2018*.

6. KPMG, <https://home.kpmg/ru/en/home/media/press-releases/2019/05/eurasian-economic-union-illicit-cigarette-report.html>

7. KPMG, *Project Stella, A study of the illicit cigarette market in the EU*, 2019

# *The Impact of Illicit Trade in Tobacco Products*

Often intertwined with organized crime, corruption and human rights abuses across the globe, illicit trade exacerbates inequality, fuels crime and damages government revenues, depriving countries of much-needed funds to finance their sustainable development activities. Illicit flows from cross-border criminal operations reach between \$1.6 trillion and \$2.2 trillion annually.<sup>8</sup>

Criminal networks often use these staggering profits to fund other criminal activities such as human trafficking, drug trafficking and even terrorism. Prioritizing efforts to reduce illicit trade is therefore essential for countries around the world to attain the sustainable developments goals.

Various authorities and experts, including the U.S. State Department, describe **illicit tobacco as a low-risk, high-reward criminal activity that fosters a culture of corruption and bad governance.**<sup>9</sup>

And evidence suggests that it is not only criminal organizations, but also terrorist groups that exploit the black tobacco

market as a lucrative source of income. In the new global reality, seemingly low-level illicit tobacco trade can be financing acts of terror.<sup>10</sup>

We all must do more to combat illicit trade. That includes governments passing the necessary laws and rigorously enforcing them, legitimate tobacco companies ensuring they do business only with trustworthy partners that will not divert their products, and consumers being aware of direct and indirect consequences of them purchasing illicit products.

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8. [https://tsr.securityconference.de/assets/2019/Transnational\\_Security/MS\\_C\\_Transnational\\_Security\\_Report.pdf](https://tsr.securityconference.de/assets/2019/Transnational_Security/MS_C_Transnational_Security_Report.pdf)

9. US State Department, *The Global Illicit Trade in Tobacco: A Threat to National Security*, p.3

10. *Idem*.

# Combating the Illicit Tobacco Trade

## A milestone in the fight against illicit tobacco trade: the WHO FCTC Protocol

The FCTC [Protocol to Eliminate Illicit Trade in Tobacco Products](#) (The Protocol) is an international treaty that complements the WHO Framework Convention on Tobacco Control (FCTC).<sup>11</sup>

Parties to the FCTC created the Protocol with the objective of eliminating all forms of illicit trade in tobacco products, expanding on the existing Article 15 of the FCTC. The WHO refers to the Protocol as a “global solution to a global problem.”<sup>12</sup>

The Protocol entered into force on September 25, 2018, i.e. 90 days after the 40th ratification. The Protocol counts now 59 Parties.<sup>13</sup> A link to the current list of countries that are Parties to the Protocol can be found [here](#).<sup>14</sup>

The governing body of the Protocol is the Meeting of the Parties (MOP). MOP keeps under regular review the implementation of the Protocol and takes the decisions necessary to promote its effective implementation. Its work is governed by its Rules of Procedure.<sup>15</sup> The first MOP (MOP1) was held in Geneva on October 8 to 10, 2018, and MOP2 will take place in November 2021.<sup>16</sup>

Consisting of 47 Articles overall, the Protocol is divided into three substantive sections relating to (i) Supply Chain Controls; (ii) Offences; and (iii) International Cooperation.

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11. <https://www.who.int/fctc/protocol/en/>

12. See: [http://www.who.int/fctc/Protocol\\_summary\\_3Jul18-en.pdf](http://www.who.int/fctc/Protocol_summary_3Jul18-en.pdf)

13. As of April 2020

14. [https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=IX-4-a&chapter=9&clang=\\_en](https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4-a&chapter=9&clang=_en)



PMI has long been supporting the measures proposed by the Protocol and has welcomed its entry into force.<sup>17</sup> With international scope and a broad remit to address the multiple drivers of illicit trade, we believe that the Protocol is a milestone in the fight against illicit tobacco trade.

Actors from different sectors – governments, international organizations, private-sector, civil society – must combine their resources, knowledge and expertise to tackle the multifaceted and highly complex problem of illicit tobacco trade. **Hearing from the tobacco industry can only bring benefits to the debate. Having the perspective and ideas of those affected by illicit trade in the**

**policymaking process can only enrich the discussions**, ensuring that regulators gain a practical understanding of how a measure will operate once implemented, avoiding unintended consequences and raising alternative solutions.

Now is the time to focus on finding sustainable solutions against illicit trade. It is only through conversation and collaboration that we can achieve real change.

PMI has been at the forefront of the fight against illegal tobacco trade. In this paper, we share our point of view on what we believe to be effective strategies for tackling the illicit tobacco trade.

**In our view, the fight against illicit trade should rest on the following pillars.**



15. <https://www.pmi.com/media-center/news/pmi-welcomes-the-forthcoming-entry-into-force-of-the-who-protocol-against-illicit-trade>

16. <https://www.who.int/fctc/mediacentre/news/2020/COP9-MOP2-postponed-nov-2021/en/>

17. <https://www.pmi.com/media-center/news/pmi-welcomes-the-forthcoming-entry-into-force-of-the-who-protocol-against-illicit-trade>

## LICENSING

*The adoption of national licensing schemes for cigarette manufacturers and manufacturing equipment is a critical component of an effective strategy to fight illicit tobacco production and trade.*

Licensing requirements should be **proportionate and practical**, allowing law-abiding entities to readily adopt them. Above all, the requirements should be meaningful and focus on the core issue of illicit tobacco trade. They should ensure that only legitimate actors are involved in the manufacture, import, and export of tobacco products and manufacturing equipment.

Considering a licensing system applicable to the retail can be a significant challenge in countries where a large informal sector exists. As a reasonable alternative to licensing in these countries, retailers could be required to register with a public registry (“negative licensing”).

We believe that licensing systems should expand to cover not only manufacturers of tobacco products, but also machinery directly involved in cigarette manufacturing. Illegal manufacturers can too easily purchase machinery that no legitimate manufacturer would ever consider using.

A sense of proportionality is important. Licensing for machinery should be restricted to key components that are fundamental to the manufacture of tobacco products. For instance, we believe it is unnecessary to require licenses for machines that make labels or are used for packaging. Such machines can make labels for or pack any type of goods, with little adjustment. And as tobacco manufacturing machines can have up to 20,000 parts it would be unreasonable to require separate licenses for each part. But authorities should seize and destroy any tobacco manufacturing machines found without a valid license.

We are ready to share our technical expertise to help formulate a balanced approach that enhances existing controls for stopping the manufacture of illicit tobacco products and avoids over-regulation and duplication of efforts.



## TRACKING AND TRACING

*Tracking and tracing (T&T) is the ability to record the forward movement of products and trace backwards their history along the supply chain.<sup>18</sup>*

PMI has long supported the implementation of a global T&T regime, which can have a material impact on the illicit trade in tobacco. **Securing our supply chain and fighting illicit trade are integral parts of our efforts to drive operational excellence and build a sustainable future.**

We have been at the forefront of applying **technology** to secure our products and our supply chain and we will continue to innovate to further propel our anti-illicit trade efforts. All manufacturers should be held to the same standards in securing their supply chains.

PMI is committed to proactively expanding the reach of T&T solutions in our factories and ensuring the compliance of our products with all laws in their respective destination markets.

We believe that an **effective, global T&T system has to be independent, interoperable and based on internationally recognised open standards.** Digital T&T systems allow interoperability, as well as facilitate innovation and the optimization of enforcement activities.

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<sup>18</sup>. GS1, Business Process and System Requirements for Full Supply Chain Traceability, Issue 1.3.0, November 2012: "Traceability is the ability to track forward the movement of products through specified stage(s) of the extended supply chain and trace backward the history or location of the product which is under consideration" (accessed April 2020).



## INDEPENDENCE

*We support independent, cost-effective solutions that do not disrupt the manufacturing and distribution environments. Strict oversight of any T&T solution is important.*

We support a regime that enables public authorities to exercise full control over the T&T system. We think that it is also necessary to take into account the technical and operational constraints of manufacturing and distribution, and that manufacturers should be allowed to retain the control of the technical equipment installed in their factories. While economic operators should be responsible to implement the T&T solutions in their factories and across the supply chain as part of day-to-day operations, authorities are responsible for establishing, controlling, and supervising the T&T system and its correct implementation.

We support the recommendation that manufacturers mark unit packets and any unit-level packages (pouch, tin, etc.) with a UI generated by an independent UI issuer. For the sake of efficiency and interoperability

along the entire supply chain and to help enforcement efforts by public authorities, economic operators should use predefined internationally recognized standards, when generating the markings for aggregated-level packaging (carton, master case, pallet) which can be easily read, verified and interpreted.

This is already the case with the [EU Tobacco Products Directive \(2014/40/EU\)](#) or TPD, which requires unique codes to track and trace each pack of cigarettes. The independence of the T&T system from the tobacco industry was one of the key concerns of the EU. PMI has welcomed the entry into force of the first ever EU-wide T&T system for tobacco products. This is a positive step for the prevention of illicit tobacco trade in the EU, and it is the first time that a technology-driven, multi-layer T&T system is implemented across all Member States.

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*While economic operators should be responsible to implement the T&T solutions in their factories and across the supply chain, authorities are responsible for establishing, controlling, and supervising the T&T system and its correct implementation*

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## INTEROPERABILITY: DIGITAL SYSTEMS AND OPEN STANDARDS

### Interoperability

Interoperability, which results from the use of open standards, allows different national T&T systems to interact in a global regime of a wide range of goods, using off-the-shelf hardware and software. This will make the usage and the retrieval of information by law enforcement authorities easier and more effective.

### Open standards

Any successful T&T system must be based on open and internationally recognized standards and should be neutral as far as technology and supplier are concerned. Only then can suppliers compete and technologies evolve to design better solutions. Open and internationally recognized standards create an environment that nurtures interoperability and allows the tracking and tracing of a wide range of goods using the same hardware and software.

### Digital systems

Digital T&T systems allow interoperability, facilitate upgrades, innovation and the optimization of enforcement activities. Digital codes generated under the control of the government and printed on packs allow for: real time application to embed all the required information, interoperability – if complying with existing defined global standards – and further data recording along the supply chain without physically altering the product.

We look forward to a free market for solution providers governed by technical guidelines and standards, not a one-size-fits-all solution. We accept that such flexibility will help drive permanent innovation and keep costs proportionate to the benefits of any T&T system.

*For a more detailed understanding of PMI's view on T&T, please access our white paper 'Fighting Illicit Trade: Tracking and Tracing'<sup>19</sup>*

19. <https://www.pmi.com/sustainability/fighting-illicit-cigarette-trade/illicit-trade-in-the-eu>

## DUE DILIGENCE

*As a responsible corporate citizen, we conduct robust due diligence on every potential business partner.*

Our comprehensive know-your-customer policy helps us meet our goal of only doing business with entities that share our high standards of integrity and ethical business practices. We also work with our customers to ensure that they are equally thorough when they transact with their business partners.

Authorities should demand no less. They should require adequate information from tobacco companies about their customers. Authorities should document and periodically repeat their controls, and always be on the lookout for potential fraud, including when customers change.

One common criminal scheme involves routing payments to non-existent third parties to mask the identity of criminal actors. We propose a set of principles designed to stop such schemes, centered on controlling the acceptable forms of payment in tobacco transactions.

Such payments should be limited to:

- Wire transfer or cheque, in both cases from a bank account in the customer's name; and
- Cashier's cheque or bank draft issued by a bank in the country in which the customer is located.

Other important principles of effective due diligence include:

- Ensuring the payment currency matches the invoice;
- Allowing cash payments in exceptional and justified cases; and
- Prohibiting third-party payment transactions.

PMI long has fulfilled these requirements. They are undoubtedly effective in helping prevent fraud.

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*we also work with our customers to seek that they are equally thorough when they transact with their business partners*

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## FREE ZONES

*We support effective controls and regulation of manufacturing, trade and international transit of tobacco and tobacco products within FZs. Such regulation needs to be implemented and enforced effectively without disrupting the legal trade and legitimate businesses.*

FZs are areas of economic activity within a country's jurisdiction where goods that enter the area are exempted or subject to lower import or export duties than those applicable if goods were released for free circulation at the moment of their entry. By their nature, FZs facilitate trade and remove administrative burden, and have played an important role in economic growth and in advancing global trade. However, evidence shows that reduced controls in FZs have made them highly vulnerable to illicit trade (production and transit), money laundering and other criminal activities. This includes the proliferation of 'illicit whites' – cigarettes made for smuggling – as well as complex schemes for diverting legitimate products into the black market.

Article 12 of the Protocol refers to FZs and requires that Parties implement controls on manufacturing and transactions of tobacco products in FZs, and on the international transit or trans-shipment of tobacco products and tobacco manufacturing equipment. We agree with the principles of Article 12, and we recommend a comprehensive approach to control manufacturing and transactions involving tobacco in FZs.

A comprehensive approach should include the following measures:

- As part of the geographic territory of a country, FZs are part of the country's Customs regime but with special prerogatives and tax benefits. The common misperception that FZs are not under Customs' authority leads to lax customs supervision and lack of transparency. As an overarching principle, **customs authorities should have full access and oversight over FZs and apply the same controls, enforcement and sanctions to FZs** as in the rest of the national territory. This is in line with the Revised Kyoto Convention<sup>20</sup>, which provides that Customs shall have *ex officio* the right to carry out at any time checks on the goods stored in a free zone.
- **A licensing or registration regime** in FZs would allow authorities to have a complete register of all operators within FZs dealing with tobacco products.
- Article 8 of the Protocol, which calls for the establishment of a **global T&T regime**, should be equally applicable within FZs as part of the territorial jurisdiction of a country.
- Licensed operators in FZs should apply due diligence, Know Your Customer (KYC) and record-keeping practices that attest to proper business relationships and sales practices, and accurate inventory controls.
- Know Your Transaction practices should complement KYC to detect potential money laundering, often associated with illicit trade.
- All tobacco products manufactured, repackaged or transported in FZs should comply with the labeling requirements of the intended countries of retail sale.

*For a more detailed understanding of PMI's view on FZs please click here for link to our White paper 'Fighting Illicit Trade: Free Zones'<sup>21</sup>*

20. The Revised Kyoto Convention, Special Annex D, Chapter 2

21. [https://www.stopillegal.com/docs/default-source/position-papers/ftz-position-paper-may-2018.pdf?sfvrsn=4dee70d7\\_2](https://www.stopillegal.com/docs/default-source/position-papers/ftz-position-paper-may-2018.pdf?sfvrsn=4dee70d7_2)

## INTERNATIONAL COOPERATION

*Cooperation is key to designing effective anti-illicit trade strategies. The private and public sectors need to come together to pool experience and expertise.*

Manufacturers, supply chain partners, governments, police and customs authorities need to share information on seizures of tobacco products, discoveries of tax evasion, production quantities and values, and other evidence about illicit trade that can lead to successful enforcement of existing laws.

Such information could include licensing records, investigative and prosecution records, payment receipts for import, export or duty-free sales, and details of seizures.

Over the years, we have worked with many governments and international organizations. These partnerships have been invaluable in promoting an effective framework to dismantle organized criminal groups.

“ *Partnerships have been invaluable in promoting an effective framework to dismantle organized criminal groups* ”





## SANCTIONS

*Any meaningful regulatory framework requires a strict enforcement of the law.*

We propose that sanctions for non-compliance with anti-illicit tobacco laws should be stringent and include both financial and non-financial elements.

These sanctions should vary, depending on the type of offense, from, for example, license withdrawals, to fines and imprisonment.



## DUTY FREE

*We support the implementation of Protocol's provisions in the Duty Free channel.*

Duty free sales represent a legitimate legal sales channel that support numerous jobs in the retail and airline industry. Duty free has a safe, secure and legitimate supply chain and complies with a range of unique and important controls that provide for verification of registration, compliance, certification, review and audit.

**We support the implementation of Protocol's provisions in the duty free channel and a legislative framework for duty free sales based on effective T&T and rigorous due diligence and record keeping by retailers and manufacturers.**

Evidence-based research study to measure

the extent of illicit trade in tobacco products related to duty free sales is required by the Protocol. We believe that such a research should be conducted after the Parties have implemented the Protocol's supply chain control provisions in order to ascertain the impact of such controls on the duty-free channel. To ensure a clear understanding of a highly controlled and complex global business, such study must be independently carried out by international bodies with the transparent consultation of the duty free industry and its stakeholders, in full compliance with articles 5.3 of the FCTC and 4.2 of the Protocol.

“ *Duty Free has a safe, secure and legitimate supply chain and complies with a range of unique and important controls* ”

# Conclusion

For PMI, preventing illicit trade has been a long-standing priority and continues to be an integral part of our efforts to drive operational excellence and build a sustainable future.

As we are working toward a smoke-free future, we know that in order to achieve a world without cigarettes, it is more essential than ever to help secure a future without illicit trade. This is why we invest significantly in applying innovative technology to protect consumers and our brands from illegal traders, while working with others to help advance the fight against illicit trade around the world.

Illicit trade is a complex problem with far-reaching consequences for the global economy and society. Public-private partnerships based on an inclusive, common sense approach by governments, the private sector, and civil society are vital to help combat illicit trade.

The FCTC Protocol brings together countries against the scourge of illicit tobacco trade. This treaty will become an effective regulatory framework for countries once its measures are implemented by its Parties, more so when more countries ratify it or accede to it globally. Its success will rely upon collaboration: national governments, international organizations, civil society and the legitimate economic operators working to fight illicit tobacco trade together.



We remain steadfast on our determination to help eliminate illicit trade, and we stand ready to continue working with public and private actors alike to end illicit trade once and for all.

Now is the time to focus on finding sustainable solutions against this issue. It is only through conversation and collaboration that we can affect real change. PMI can be part of the solution.



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