

CONFRONTING ILLICIT TOBACCO TRADE:



WORLD BANK GROUP

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

UNITED KINGDOM: TACKLING ILLICIT TOBACCO

TECHNICAL REPORT OF THE WORLD BANK GROUP
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UNITED KINGDOM:

Tackling Illicit Tobacco

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Chapter Summary

Background

The United Kingdom (UK) has implemented a comprehensive package of tobacco control measures in the last 20 years and has seen significant decreases in smoking prevalence. In 2016, adult smoking prevalence was 16 percent. A crucial component of UK tobacco control policy has been high tobacco taxation, which has been implemented as both a public health and a tax revenue-generating measure. Following a series of tax rises, the illicit tobacco trade increased rapidly in the 1990s. This trend was due in particular to well-documented tobacco industry practices: tobacco manufacturers increasingly produced and exported cigarettes in volumes much greater than the known demand in their stated markets. These products were then smuggled, with no duty paid, into the UK (This type of illicit tobacco is known as “tobacco industry (TI) illicit.”) The revenue losses associated with the illicit tobacco trade were significant, equivalent to 25 percent of all tobacco revenue due, and the availability of tobacco at a fraction of the usual price undermined the public health impact of the tax increases.

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Approach to Tackling the Illicit Tobacco Trade in the UK

In 2000, the UK embarked on a comprehensive strategy to reduce the illicit tobacco trade. The strategy focused on supply-side measures, investing in a range of operational responses including disrupting the supply and distribution chains for illegal tobacco products and reducing the rewards from smuggling by increasing sanctions. The strategy has been regularly revised since 2000, in response to ongoing TI involvement in the illicit market and newly emerging threats, such as counterfeit products and cheap whites. The UK illicit tobacco strategy is underpinned by the principle that smuggling is an enforcement issue, rather than being caused by high tobacco prices.

The UK's customs and immigration authorities (HM Revenue and Customs and Border Force) currently share responsibility for tackling the illicit tobacco trade. Responsibilities include detecting and disrupting the supply of illicit tobacco and arresting and investigating those suspected of smuggling offences. Abroad, a team of Fiscal Crime Liaison Officers is responsible for liaising with international fiscal and law enforcement agencies and developing intelligence to intercept illicit tobacco destined for the UK market. In some regions, partnerships between stakeholders have been effective in raising awareness of key issues relating to illicit tobacco such as its links to crime and its availability to children. At the local level, local governments are responsible for local intelligence, and for detecting and seizing illicit tobacco products. Recent developments include the introduction of a registration scheme for anyone carrying out activities using raw tobacco and a tobacco machinery licensing scheme.

A number of enforcement mechanisms are in place. Supply chain legislation places a legal obligation on tobacco manufacturers not to facilitate smuggling. Sanctions to punish individuals linked to the illicit trade include seizure of goods, criminal prosecution with custodial sentences, and fines. Fiscal marks and anti-counterfeiting technology aid the identification of illicit products.

Strong governance including effective implementation of Article 5.3 has helped to ensure the success of the illicit tobacco strategy and its full independence from the TI. Key governance processes include the publication of monitoring data to ensure transparency, and reports on progress in tackling illicit tobacco published by parliamentary committees. Activity to combat the illicit tobacco trade in the UK is supported by action at the international level. This includes legal agreements between the EU and all the major multinational tobacco companies, which independent reviews suggest have not served their intended purpose. The UK is a Party to the Illicit Trade Protocol of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), which comes into force in September 2018, with a first Meeting of the Parties in October.

Results of Measures to Tackle the Illicit Tobacco Trade

The UK government collates data on the illicit market share, revenue losses associated with the illicit trade, seizure volumes, and the number and results of criminal investigations. During the first ten years of the illicit tobacco strategy, the illicit market share for cigarettes was nearly halved, falling from 22 percent to 12 percent (central estimates). The illicit market share of handrolling tobacco (HRT) saw a drop from 61 percent to 44 percent (central estimates) during the same period. The strategy has continued to have some success in recent years, with continued decreases in the illicit market share of HRT. However, while smoking prevalence has decreased, the illicit market for cigarettes has become a larger proportion of a declining market. This may reflect cuts in funding for local-level enforcement in recent years.

The scale and success of the enforcement effort is also indicated by the large volumes of seizures of both cigarettes and HRT. In 2015/16, an estimated 1.7 billion cigarettes and nearly 300 tonnes of HRT were seized, representing a total revenue value of over £600 million. Furthermore, significant revenue losses have been prevented as a result of enforcement activity.

A formal evaluation of the financial costs and benefits of the illicit tobacco strategy has not been published; however, data published in the public domain indicate that funding measures to tackle the illicit trade have delivered a significant return on investment.

The Ongoing Role of the Tobacco Industry in Illicit Trade and the Importance of Civil Society

Government data suggest a recent decline in the proportion of illicit tobacco that is TI illicit. However, a range of UK and international data sources indicate that these data significantly underestimate the proportion of the illicit market that consists of TI illicit, and that TI illicit remains the single largest problem. There is evidence that the industry has continued to oversupply its products, and fines in response to this practice have to date been small. Furthermore, the tobacco industry has repeatedly presented misleading data and arguments, including claims that tax increases and standardized tobacco packaging drive the illicit trade, with many of these data being collected and communicated by individuals and organizations paid by the industry itself.

Civil society has played a central role in exposing tobacco-industry misconduct and misleading data and arguments, and has thereby enabled the advancement of evidence-based government policy. For example, independent analyses have been able to counter industry claims around tobacco tax and standardized packaging; high taxes on tobacco remain a key component of UK tobacco control policy, and standardized packaging was implemented in 2016.

What Else Can Be Done?

The strategy is widely regarded as having been a success, but further action is needed. The collection and publication of detailed data on tobacco sales, profits, marketing, and research

would allow analysis of market developments and inform tobacco control policy. Anti-illicit trade partnerships between stakeholders across regions have been successful in parts of the UK, and should be rolled out nationally. Positive supply chain licensing schemes are arrangements whereby businesses have to demonstrate that they meet required standards. To apply such schemes to the whole tobacco supply chain could help drive out those involved in the supply of illicit tobacco at all levels.

Lessons Learned and Implications for Other Countries

The UK experience demonstrates that the illicit tobacco trade can be addressed effectively even in the presence of high tobacco taxes. The overarching approach of focusing on supply-side measures has proved successful, although demand side measures may also be appropriate where there is cultural acceptance of illicit tobacco and/or a lack of awareness of its implications.

The fundamental components of an illicit tobacco strategy are improved detection and enforcement and penalties for those involved. While some technology – such as x-ray scanners and anti-counterfeiting technology – is required, investment in human resources is essential in developing intelligence, detecting illicit products, and undertaking criminal investigations.

Several studies have highlighted the association between corruption and the illicit tobacco trade; good governance and government commitment are essential for a successful illicit trade strategy. The ongoing role of the tobacco industry and its repeated efforts to mislead the public and decision makers in relation to the causes, effects, and scale of illicit trade demonstrate that strategies to tackle this problem must be developed and implemented independently from the tobacco industry. While significant upfront investment is required, the substantial long-term return on investment in activity to combat the illicit trade is a key incentive for government intervention and enforcement.

1. What Has Been Done to Address the Illicit Trade in Tobacco? What Are the Results?

1.1 Background

OVERVIEW OF TOBACCO CONTROL POLICY IN THE UNITED KINGDOM

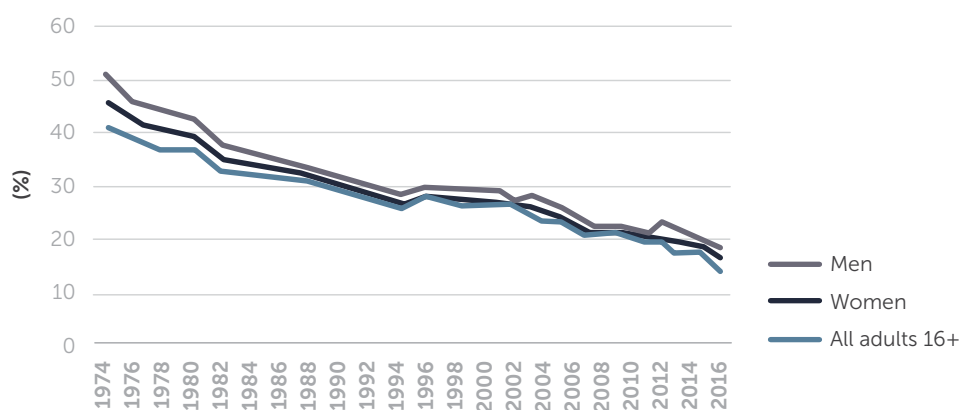
Despite evidence of the health harms caused by tobacco use, implementation of policies to reduce smoking prevalence in the United Kingdom (UK) was slow until the late 1990s. The first comprehensive UK tobacco control policy document, *Smoking Kills*, was published in 1998.⁽¹⁾ It defined a package of population- and individual-level policies and interventions, and since then the UK has implemented comprehensive measures to support quitting, reduce uptake, and reduce the harms caused by secondhand smoke exposure.

Table 1. Summary of Tobacco Control Policies in the UK

POLICY AREA	SUMMARY OF MEASURES
Restrictions on smoking	<ul style="list-style-type: none"> › Legislation prohibiting smoking in public places introduced in Scotland in 2006, then in Wales, NI, and England in 2007 › Ban on smoking in private cars in the presence of children in October 2015 in England and Wales and December 2016 in Scotland
Tobacco tax	<ul style="list-style-type: none"> › High levels of taxation have been a feature of tobacco control policy in the UK
Illicit trade	<ul style="list-style-type: none"> › Strategy to tackle illicit tobacco trade implemented from 2000
Mass media campaigns (MMCs)	<ul style="list-style-type: none"> › Large-scale MMCs have been a key component of UK tobacco control strategy since the early 2000s, although funding has been much reduced in recent years
Health warnings	<ul style="list-style-type: none"> › Text warnings became a legal requirement in the UK in 1971 › From 2008, graphic pictorial warnings covering 40% of the back of the pack, and text warnings covering 30% of the front of the pack were required › From 2016, picture and text warnings covering at least 65% of the front and back of tobacco packaging
Advertising and promotion	<ul style="list-style-type: none"> › Television advertising for tobacco products banned in 1965 › UK Tobacco Advertising and Promotion Act 2002 banned print media and billboard advertising from February 2003, tobacco direct marketing from May 2003, and sponsorship in July 2003 › Point-of-sale displays in large retailers banned in England, NI, and Wales in 2012 and in Scotland in 2013 › Point-of sale displays in smaller shops prohibited across UK in 2015 › Standardized tobacco packaging implemented in May 2016
Youth access	<ul style="list-style-type: none"> › Minimum age of sale raised from 16 to 18 in 2007 in England, Scotland, and Wales, and NI in 2012 › Vending machine ban implemented between 2011 and 2013 › Ban on proxy purchasing by adults in Scotland in 2010, England and Wales in 2015, and NI in 2016
Treatments to help smokers quit	<ul style="list-style-type: none"> › Extensive provision of free stop-smoking services providing counselling and access to pharmacotherapy from 2000 onwards › Nicotine replacement therapy (NRT), bupropion and varenicline, available on prescription; NRT available on general sale › E-cigarettes available on general sale. National smoking cessation guidance states that the evidence suggests that e-cigarettes are substantially less harmful to health than smoking but are not risk free (3)

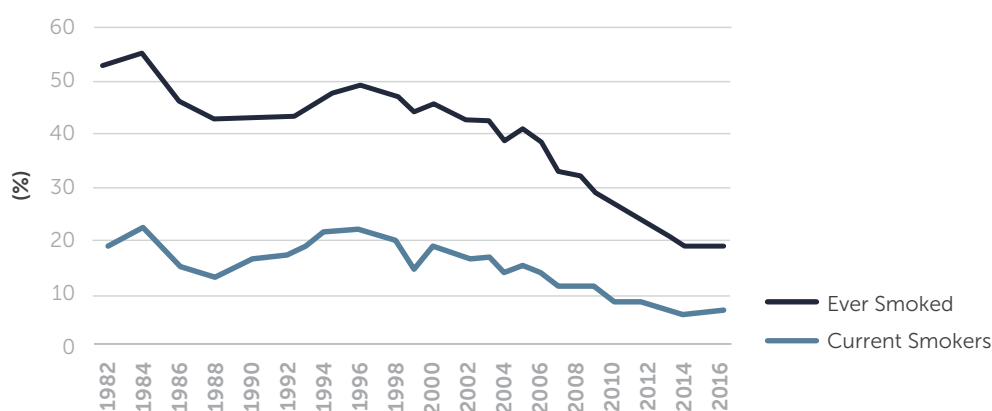
Powers for health in the UK are devolved to national governments (England, Scotland, Wales, and Northern Ireland (NI)). As a result, many measures have been implemented at different times within the UK. UK tobacco control policy is also guided by the Framework Convention on Tobacco Control (FCTC, ratified in 2004) and the European Union (EU). In 2016, the UK led the European Tobacco Control Scale, a ranking of country-level activity on tobacco control.(2) The key tobacco control policy measures which have been implemented in the UK are summarized in Table 1.

Figure 1. Adult (16+) Smoking Prevalence in Great Britain, 1974-2016



Source: Office for National Statistics. Adult smoking habits in the UK: 2016 (Adult Smoking Habits in Great Britain dataset)(4)

Figure 2. Prevalence of Adolescent (11-15 Years) Smoking in England, 1982-2016



Source: Health and Social Care Information Centre. Smoking, Drinking and Drug Use Among Young People in England – 2016 (Chapter 2 tables - smoking prevalence)(10)

TRENDS IN TOBACCO USE IN THE UK

Adult prevalence. Over the past four decades, there has been a significant decline in rates of adult smoking in the UK (Figure 1).(4-6) In 2016, smoking prevalence in the UK was 15.8 percent.(6)

Smoking prevalence has consistently been higher in men than in women (Figure 1) and is highest among low socioeconomic groups.(4)

Youth prevalence. Smoking prevalence among adolescents in England has declined over time, with 6 percent of 11-15 year olds in England reported to be current (regular or occasional) smokers in 2016 (Figure 2). Youth smoking prevalence has also fallen in other parts of the UK.(7-9)

Types of products. The majority of smokers in Britain smoke exclusively manufactured cigarettes (55 percent).(4) While only one-third smoke exclusively hand-rolling tobacco (HRT), and 10 percent smoke both, the proportion of smokers using HRT has increased over time, in line with a trend of more smokers smoking cheap tobacco.(11, 12) Younger and low-SES smokers are more likely to smoke HRT.(11) The sale, purchase, and use of electronic cigarettes (e-cigarettes) are legal in the UK. The prevalence of current e-cigarette use among adults in Britain is in the region of 6 percent, with use almost entirely restricted to current and ex-smokers.(13)

OVERVIEW OF THE HISTORY OF TOBACCO TAXES IN THE UK

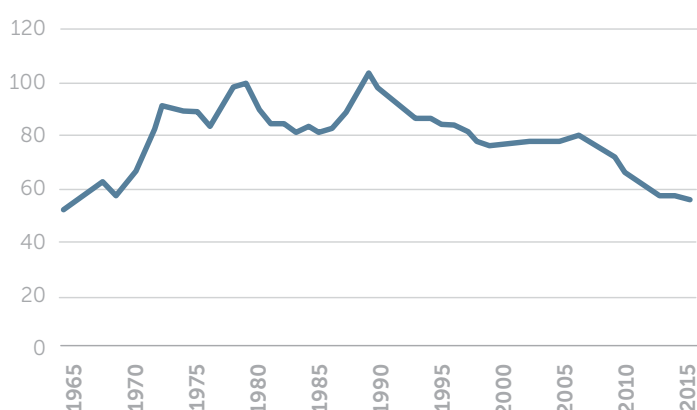
Summary. In the 1990s, a policy of increasing tobacco taxes above inflation was implemented by the UK government, designed both to increase government revenues and reduce smoking prevalence (Table 2). Between 2001 and 2008, the Government increased taxes in line with inflation. From 2009 onwards tobacco taxes were again increased above inflation. Tobacco affordability has now dropped to its lowest level since the mid-1960s (Figure 3).

Tobacco tax policy since the 1990s. In the mid- to late twentieth century, tobacco became increasingly affordable in the UK, as tax increases failed to keep pace with income growth. Affordability reached its peak in 1989-90 (Figure 3). In the 1990s, a policy of increasing tobacco excise taxes above inflation was implemented by the UK government. To begin with, this was on an ad hoc basis, but in the 1993 Budget, the Government announced that tobacco duties would rise by "at least 3 per cent a year in real terms (i.e., above inflation) in future Budgets." Increasing tax above the rate of inflation is known as a tax escalator. This was explicitly a health as well as revenue measure, with the Chancellor stating that, "I believe that the approach we are adopting in Britain is the most effective way to reduce smoking."(14)

Illicit trade also increased rapidly during this period, particularly as a result of the tobacco industry (TI) facilitating the evasion of UK duty (see section 1.5).(15) In 2000, the government therefore announced the introduction of a comprehensive strategy to tackle tobacco smuggling, asserting that, "The Government is determined that criminal activity will not undermine its policies to improve the nation's health."(16) Despite TI pressure, between 2001 and 2008,

the Government increased taxes in line with inflation while the illicit market was brought under control. The strategy had immediate impact. It did not simply halt the rapid growth of the illicit market, but drove it downwards (see section 1.4). In the 2009 Budget, tobacco excise taxes were once again increased above inflation.(17)

Figure 3. Tobacco Affordability Index, 1965-2016



Source: Beyond Smoking Kills, 1965-1980 [England] (19), NHS Digital, 1980-2016 [UK] (20)

Table 2. Timeline of Tobacco Tax Increases for Manufactured Cigarettes and Hand-Rolling Tobacco (HRT) in the UK

YEARS	TOBACCO TAXES
1989	Spring: No increase (Retail Price Index (RPI) increased by 7.8%)
1990	Spring: 10% (RPI increase = 9.5%)
1991	Spring: 15% (RPI increase = 5.9%)
1992	Spring: 10% (RPI increase = 3.7%) Spring: 6% (RPI increase = 1.6%)
1993	Autumn: 7.3%. Authorities committed to introduce an annual tobacco tax escalator of a minimum of 3% above projected RPI
1994	Autumn: 7.3% (RPI increase = 2.4%)
1995	Autumn: 3% above projected RPI for cigarettes, tax on HRT frozen (RPI increase= 3.5%)
1996	Autumn: 3% above projected RPI for cigarettes, increase at projected RPI for HRT
1997-1998	Commitment to annual tobacco tax escalator of 5% above projected RPI. Took effect in December 1997 and December 1998.
1999	Spring: 5% above projected RPI for cigarettes, no increase for HRT (RPI increase = 1.5%)

Table 2. Timeline of Tobacco Tax Increases for Manufactured Cigarettes and Hand-Rolling Tobacco (HRT) in the UK, Cont.

YEARS	TOBACCO TAXES
2000	Spring: Escalator abolished. Tobacco tax increased by 5% above projected RPI
2001-2008	Spring: annual increases in line with projected RPI
2009	Spring: 2% increase [NB RPI increase = -0.5%, so effective increase of 2.5%]
2010	Spring: 1% above projected RPI with commitment to escalator of 2% above RPI for all tobacco products for remainder of the parliament (2011-2015)
2011	Spring: 2% above projected RPI plus additional 10% increase on hand-rolled tobacco (HRT)
2012-2013	Spring: 2% above projected RPI
2014	Spring: 2% above projected RPI with commitment to continue tax escalator for the subsequent parliament from 2015-2020
2015	Spring: 2% above projected RPI
2016	Spring: 2% above projected RPI with additional 3% for HRT
	Spring: 2% above projected RPI
	20 May 2017: Introduction of Minimum Excise Tax (MET) of £268.63 per 1,000 cigarettes, setting a floor below which taxes cannot fall (see section 1.2).
2017	Autumn: one-off additional 1% for HRT. MET set at £280 per 1,000 cigarettes.
	A commitment to an annual escalator of 2% above projected RPI for all tobacco products for remainder of current parliament (until 2022).

Note: UK budgets are usually annual events, in Spring or Autumn (usually March or November).
Sources: (17, 21-50) See also ASH. Timeline of tobacco tax increases in the United Kingdom.(51)

The tax escalator has since been sustained in line with the Government’s commitment to “maintain high duty rates for tobacco products to make tobacco less affordable.”(18) Reducing affordability, rather than just increasing price, is the key to reducing consumption and smoking prevalence. Prices therefore need to rise more than incomes and the level of inflation. A tax escalator is a simple way of achieving this. Tobacco is now no more affordable than it was in the mid-1960s (Figure 3), and the tax escalator will ensure that it becomes less and less affordable over time.

CURRENT STRUCTURE AND RATES OF TOBACCO TAX IN THE UK

Tobacco products duty is currently payable on:

- » Cigarettes
- » Cigars

- » Hand-rolling tobacco
- » Other smoking tobacco, for example pipe tobacco
- » Chewing tobacco
- » Cigarette rag and expanded tobacco, if it can be smoked without further processing
- » Herbal smoking products that do not contain tobacco or tobacco substitute (52)

The current duty rates are summarized in Table 3. Cigarettes are taxed using either a combination of a specific tax and an ad valorem tax or, since May 2017, using a Minimum Excise Tax (MET) – whichever is higher. A specific tax alone is applied to all other products. In 2017, the weighted average price for a pack of 20 cigarettes in the UK was £7.81.(53)

Table 3. Tobacco Tax Rates in the UK as of November 2017

TYPE OF PRODUCT	EXCISE DUTY RATE	MINIMUM EXCISE TAX (MET)
Cigarettes	Either £217.23 per 1,000 cigarettes plus 16.5% of retail price*	Or £280.15 per 1,000 cigarettes*
Hand rolling tobacco	£270.96/kg	Not applicable
Cigars	£221.18/kg	Not applicable
Other smoking and chewing tobacco	£119.13/kg	Not applicable

Source: Guidance: Excise Duty - Tobacco Duty rates(55) *Excise duty formula or MET – whichever is higher.

A MET sets a minimum level of excise duty for any packet of cigarettes, i.e., a floor below which tax on cigarettes cannot fall. MET was introduced in the UK in 2017 with a view to reducing the availability of very cheap cigarettes, which in turn encourages quitting, and to increase tax revenues.(54) The UK government has stopped short of introducing a Minimum Consumption Tax, to include VAT as well as excise tax, which would raise tax levels at the lower-priced end of the HRT market and limit the opportunity for downtrading within the HRT category.

Products become liable to the duty when they either enter the UK from overseas or reach a smokeable condition during manufacture. Products may be stored duty-suspended in approved excise warehouses. When goods are released from an excise warehouse for consumption, the excise duty must have been paid or accounted for before they leave the warehouse.(56)

EU law on tobacco tax. EU law imposes minimum rates of tobacco duty with a view to minimizing variation in the price of tobacco products between EU countries (Directive 2011/64/EU).(57)

For cigarettes, this minimum rate must consist of:

- » A specific component of between 7.5 percent and 76.5 percent of the total tax burden – a fixed amount per 1000 cigarettes
- » An ad valorem component - a percentage of the maximum retail selling price

In addition, the overall excise rate must be:

- » At least €90 per 1000 cigarettes
- » At least 60 percent of the weighted average retail selling price (unless excise duty \geq €115)

For HRT, Member States can apply a specific component (€54 per kilogram) or an ad valorem component (46 percent of the maximum retail selling price), or a combination of the two. The Directive also sets out minimum duty rates for other types of tobacco.

The UK is due to leave the EU in March 2019, and the implications of this for tobacco duty rates are as yet unconfirmed, although there is a commitment to increase tobacco taxes by 2 percent above RPI per annum until the end of the current parliament in 2022. However, the UK has historically implemented tobacco duty rates far in excess of EU-imposed minima, and it is therefore to be expected that tobacco taxes in the UK will remain high. In January 2018, the UK had the highest overall excise duty as a percentage of weighted average price in the EU (72.13 percent).(53)

The Problem of Smuggling Prior to Introduction of Measures to Reduce Illicit Trade: Evolution of the Illicit Trade in Tobacco in the 1990s

Sustained above-inflation tax increases were designed to reduce tobacco consumption, which threatened tobacco manufacturers' sales. The tobacco manufacturers' solution was to facilitate the growth of a parallel illicit market. This undermined the impact of the Government's tax strategy by ensuring that smokers -- particularly younger and poorer, thus more price-sensitive smokers -- had access to untaxed and therefore much cheaper tobacco products.

In the early 1990s, the illicit tobacco trade in the UK consisted mostly of small-scale cigarette smuggling from lower-tax jurisdictions in Europe. However, during the 1990s, tobacco manufacturers increasingly produced and exported cigarettes in volumes much greater than the known demand in their stated markets. These cigarettes were then smuggled, with no duty paid, back into the UK.(15) For example, the number of UK cigarettes exported to Andorra grew over a hundred-fold between 1993 and 1997, from 13 million to 1,520 million, enough for

every man woman and child in Andorra to smoke 140 cigarettes a day.(58) This was just one of many destinations where the supply massively outstripped plausible demand. As a Member of Parliament said to the chief executive of 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 neighboring countries, and not in the expectation they would be smuggled?"(15)

This form of cigarette smuggling – involving shipping-container loads diverted from the legal to the black market while in international transit, with no duty paid – grew dramatically throughout the 1990s.(15) The share of the UK cigarette market accounted for by illicit manufactured cigarettes rose from only 3 percent in 1996-97 to 18 percent in 1999-2000. Most of these illicit cigarettes were estimated by Customs to be "duty not-paid" genuine UK brands (also referred to as tobacco industry illicit – representing 85 percent of seizures in 2000-01).(16, 59) The proportion of HRT which was illicit rose even faster, to reach nearly 80 percent by 1999.(16) HRT smuggling was largely of duty-paid product, smuggled into the UK from lower-tax European jurisdictions, in particular the Benelux countries.(60, 61)

The tobacco manufacturers were selling to intermediaries at the ex-tax price, still making their profits on the sales, but government revenues were undermined, as taxes were not paid.(15, 16) Indeed, as a study for the World Bank showed, the tobacco industry benefits from the existence of smuggling of its products, as smuggling reduces the average price (thereby increasing sales) and can provide access to closed markets.(62) In addition, the industry can use the increase in size of the illicit market to argue for reductions in tobacco taxes, an argument that industry spokespersons continue to deploy regularly.(63-65)

By 1999, the revenue losses associated with all forms of tobacco smuggling were estimated to be £2.5 billion, equivalent to 25 percent of all tobacco revenue (excise duty and Value-Added Tax (VAT)) due.(16) Furthermore, government projections suggested that the market share of illicit cigarettes would increase to over a third by 2003-04, in the absence of any action. The street price for a premium-brand pack of 20 illicit cigarettes was in the region of £2.50, compared with £4.20 for a legal pack (16). Given that, in 2000, the tax as a percentage of price among licit products in this price category was 80 percent, significant profits were clearly being made from smuggling.(66)

Summary of Approach to Reducing Illicit Tobacco in the UK since 2000

In response to the significant problem of tobacco smuggling, the UK customs authority (HM Revenue and Customs, HMRC) and economic and finance department (HM Treasury) introduced the UK's first anti-smuggling strategy in 2000.(16) This move coincided with widespread public exposure of the tobacco industry's involvement in tobacco smuggling,

Box 1: Types of Tobacco Products Available in the UK**LICIT TOBACCO**

GENUINE PRODUCT: Legally manufactured product of a tobacco manufacturer which owns all trademarks and branding featured on the product. The product is sold in compliance with all applicable laws.

ILLICIT TOBACCO

TOBACCO INDUSTRY ILLICIT: Genuine product of tobacco manufacturer that was en route to, imported into, distributed in or sold in a jurisdiction in violation of the applicable laws of that jurisdiction. The fact that this product was manufactured by a tobacco company does not imply that company is always responsible when its product ends up on the illicit market. Tobacco industry illicit comprises genuine UK brands on which UK duty is not paid and genuine non-UK brands.(74)

COUNTERFEITS: Products bearing a trademark of a tobacco manufacturer that are actually manufactured by a third party without the consent of the authorized cigarette manufacturer.

CHEAP WHITES (ALSO KNOWN AS ILLICIT WHITES): Cigarettes that are legally produced (usually not by a transnational tobacco company (TTC)), but have no legitimate market and are manufactured with the intent of being smuggled and sold outside of their country of production. These are defined by the European Commission as: “brands manufactured legitimately in one market, either taxed for local consumption or untaxed for export, and sold knowingly to traders who transport them to another country where the products are sold illegally without domestic duty paid.”(75)

Source: Adapted from Gilmore et al.(73)

prompting government inquiries and court cases (15, 67-72). As a result, the nature of the illicit market began to change. The tobacco industry began to alter its practices, and levels of tobacco-industry illicit declined. While tobacco industry illicit remained the leading source of illegally traded cigarettes in the country, other forms of illicit – cheap whites and counterfeit – emerged (Box 1).(73) The UK anti-smuggling strategy has been renewed and refreshed several times since 2000 in response to emerging threats and seeks to tackle each of these forms of illicit.

The UK's initial strategy was a comprehensive approach which included:

- » Estimating the size of the illicit market
- » Analyzing the problem
- » Investing in a range of operational responses to the problem identified:

- › Making it harder for criminals to source tobacco products
 - › Disrupting the supply and distribution chains for illegal tobacco products
 - › Reducing the rewards from smuggling by increasing the criminal and civil sanctions
 - › Reducing demand by raising public awareness to discourage purchases of illicit tobacco products
- » Committing to review the effectiveness of the strategy over time.

The strategy set a target of preventing the illicit market from increasing, stabilizing and then beginning to drive down the smuggled share of the cigarette market. Investment was weighted towards tackling the problem at source on the supply side, and in particular preventing illicit tobacco from entering the UK market. £209 million was invested over three years in 1000 more frontline and investigative staff and additional x-ray scanners to detect high volume cigarette smuggling in freight. The strategy also included the introduction of fiscal marks on UK duty-paid products and increased use of criminal and civil sanctions to deter smuggling and reduce its profitability. The strategy very explicitly set out that eradicating smuggling was an issue of enforcement, and that the arguments used by some that the solution was to cut duty were erroneous. The strategy's authors pointed out that many other countries in Europe with relatively low taxes suffer significant smuggling, indicating that low tax rates do not protect against smuggling.

The strategy had an immediate effect. Within three years, the market share of illicit cigarettes was on a steep downward trend (see section 1.4). The approach was so successful that a tougher target was introduced, of reducing the illicit market share to 17 percent by March 2006.⁽⁷⁶⁾ However, the illicit market evolved in response to the strategy, and the need for regular revision was clear. The market share of illicit HRT remained stubbornly high at 63 percent in 2000-01 and 55 percent in 2003-04.⁽⁷⁷⁾ Furthermore, smokers were increasingly downtrading from factory-made cigarettes to HRT, and HRT consumption was primarily of smuggled, non-UK duty-paid product. In addition, as the supply of smuggled genuine, UK-manufactured cigarettes (tobacco industry illicit) was increasingly brought under control, counterfeit cigarettes began to emerge as a problem.

Therefore, in 2006, a new strategy was launched, with investment in an additional 200 staff to focus on HRT and a 30 percent increase in the network of Fiscal Crime Liaison Officers (FCLOs) responsible for intelligence gathering and liaison between the UK and government investigators in other countries.⁽⁷⁸⁾ A specific new target was set of reducing the size of the illicit HRT market by 1,200 tonnes, the equivalent of around 20 percent of the market, by 2007-08. Memoranda of Understanding (MoUs) were signed with the tobacco manufacturers committing them to only sell their products in brands and amounts consistent with the legitimate demand in the export market. These commitments were backed up by legislation placing a legal duty on tobacco manufacturers and importers not to facilitate smuggling, with a penalty of up to £5 million for failure to comply.⁽⁷⁹⁾

In 2008, the UK Border Agency (the UK's immigration authority, now known as the UK Border Force) took over responsibility for the frontier work of HMRC. In recognition of this shift, an updated anti-smuggling strategy was developed.⁽⁸⁰⁾ Meanwhile, the illicit trade was continuing to evolve in response to enforcement approaches. Postal smuggling, particularly from China, emerged as a new threat. Although the overall size of the illicit HRT market was going down, counterfeit HRT was a growing problem, as the anti-smuggling strategy started to reduce the oversupply of genuine HRT to overseas markets. In addition, a new problem had emerged: non-UK branded cigarettes, manufactured for smuggling into the UK, known as "cheap/illicit whites," began to appear on the UK market.

By 2011, the size of the illicit market had been cut by almost half; however, tobacco fraud was still costing the government over £2 billion in tax revenues every year. A revised strategy was published, which committed to: increase resources; introduce new technology, intelligence, and detection capability; pursue proceeds of crime while applying new powers of assessment and penalties; and reduce the minimum indicative levels for personal imports from 3200 cigarettes and 3 kg HRT to 800 cigarettes and 1 kg HRT.⁽⁸¹⁾ These are only indicative limits, so are not a legal maximum, but imports above this level have to be justified to customs as genuinely for personal use.⁽⁸²⁾

A new strategy, the most recent, was published in 2015.⁽⁸³⁾ It outlined a continuation of the broad cross-government approach previously adopted, and placed increased emphasis on international engagement, undermining the profitability of illicit trade, and changing public perceptions of the illicit tobacco trade. It also set out plans for a review of sanctions for perpetrators, along with the introduction of a registration scheme for raw tobacco by the end of 2016, to tackle the growing problem of diversion into the illegal market in the form of counterfeit HRT.

Figure 4 summarizes the key challenges and responses over time. The approach has consistently focused on reducing the availability of illicit tobacco and punishing those involved in the illicit supply chain; while it is illegal to purchase illicit tobacco in the UK, enforcement has focused on suppliers as opposed to identifying and punishing consumers of illicit tobacco.

Tobacco industry involvement in the illicit trade has been and remains a particular challenge in the UK context (see section 1.5).

Overview of the Current Approach to Tackling the Illicit Tobacco Trade in the UK

While the illicit tobacco strategy has been regularly updated, the general approach remains weighted towards addressing the supply of illicit, covering both large- and small-scale smuggling, and aiming to tackle the problem both at home and abroad. Estimates of the size of the illicit market and analysis of the nature of the problem continue to inform activity.

The 2015 strategy emphasized the need for a strong focus on HRT with a view to reversing an upward trend in the illicit HRT market share. While the share of illicit HRT within the total market for HRT has decreased since then, recent data suggest that illicit cigarettes account for an increasing share of a declining cigarette market, indicating a need for renewed effort to tackle illicit cigarettes.

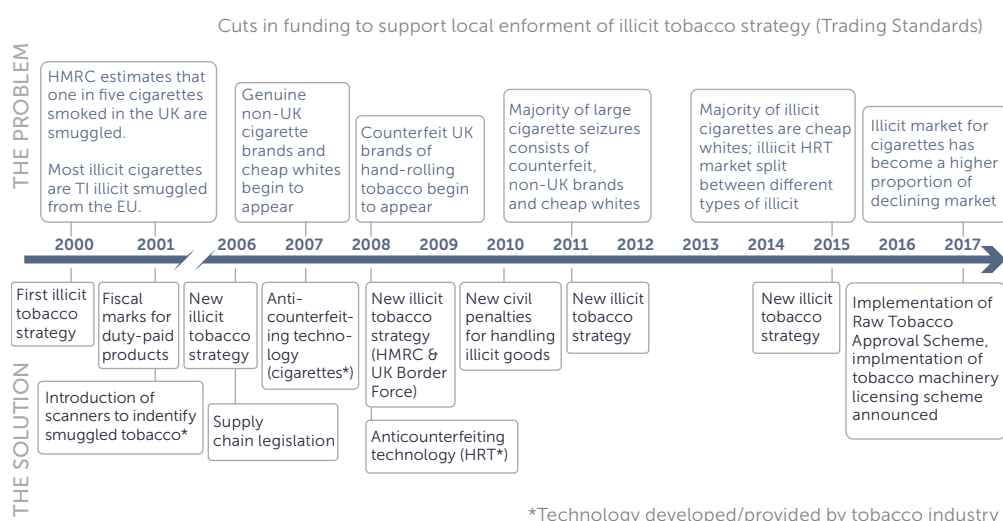
Developments since the 2015 strategy include the introduction of:

- » a registration scheme for anyone carrying out activities using raw tobacco (April 2017)
- » a tobacco machinery licensing scheme (August 2018)

The details of the current approach, including the legal and institutional frameworks, enforcement mechanisms, and packaging technology used are summarized in sections 1.2 and 1.3.

The UK is due to leave the European Union in 2019, and it is currently unclear what the implications of this for the illicit tobacco strategy and wider tobacco control will be. The UK is a frontrunner in the implementation of the FCTC and is a Party to the Illicit Trade Protocol (ITP) which comes into force in September 2018. Furthermore, UK tobacco regulation has generally exceeded EU minimum requirements. It is therefore unlikely that the UK's commitment to tobacco control will be diminished by departure from the EU. However, the UK's withdrawal may create barriers to collaborating with European partners to combat illicit trade. For example, UK officials may lose access to EU systems that support the reduction in illicit trade, such as the Excise Movement and Control System. Furthermore, at the time of

Figure 4. Timeline of Key Challenges and Responses to Illicit Tobacco Trade in the UK



Source: Adapted from National Audit Office. Progress in tackling tobacco smuggling. (85) Tackling Tobacco Smuggling. 2011.(81) Tackling illicit tobacco. 2015.(83)

writing, the UK has committed to leaving the European customs union. The disruption this is likely to cause could provide opportunities for those engaged in the illicit trade.

The illicit tobacco trade is by no means the only type of illicit trade in the UK; the country's total tax gap for 2015-16 was estimated at £34 billion (6 percent of tax liabilities), with tax evasion accounting for an estimated £5.2 billion.⁽⁸⁴⁾ Tobacco excise duties and VAT accounted for £2.4 billion of the tax gap. Efforts to reduce illicit tobacco therefore sit amidst wider efforts to tackle illicit trade in the UK.

1.2 DESCRIPTION OF CURRENT APPROACH TO REDUCING ILLICIT TRADE

Overview of Legal Framework for Tobacco Products

Regulation of tobacco manufacturers. Tobacco manufacturing has ceased in the UK; however, tobacco manufacturers who supply the UK market must comply with the full range of relevant legislation, including tobacco product regulations (86, 87) and supply chain legislation.

Licensing of wholesale and retail licensing. Wholesale and retail tobacco sellers are currently not licensed in the UK. Retailers are legally required to comply with a range of retail laws including age restrictions (minimum age of sale 18 years), standardized packaging, and point of sale tobacco display bans. These are enforced by local government.

Regulation of raw tobacco. Raw tobacco is not subject to excise duty, and there is therefore a risk of illegal manufacture of tobacco products and excise duty evasion. Since April 2017, businesses and individuals are prohibited from carrying on any activity involving raw tobacco unless they have obtained approval from HMRC.⁽⁸⁸⁾

Tobacco machinery licensing. Since April 2018, a registration scheme has been in operation to license manufacturing machinery used to make tobacco products. From August 2018, anybody manufacturing, purchasing, acquiring, owning, or in possession of tobacco-manufacturing machinery must hold a license issued by HMRC. The scheme has been introduced to reduce the risk of excise duty evasion and prevent the illegal manufacture of tobacco products. The creation of such a scheme was required to make the UK compliant with the WHO FCTC Illicit Trade Protocol.⁽⁸⁹⁾

Excise Movement and Control System. Under EU law, excise tax is paid in the country of final consumption. The Excise Movement and Control System (EMCS) is an EU-wide computer system which records duty-suspended movements of excise goods taking place within the EU.⁽⁹⁰⁾ Since January 2011, all movements of goods under duty suspension are monitored by the EMCS. The system records in real time the movement of tobacco and other excise products for which excise duties have still to be paid, and helps to ensure that the appropriate duties are paid at the final destination.

Internet and overseas sales. Buying some types of tobacco over the internet from another EU country for personal use is permitted; however, UK VAT and excise duty must be paid on the products prior to their entering the UK, and cigarettes and HRT may not be purchased in

this way, due to UK fiscal mark requirements. Sellers are required to register by completing a form which is submitted to HMRC, charge customers the relevant amount of tax, and make arrangements for these taxes to be paid.(91)

Tax is not required to be paid on tobacco products brought into the UK by travelers, as long as they are transported by the individual, they are for the traveler's own consumption or will be given away as gifts, and tax has been paid in the country of purchase. Travelers may bring in an unlimited amount of tobacco; however, guide levels are provided to help Customs officers distinguish between genuinely private imports and commercial importation.(92, 93) The guide levels for shoppers from within the EU are 800 cigarettes and 1 kg HRT.(94) Travelers from outside the EU may bring in up to 200 cigarettes or 250 g HRT.(95)

Current requirements for tobacco packaging in the UK. The appearance of tobacco packaging in the UK is determined by national and EU legislation. A recent EU Tobacco Products Directive (TPD) set out rules for the presentation of tobacco products, but stopped short of requiring standardized packaging of tobacco products (SPoT).(96) The UK government implemented UK-level SPoT from May 2016.(86) SPoT applies to manufactured cigarettes and HRT. The UK implementation of SPoT is too recent to assess whether it has had an impact on the illicit market; however, prior to its implementation, HMRC published an analysis which concluded that it was unlikely to have a significant impact.(97)

For all tobacco products, there are packaging requirements intended to avoid misleading customers. For example, the products must not feature information about the tar, nicotine, or carbon monoxide content or an indication that the product is less harmful than other products.

In addition, all tobacco products must carry combined health warnings (CHW) comprising a text warning, graphic warnings, and smoking cessation information. There are general conditions applicable to health warnings, such as that the health warning must cover the entire area that is reserved for it and that the exact wording prescribed must be used.

Packaging requirements are summarized in Tobacco Packaging Guidance published by the Department of Health.(98) The key requirements for cigarettes and HRT are summarized here.

All cigarette packs and individual cigarettes must be in standardized packaging, as follows:

- » external packet color Pantone 448C (a drab dark brown) with a matt finish
- » cuboid shape (rounded edges allowed)
- » a minimum of 20 cigarettes in each pack
- » packet made of carton or soft material
- » smooth surface with no texture or embossing
- » specified picture and text health warnings

Cigarette packs may not have

- » any other colors or markings

- » promotional images or logos
- » inserts / onserts
- » slim packets (but slim individual cigarette sticks are allowed)
- » indication of flavor of cigarette
- » non-standard noises or smells
- » features which change after sale

Similar, to cigarettes, HRT packs must be a non-shiny, drab dark brown and adopt a pre-scribed shape. There are specifications as to featured text and internal packaging. HRT packs must be either a pouch, cylindrical, or cuboid in shape, and a unit pack must contain a minimum of 30 g of tobacco.

Brand names and variant names are permitted on cigarettes, cigarette packs, and HRT packs, but these must be in a standardized format (font, size, color, etc.).

CHWs on both cigarette packs and HRT packs must cover 65 percent of the front and back of pack (the same CHW on both sides), appear at the top edge of the surface, be positioned in the same direction as any other information on that surface, have minimum dimensions of 52 mm wide and 44 mm high, and have a graphic health warning taken from an approved set of images which are rotated annually.

Fiscal marks are required on both cigarette and HRT packs. An alphanumeric code is permitted. Packaging security features used in the UK are described in section 1.3. There are also requirements for the appearance of cigarette sticks and internal pack features (e.g., wrappers).

Overview of Institutional Framework for Tackling the Illicit Trade

National agencies. Since 2008, HMRC and the UK Border Force (previously Border Agency) have shared responsibility for tackling the illicit tobacco trade in the UK. They share responsibility for developing intelligence and reducing revenue losses, with distinct roles.

HMRC has responsibility for:

- » Collecting and enforcing tobacco duties
- » Investigating and disrupting criminal offences
- » Detecting and disrupting the supply of illicit tobacco inland
- » Excise and customs powers and legislation (80)

The UK Border Force has responsibility for

- » Detecting and seizing smuggled tobacco at the border
- » Arresting those suspected of smuggling offences and referring them to HMRC for investigation (80)

Table 4. Full-Time Equivalents of Staff Employed on Tackling Illicit Tobacco, 2005-2010

HMRC				UKBA*	TOTAL
YEAR	DETECTION	INVESTIGATION	INTELLIGENCE	DETECTION & INTELLIGENCE	FULL-TIME EQUIVALENTS
2005/06	1407	319	279	n/a	2005
2006/07	1557	278	295	n/a	2130
2007/08	1574	287	264	n/a	2125
2008/09	1500	395	255	n/a	2150
2009/10	153	360	172	1504	2189
2010/11	130	399	172	1504*	2205

*Note: For the UKBA, the figures provided are for staff assigned to detection and intelligence duties combined. n/a denotes "not available." The UKBA figures for 2010/11 and therefore the total for both agencies are estimates, since the UKBA has not yet released these data.
Source: ASH. UK Tobacco Control Policy and Expenditure. (99)

Table 5. Expenditure on Staff Employed on Tackling Illicit Tobacco, 2005-2010*

HMRC				UKBA*	TOTAL
YEAR	DETECTION	INVESTIGATION	INTELLIGENCE	DETECTION & INTELLIGENCE	
2006/07	£61,351,790.69	£13,246,434.95	£12,246,665.35	n/a	£86,844,890
2007/08	£65,037,870.02	£14,243,597.55	£11,271,899.07	n/a	£90,553,366
2008/09	£64,257,196.50	£19,998,544.53	£12,244,642.47	n/a	£96,500,383
2009/10	£ 5,362,740	£20,840,605	£ 7,946,658	£61,100,000	£95,250,003
2010/11	£ 5,504,241	£20,270,831	£ 6,152,047	£58,735,712	£90,662,831
2011/12	n/a separately	£25,636,005*	£ 8,143,109	n/a	n/a

*Note: includes detection, criminal investigation, and specialist civil investigation. Data from UKBA are not available for 2011/12.
Source: ASH. UK Tobacco Control Policy and Expenditure. (99)

The UK takes an "end-to-end" approach to disrupting the illicit supply chain, which requires activity both inland and overseas. Key to HMRC's efforts to tackle the illicit trade is its international network of Fiscal Crime Liaison Officers (FCLOs). The FCLOs are responsible for liaising with international fiscal and law-enforcement agencies and developing intelligence to intercept illicit tobacco destined for the UK market.

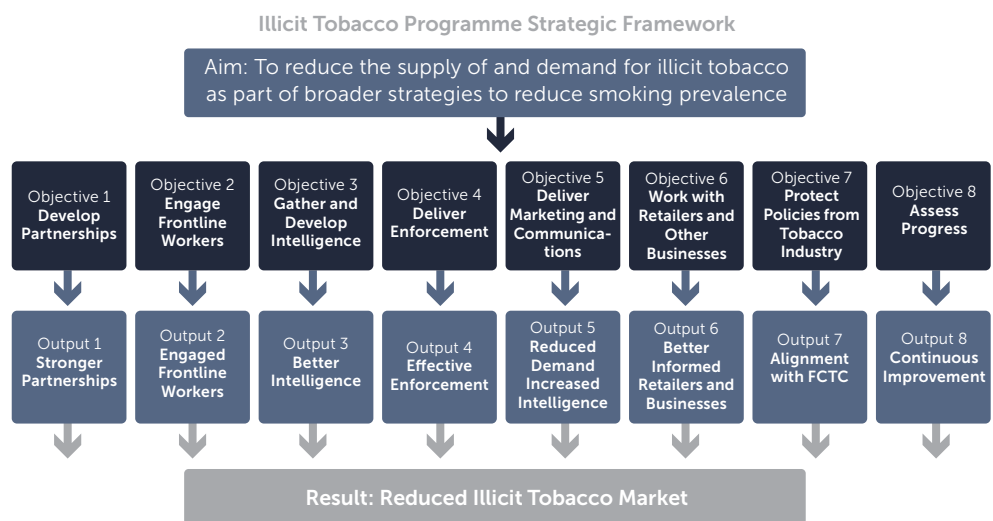
National staffing and expenditure. From 2000, a total of £209 million was invested over three years in 1000 more frontline and investigative staff, and additional x-ray scanners to detect high-volume cigarette smuggling in freight. Detailed data on levels of staffing and

expenditure are generally not published; some information was provided in response to a series of Parliamentary Questions. This information is summarized in Table 4 and Table 5. Since 2010/11, the Government has refused to provide this information, so more recent data are not available.

Local government. In the UK, Trading Standards are local government departments that promote and enforce fair, safe, and legal trading practices. Trading Standards are responsible for developing local intelligence and detecting and seizing illicit tobacco products.

The Trading Standards staff, who cover a wide range of consumer protection responsibilities and are crucial to effective collaborative working on illicit trade, are increasingly under threat. During the last six years, total spend nationally on Trading Standards has fallen from £213m in 2010 to £124m in 2016.⁽¹⁰⁰⁾ The National Audit Office (NAO) has calculated that the number of full-time equivalent Trading Standards staff decreased by 56 percent in seven years, from 3,534 in 2009 to 1,561 in 2016, with 81 percent of services considering that funding reductions have had a negative impact on their ability to protect consumers in their area.⁽⁸⁵⁾

Figure 5. The Illicit Tobacco Program Strategic Framework



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Source: Illicit Tobacco Partnership.

Regional partnerships. Local government departments are well placed to tackle illicit trade, but need to work across wider geographical boundaries and with key stakeholders. In the UK, multi-agency regional partnerships designed to tackle the supply of illicit tobacco products in a coordinated way have been successful.

The North of England Tackling Illicit Tobacco for Better Health program was initially a partnership between public health, local, and national enforcement authorities. With the Illicit

Tobacco Partnership (a collaboration of Fresh, Action on Smoking and Health [ASH], and the UK Centre for Tobacco and Alcohol Studies [UKCTAS]⁵), the group has adopted an eight-strand strategic framework for reducing illicit tobacco as part of broader tobacco control measures. The strategy was refreshed and updated in 2016 (Figure 5).

In response to the results of research at the launch of the program, a number of policy responses were developed and delivered:

- » England's first sub-national demand-reduction social marketing campaign, "Get Some Answers," was launched in 2010, designed to inform the public of issues relating to illicit tobacco, for example, its links to crime and its availability to children.
- » Successful evaluation and evidence that the public had been "warmed up" to these issues led to the campaign's evolution into the "Keep It Out" campaign, which had a stronger call to action – if you know where illicit tobacco is being sold, report it. The campaign provided clear channels for reporting intelligence. It was refreshed and re-launched in the North East in 2017.
- » Local trading standards teams, based within local government, were provided with electronic handheld scanners to scan the anti-counterfeit marking on cigarette packs, helping determine the authenticity or otherwise of suspected illicit tobacco products. A regional post, working across the North East, also enhanced local enforcement capability and encouraged collaboration across boundaries.
- » Enhanced partnership working between local enforcement colleagues in trading standards and national partners in HM Revenue & Customs.
- » A commitment was made to track the size of the illicit tobacco market, and public opinion on the topic, every two years from the 2009 baseline.
- » Regular North East and national meetings to discuss illicit tobacco are convened, in line with obligations under Article 5.3 of the WHO FCTC.

The first two years of the North of England program were evaluated, and the partnership was deemed to be "an exemplar of partnership working ... and deserves to be widely disseminated."⁽¹⁰²⁾ This recommendation was supported by the National Audit Office (NAO), which scrutinizes public spending for Parliament.⁽⁸²⁾ Unfortunately, due to lack of funding, this has not been possible to date.

Enforcement Mechanisms

Supply chain legislation. Memoranda of Understanding (MoUs) between HMRC and tobacco companies have been consistently used as a means of restricting the availability of tobacco industry illicit; however, MoUs are voluntary agreements and are not legally binding.

⁵ Fresh is the UK's first dedicated regional tobacco control program. ASH is a campaigning public health charity that works to eliminate the harm caused by tobacco. UKCTAS is a network of universities conducting research, teaching, and policy work on tobacco and alcohol.

In 2006, the UK government introduced supply chain legislation (SCL) legally obligating tobacco manufacturers not to facilitate smuggling. The purpose of the legislation is to restrict the supply of genuine tobacco products to lower-tax EU countries with a view to these products' being smuggled back into the UK and becoming tobacco industry illicit. The legislation allows for penalties of up to £5 million for manufacturers that do not adequately control their supply chains.

In its 2013 report examining HMRC's progress in tobacco smuggling, the NAO highlighted that over-supply of genuine TI products was still a major concern and concluded that HMRC had not applied the full range of sanctions available under supply chain legislation. (85) Section 1.5 of this chapter describes the extent to which tobacco industry illicit (genuine product on the illicit market) remains a problem.

Sanctions. A range of sanctions are in place to punish individuals linked to all levels of the illicit tobacco trade. These include:

- » Seizure of goods
- » Seizures of vehicles/vessels and possible non-restoration
- » Seizure of cash under the proceeds of crime
- » Criminal prosecution with custodial sentences up to seven years
- » Confiscation of assets under the proceeds of crime
- » Assessment for the loss of duty
- » Financial wrongdoing penalties of up to 100 percent of the duty due
- » Civil action
- » Fines of up to £5000 for selling illicit tobacco not bearing appropriate fiscal marks
- » Prohibition on the sale of tobacco products for up to six months
- » Referral for withdrawal of haulier's licence
- » Naming & Shaming (83)

Governance processes in relation to tackling illicit tobacco in the UK

The UK government's anti-smuggling strategies are published in the public domain. The magnitude and impact of the illicit market is made public through annual publication of data about the size of the illicit market and quarterly reports on tax revenues and the quantity of tobacco released for sale.(103, 104) The Government also publishes information on the delivery of the objectives of its anti-smuggling strategies, including seizures and enforcement activity, although at the time of writing this had not been updated since July 2016.(105)

In addition, the NAO scrutinizes public spending for Parliament and helps Parliament hold the government to account and improve public services. The NAO published a report on HMRC's progress in tackling the illicit tobacco trade in 2013.(85) Parliamentary oversight is provided by

parliamentary select committees. The primary committee with oversight of HM Revenue and Customs performance is the Public Accounts Committee, which published specific reports on tobacco smuggling in 2002 and 2013.(15, 106) However, Inquiries covering issues relating to the illicit trade in tobacco were also carried out by the Health Select Committee in 2000 and the Home Affairs Select Committee in 2014.(107, 108) The Government is required to respond to Select Committee Inquiry reports and recommendations.

The UK government has also committed to fulfilling its obligations under Article 5.3 of the WHO FCTC to protect its public policy with respect to tobacco from the commercial and vested interests of the tobacco industry.(18, 109, 110) It has committed to publishing the details of all policy-related meetings between the tobacco industry and government departments. However, this excludes meetings to discuss operational matters to reduce the illicit trade in tobacco and bilateral meetings between tobacco manufacturers and HM Revenue & Customs.(111)

The oversight and scrutiny provided by these mechanisms has been helpful in ensuring that the Government's anti-illicit strategies have been regularly reviewed in the light of the evidence. The Finance Ministry works collaboratively with the Department of Health and with civil society to ensure that government policies take into account not just the need to protect revenues but also public health.(83) The publication and regular updating of government strategies on tackling the illicit trade in tobacco and the outcomes of these strategies ensure that the action taken by government to tackle the illicit trade can be subjected to public scrutiny.

International Action to Tackle Illicit Tobacco

Activity to combat the illicit tobacco trade in the UK is supported by action at the international level, in particular, legal agreements between the EU and all the major multi-national tobacco companies. The first Agreement, in 2004, was with Philip Morris International in settlement of legal action in the US courts to recover excise duties lost through smuggling. (112) Philip Morris International (PMI) committed to paying the EU £1.25 billion over twelve years and to control its supply chain in future, with financial penalties due if it were found not to have done so. Similar agreements were subsequently signed with Japan Tobacco International (JTI) in 2007 (expiring 2022), and with British American Tobacco (BAT) and Imperial in 2010 (expiring 2030).(112-114) The UK was not originally a party to the Agreements but signed up in 2009.(115)

An independent evaluation suggests these agreements have not served their intended purpose and instead have tended to benefit the industry.(72) Fines (referred to as payments), for example, have been tiny and an insufficient deterrent to ongoing TI involvement in illicit trade. The total paid out by TTCs as a result of the agreements between 2004-12 amounted to only 0.08 percent of the estimated loss of revenue in the EU caused by illicit trade during this period.(72, 73) Meanwhile, the industry's own data suggest that TI product accounted for the vast majority of the illicit market during that period (Figure 9). Following criticisms of its effectiveness, the PMI Agreement was not renewed when it came to an end in 2016.(72, 73)

The UK is a Party to the Illicit Trade Protocol of the WHO FCTC, which comes into force in September 2018, with a first Meeting of the Parties in October. A cost-benefit analysis of implementing the Protocol suggested that it could reduce smuggling in the UK by up to 80 percent, save 760 lives a year, and be worth £5.7 billion to the UK in net present value.(116)

1.3 INNOVATIVE AND TECHNOLOGICAL SOLUTIONS (FOR PACKAGING)

Fiscal Marks

A fiscal mark is required on cigarettes and HRT imported into the UK to indicate that UK duty has been paid (Note: this also applies to products produced in the UK, but UK-based production has recently ceased). Other tobacco products are exempted. The products must be marked before they enter the UK, and there are penalties for supplying or selling non-compliant products. The requirements for the mark are clearly specified.(117) In brief, the words "UK DUTY PAID" are required in Helvetica black bold type against a white background, and must be written indelibly, clearly, and legibly. The mark must not be hidden or obscured, nor must the mark obscure any health warning or other written or pictorial matter.

Anti-Counterfeiting Technology

An anti-counterfeit marking scheme has been in place in the UK since 2007, with a view to deterring and detecting counterfeit products, and to prevent legitimate retailers from being unfairly disadvantaged. The marks consist of a covert (not visible with the naked eye) taggant. A taggant is a chemical element which is added to the ink, and is detectable using hand-held scanners.(118, 119) The implementation of anti-counterfeiting technology was the result of a voluntary agreement between the industry and the UK government. The marks were introduced for cigarettes in October 2007 and extended to HRT in October 2008.(81) The UK government has also allowed the tobacco industry to trial its Codentify system in the UK as a means for testing product authenticity, so that it could examine whether it could provide a useful additional tool to enable product authentication. Given (1) the TI's attempts to promote Codentify as a track-and-trace system and (2) widely held concerns about Codentify, it is important to note that the trial is concerned only with the use of Codentify for product authentication. No other aspect of the system is being used or evaluated, and the government has made clear that it does not endorse this product in any way.(120-122)

Tracking and Tracing

Tracking and tracing involves monitoring the production, movement, and trade of tobacco products using secure and unique identifiers on such products. The new EU Tobacco Products Directive (2014/40/EU) requires EU member states to introduce an EU-wide tracking and tracing system by May 2019.(96) The Illicit Trade Protocol, to which the UK is a Party, also requires the implementation of a tracking and tracing system.(123)

1.4 RESULTS OF REFORMS TO ADDRESS ILLICIT TRADE - GOVERNMENT DATA

The UK government makes a concerted effort to collate data on the illicit tobacco trade, both to measure revenue losses and to evaluate its anti-illicit strategy. This is essential in understanding the size and nature of the problem, identifying emerging issues, and assessing the effectiveness of the strategy. This section gives an overview of the methods of measurement used by government to measure the illicit trade and the data they provide to evaluate the illicit tobacco strategy:

- » The illicit market share
- » Revenue losses associated with the illicit trade
- » Seizure volumes
- » Number and results of criminal investigations

Illicit Market Shares and Associated Revenue Losses

Measurement methods. HMRC publishes tax gap estimates for cigarettes and HRT each year. Up-to-date survey data currently allow HMRC to publish these in a timely fashion, with a lag of around six months.

The general approach has remained consistent since the first publication in 2001, but the methodology has been modified over time to take account of changes to data collection. Each year, previous estimates are re-estimated using the revised methodology, to ensure that they are comparable over time.

The most recent data on illicit market shares and associated revenue losses were published in 2017. The methods used are made public in a detailed methodological annex and are summarized here.⁽¹²⁴⁾

Calculating illicit consumption and market share. HMRC adopt a top-down approach to measuring tax gaps for tobacco, whereby they estimate total consumption and subtract legitimate consumption to estimate illicit consumption:

$$\text{ILLICIT CONSUMPTION} = \text{TOTAL CONSUMPTION} - \text{LEGITIMATE CONSUMPTION}$$

Illicit market share is calculated as:

$$\text{ILLICIT MARKET SHARE} = (\text{ILLICIT CONSUMPTION} / \text{TOTAL CONSUMPTION}) * 100$$

Total consumption per year is calculated using:

- » Estimates of prevalence of cigarette and HRT use and levels of consumption based on national survey data

- » Estimates of the adult population
- » An uplift factor to account for under-reporting (see below)

Legitimate consumption is calculated as:

LEGITIMATE CONSUMPTION = UK DUTY PAID CONSUMPTION + CROSS-BORDER SHOPPING + DUTY FREE

Estimates of UK duty paid are taken directly from HMRC returns. Cross-border shopping is based on a survey of air and sea passengers, while duty free estimates are based on commercial data.

Calculating revenue losses. Revenue losses are calculated by combining illicit market data with information on duty rates and VAT:

REVENUE LOSS = (SPECIFIC DUTY + (AD VALOREM + VAT FRACTION)*AVERAGE PRICE) * ILLICIT VOLUME

VAT fraction is the portion of the retail price that is VAT. HMRC acknowledge that because some illicit product is sold in legitimate outlets, assuming that the VAT fraction is lost on all purchases overestimates the losses.

The average price used is the weighted average price (WAP) of all cigarettes/HRT that were UK duty paid. The WAP is calculated by weighting the retail price of each product by the share of clearances in the cigarette/HRT market.

Measuring illicit market shares and associated revenue losses - limitations. A key limitation of the way that HMRC calculates the tax gap is that the approach relies heavily on self-reported survey data on prevalence and consumption; an uplift factor is used to account for underreporting. The uplift factor applied to estimates of consumption is based on estimates of consumption in a base year in which there is believed to have been little or no illicit market, i.e. legitimate consumption accounts for all consumption.

There is uncertainty about some of the estimates that contribute to the calculations of illicit market magnitude and revenue losses. HMRC publishes a range for the tobacco tax gap to reflect the extent of this uncertainty.

Results. The government's tax gap estimates indicate that during the first ten years of the illicit tobacco strategy, from 2000-01 to 2009-10, the illicit market share for cigarettes was nearly halved, dropping from 22 percent to 12 percent (central estimates) (Figure 6). The illicit market share for HRT fell less consistently, but saw a drop from 61 percent to 44 percent (central estimates) during the same period (Figure 7).

The estimated range for the revenue losses associated with illicit cigarettes and HRT is large, and the estimates need to be considered in the context of changes in smoking prevalence, changes in duty rates, and of the overall size of tax evasion in the UK. However, the estimates for cigarettes suggest a significant fall during this period (Table 6). The trend for HRT is less clear.

Overall, these estimates demonstrate the success of the illicit trade strategy during this period.

Figure 6 suggests that, contrary to the first ten years of the strategy, the illicit market share of cigarettes increased between 2010-11 and 2016-17. Due to a decline in smoking prevalence, the size of the illicit market remained fairly stable during this period at around 5 billion cigarettes per year (Table 6) (125); taken together, these estimates indicate that the illicit market for cigarettes has become a larger proportion of a declining overall cigarette market.

Figure 6. Cigarettes: Estimated Range of Illicit Market Shares, 2000-01 - 2016-17

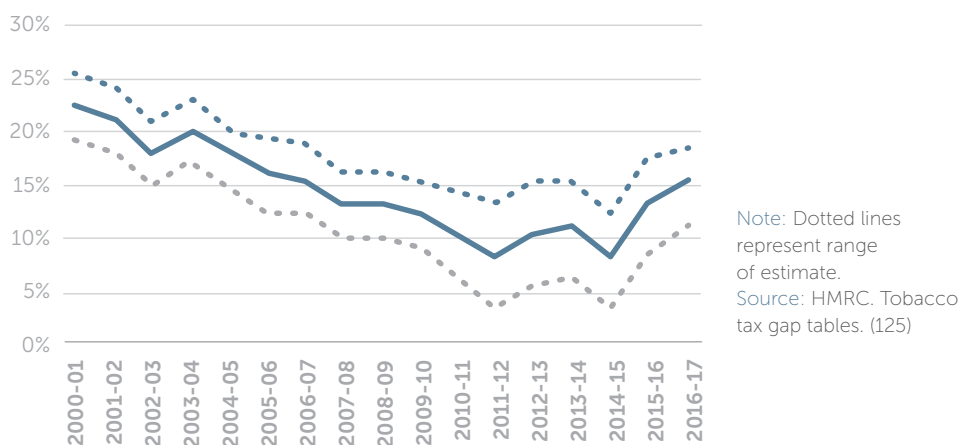


Figure 7. HRT: Estimated Range of Illicit Market Shares, 2000-01 - 2016-17

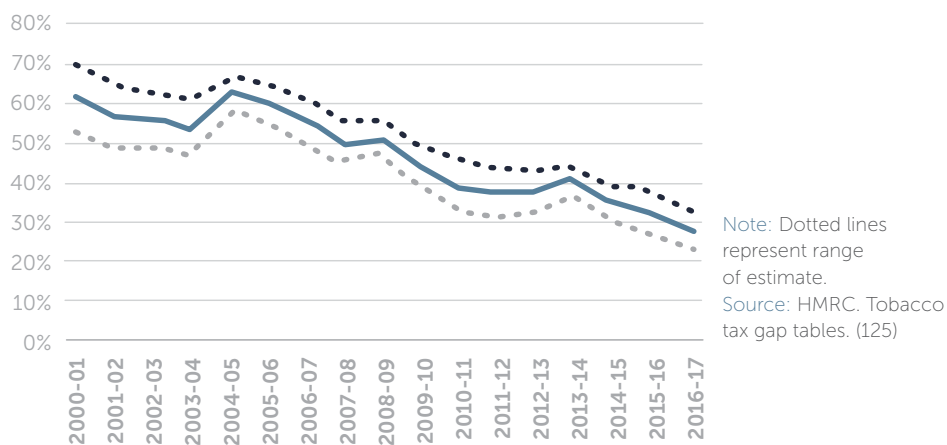


Table 6. Illicit Market Volumes and Associated Revenue Losses, 2000-01 - 2016-17

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
CIGARETTE ILLICIT MARKET VOLUMES (BILLION CIGARETTES)																	
Upper estimate	20.0	19.5	16.5	18.0	14.5	12.5	12.0	9.5	9.5	9.0	7.5	6.5	7.0	6.5	5.0	7.0	7.0
Central estimate	17.0	16.5	13.5	15.5	12.5	10.0	9.5	7.5	7.5	7.0	5.0	4.0	4.5	4.5	3.0	5.0	5.5
Lower estimate	14.0	13.5	10.5	12.5	10.0	7.5	7.5	5.5	5.0	5.0	3.0	1.5	2.5	2.5	1.5	3.0	4.0
CIGARETTE REVENUE LOSSES (£ MILLION)																	
Upper estimate	3200	3200	2800	3200	2600	2400	2300	1900	1900	1900	1700	1600	1900	2000	1500	2200	2300
Central estimate	2800	2700	2300	2700	2200	1900	1800	1500	1500	1500	1200	1000	1300	1400	900	1600	1800
Lower estimate	2300	2200	1800	2200	1800	1400	1400	1100	1100	1000	700	400	600	800	400	1000	1200
HRT ILLICIT MARKET VOLUMES (THOUSAND KG)																	
Upper estimate	7,000	7,400	7,300	6,600	7,700	7,200	6,800	5,700	6,500	5,600	5,200	4,900	5,200	5,500	4,400	4,000	3,400
Central estimate	5,600	5,900	6,000	5,400	6,700	6,100	5,700	4,700	5,500	4,700	4,200	4,000	4,200	4,700	3,700	3,300	2,700
Lower estimate	4,200	4,500	4,700	4,200	5,800	5,000	4,500	3,700	4,600	3,800	3,200	3,100	3,300	3,800	3,000	2,500	2,100
HRT REVENUE LOSSES (£ MILLION)																	
Upper estimate	800	900	900	900	1000	1000	1000	800	1000	900	900	1000	1100	1200	1000	1000	900
Central estimate	700	700	700	700	800	800	800	700	800	700	700	800	900	1100	900	800	700
Lower estimate	500	600	600	500	800	700	600	600	700	600	500	600	700	900	700	600	500

Source: HMRC. Tobacco tax gap tables. (125)

During the same period, the illicit HRT market continued to decrease, both in terms of market share (Figure 7) and in terms of volume. The market volume of illicit tobacco was estimated at 4,200,000 kg in 2010-11 and 2,700,000 kg in 2016-17 (Table 6).(125)

These findings suggest that, while the strategy has continued to have some success, this may have been undermined by cuts in funding for local-level enforcement in recent years; however, the reasons for the change in trend have not been comprehensively evaluated. (126)

Volume and Composition of Products Seized

Measurement methods. The volumes of seizures reported by HMRC and Border Force are based on estimates made at the point of seizure. While seizure volumes can reflect levels of illicit, they more clearly reflect the scale of the enforcement effort and fluctuations in the ease of detection resulting from changes in the nature of the illicit market.

The composition of seizures – in terms of the proportions of the illicit trade which consist of T1 illicit, cheap whites, and counterfeit - is an indicator of the success of efforts to control the supply chain, particularly supply chain legislation. However, these data are only compiled on large seizures (250,000 cigarettes or more from 2004-05 to 2006-07 and 100,000 or more cigarettes thereafter).

Results. UK government data indicate the high volume of seizures since the implementation of the strategy in 2000. During the first 10 years of the illicit tobacco strategy, more than 20 billion cigarettes and 2700 tonnes of HRT were seized.(81) Table 7 summarizes the volume and revenue value of seizures since 2008-09.

Between 2008-09 and 2015-16, cigarette seizures were relatively constant; the illicit market share declined during much of that period, indicating an increase in the interdiction rate (the volume of goods seized as a proportion of the total volume of illicit goods targeted at the UK).(85) HRT seizures fluctuated between 259 tonnes and 572 tonnes. In 2012-13, over two-thirds of cigarettes seized were seized abroad, while approximately three-quarters of HRT was seized at the border.(85)

Data on large seizures suggest that the share of the illicit cigarette market accounted for by genuine UK brand cigarettes has declined under recent supply-chain legislation, from 31 percent in 2004-05 to 5 percent in 2012-13.(85) For HRT (based on large seizures consisting of 50 kg of HRT or more), the proportion fell from 75 percent in 2007-08 to 17 percent in 2012-13, but this proportion has fluctuated significantly over time.(85)

Significant concerns have been raised about the accuracy of seizure data. In particular, experts have questioned the practice of basing seizure composition reports entirely on data from large seizures.(73, 122) The UK government has therefore recently invested in compiling comprehensive seizure data.(127, 128)

Table 7. Total Illicit Cigarette and HRT Seizures by HMRC and Border Force, 2008-09 - 2015-16

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
CIGARETTES								
Volume (billion)	1.8	1.7	1.7	1.7	1.9	1.4	1.7	1.7
Revenue value (£ million)	n/a	n/a	n/a	n/a	n/a	410	542.7	561
HRT								
Volume (tonnes)	259	403	389	572	483	330	313	286
Revenue value (£ million)	n/a	n/a	n/a	n/a	n/a	74.6	73.8	70

*Note: NAO report did not report value of seizures.

Source: 2008-09 – 2012-13: National Audit Office. Progress in tackling tobacco smuggling. (85); 2013-14 – 2015-16: HMRC Tackling tobacco smuggling: outputs(105)

Number and results of criminal investigations

Measurement methods. HMRC publishes a range of data on levels of criminal enforcement activity and civil penalties related to the illicit tobacco trade, including numbers of prosecutions and the revenue loss prevented as a result of criminal enforcement activity. These data provide a further indication of the benefits of efforts to tackle illicit trade.

HMRC's key indicator of the impact of its investigations against organized crime is an estimate of revenue loss prevented. HMRC's estimates of revenue loss prevented through criminal enforcement activity are calculated at the point of first intervention (seizure or arrest). The scale of the fraud disrupted is estimated, and then extrapolated based on the prevention of 12 months of future fraudulent activity.

The NAO underlines that this method can either under-report benefits (if initial estimates of the scale of the fraud are conservative) or over-report benefits (for example, if a case does not progress to full prosecution).(85) While reporting the impact at outcome (e.g., successful prosecution) would be more accurate, this would weaken the link between the activity and benefit reported within a year.

Results. Between 2011 and 2015, annual prosecutions for tobacco offences rose by 50 percent, with 177 people being convicted of organized tobacco crime offences, and 605 people convicted of smaller-scale tobacco crime offences.(83) While detailed data on the prosecutions are not published, cases are in the public domain and press releases about cases are regularly published.(129)

HMRC's key measure in relation to lower-level criminal activity is the value of civil assessments and penalties issued. In 2011-12, these reached £8.2 million; in 2012-13 their value

Table 8. Criminal Enforcement Activity and Civil Penalties, 2013-14 to 2015-16

CRIMINAL ENFORCEMENT ACTIVITY	2013-14	2014-15	2015-16
Number of individuals prosecuted	328	417	431
Number of individuals convicted	271	237	268
Number of tobacco related confiscation orders	28	36	38
Value of tobacco related confiscation orders (£ million)	3.50	1.4	1.32
Revenue loss prevented (£ million)	606	968.1	983.1
CIVIL PENALTIES			
Number of tobacco related wrongdoing penalties issued	1,571	1,339	1,335
Value of tobacco related wrongdoing penalties issued (£ million)	3.2	2.5	2.2
Number of assessments for tobacco products duty issued	1,659	1,376	1,461
Value of tobacco products duty assessments issued (£ million)	15	7.6	15.7

Source: HMRC Tackling tobacco smuggling: outputs (105)

was £17.7 million.⁽⁸⁵⁾ Between 2011 and 2015, £49 million was raised in assessments and penalties.⁽⁸³⁾

The results of criminal investigations and civil penalties issued from 2013-14 to 2015-16 are summarized in Table 8 below. The revenue loss prevented in recent years has been estimated at close to £1 billion.

1.5 COSTS AND BENEFITS OF THE ILLICIT TOBACCO STRATEGY

A formal evaluation of the financial costs and benefits of the illicit tobacco strategy has not been published; nor has the effect of the strategy on smoking prevalence been assessed. In the absence of detailed data on expenditure on tackling illicit tobacco, it is not possible to fully assess the return on investment. Nevertheless, the data presented above give some indication of the financial costs and benefits, which are summarized here.

In 2000, £209 million was invested in extra staff and x-ray scanners to support implementation of the illicit tobacco strategy.⁽¹⁶⁾ The limited data published more recently indicate staff expenditures by HMRC and the Border Agency on detection, investigation, and intelligence of around £90 million per year.⁽⁹⁹⁾ These data do not capture all relevant costs, such as expenditure on new technology or trading standards, but are likely to represent the bulk of expenditure on the illicit tobacco strategy.

It is not possible to determine what the value of revenue losses would have been in the absence of the illicit tobacco strategy; however, when the first strategy was published, smuggling was on an upward trend and it was predicted that the market share of illicit tobacco would grow from 21 percent to a third within two years in the absence of action.

As described above, the strategy successfully reversed the increasing trend. The value of seizures, estimates of revenue losses prevented by criminal investigations, and reductions in estimated revenue losses - despite regular tax increases - demonstrate that the financial benefits are significant.

In 2016-17, the estimated revenue losses associated with illicit cigarettes were £1 billion lower than in 2000-01; in 2014-15, they were nearly £2 billion lower.⁽¹²⁵⁾ The revenue value of cigarettes and HRT seized by HMRC and the Border Agency has been over £600 million in recent years.⁽¹⁰⁵⁾ The future revenue loss prevented by criminal enforcement activity increased to close to £1 billion for the year 2015-16.⁽¹⁰⁵⁾

Taken together, the available data indicate that investment in measures to tackle the illicit trade has delivered a significant return on investment.

1.6 ONGOING CHALLENGES: TACKLING THE TOBACCO INDUSTRY'S ROLE IN THE ILLICIT TOBACCO TRADE

Sections 1.4 and 1.5 described the success of the government strategy since 2000 but underlined that the problem of illicit tobacco in the UK remains significant. Furthermore, the data presented above do not capture comprehensive information about the nature of the illicit market. This section describes the nature of the illicit market in the UK. It offers evidence of the industry's ongoing role in the illicit tobacco trade and explores approaches to tackling that involvement.

Data Suggesting Ongoing Industry Involvement - Tobacco Industry Illicit Remains the Single Largest Problem

Based on the composition of cigarette seizures, experts deduce the proportions of the illicit trade which consist of tobacco industry illicit, cheap whites, and counterfeit. This information can be vital in identifying underlying problems and directing appropriate supply chain interventions. As outlined above, HMRC and UK Border Force data on the composition of seizures only cover large seizures (consisting of 250,000 cigarettes or more from 2004-05 and 100,000 or more from 2006-13). These data indicate that UK-branded TI illicit as a proportion of the illicit cigarette market has declined since supply chain legislation was implemented, falling from 17 percent to 5 percent in 2012-13.⁽⁸⁵⁾ For HRT, the proportion has fallen since 2007-08 (75 percent), to 17 percent in 2012-13.⁽⁸⁵⁾

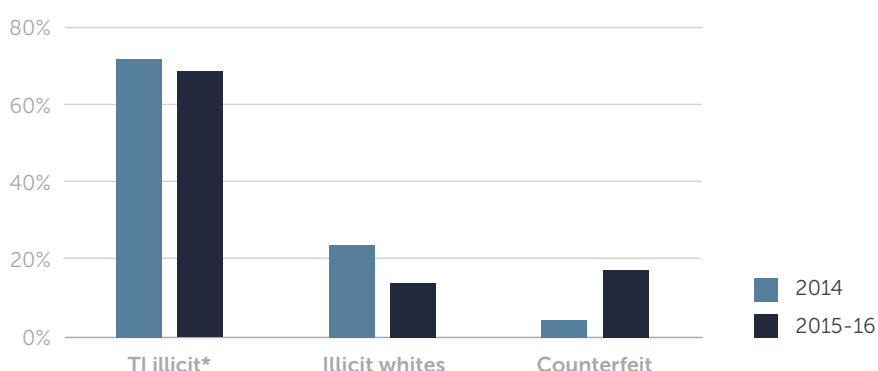
However, as previously noted, significant concerns have been raised about the quality and relevance of large-seizure data.⁽⁷³⁾ Other data sources (including those based on seizures regardless of size) indicate that estimates based only on large seizures significantly underestimate the proportion of the illicit market that comprises tobacco industry illicit product.^(72, 73) This is thought to reflect a number of issues: (i) counterfeit products are now transported in large quantities and are therefore likely to be seized in large batches, while TI illicit is increasingly transported in smaller quantities; (ii) TTCs investigate and alert government authorities to other forms of illicit (counterfeits and cheap whites), which are therefore more

likely to be seized; (iii) TTCs play a role in evaluating which seized products are counterfeit and which genuine. For example, following litigation brought against the major tobacco transnationals for their involvement in tobacco smuggling, the EU reached legal agreements with the firms. (130-133) Under these arrangements, the companies were required to pay ongoing penalties, should their products continue to be found in illicit seizures. However, the tobacco firms themselves were asked to help determine which seized products were genuine and which counterfeit.(72, 73)

The need for independent data on the nature of the illicit market is clear. The UK Department of Health therefore funded the Trading Standards Institute to systematically collect data on tobacco seizures regardless of size. Two periods of data collection in 2014 and 2015-16 suggested that approximately 70 percent of seized cigarettes were tobacco industry illicit (Figure 8).(122, 127, 128) Other data sources support that finding.(122) The latest World Customs Organization data indicate that, globally, approximately 70 percent of seizures are tobacco industry illicit (Figure 10). Even data funded by the tobacco industry itself show that tobacco industry illicit remains the largest category of illicit cigarettes across the EU (Figure 9), with TI illicit comprising an estimated 89 percent of the illicit market in 2007 and 58 percent in 2016.

In short, diverse data consistently show that across the UK, the EU, and globally, the single largest component of the illicit tobacco market is tobacco industry illicit.(122) This is despite regular claims by the tobacco industry that the main problems are cheap whites and counterfeit.

Figure 8. Operation Henry Results: % Share of UK Illicit Market by Type With Correction for 2015/16 data* Estimates

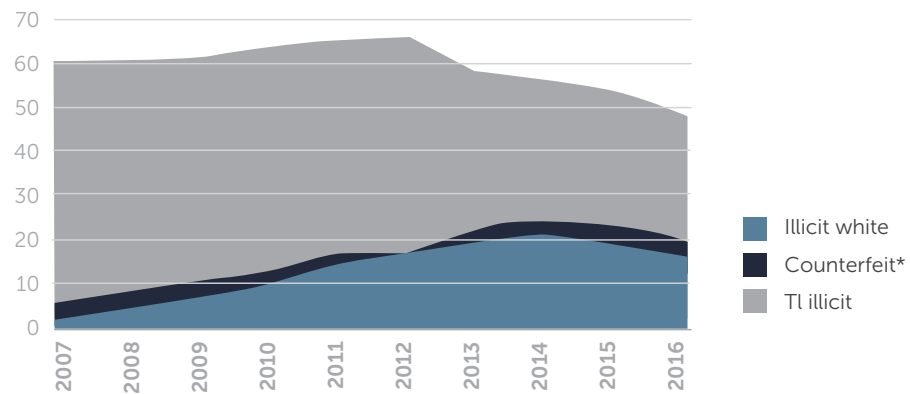


Source: Trading Standards Institute.(127, 128) Based on systematically collected seizure data from nine English regions between April-November 2014 and December-April 2016.

*Graphs and corrected analysis by Gilmore

This report identified the two most-seized products, West and Winston, as cheap whites. However, these are tobacco industry brands, sold in the UK by Imperial Tobacco and Japan Tobacco International, respectively. In the above graphs, these products have therefore been recoded as tobacco industry illicit. This is more likely to give an accurate picture. It is unclear if a determination was made as to whether these seized products were genuine or counterfeit. However, these products are generally not widely sold in the UK. Thus, it is thought unlikely that counterfeiters would target counterfeit West and Winston at the UK market.

Figure 9. Nature of Illicit Cigarettes in the European Union – Collated Results from the Project Sun and Star Reports Of Volume and Type (billions of sticks)

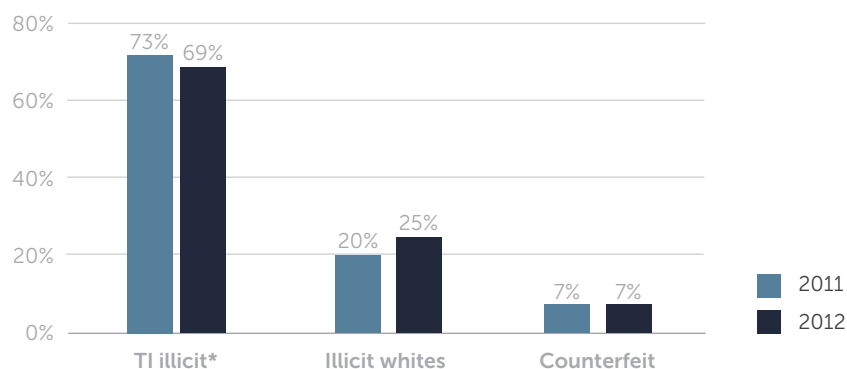


Source: Data (based on sales figures, empty pack surveys, and consumer surveys) taken from the Project Sun and Project Star reports published by KPMG and funded by the tobacco industry. KPMG’s 2017 Project Sun report (with data for 2016) was funded by the Royal United Services Institute which receives funding from the tobacco industry.(134-140)

* The Counterfeit data in the Project Sun/Star reports comprises just counterfeit PMI brands from 2007-11 and counterfeited brands for all 4 TTCs from 2013 onward.

Analysis and graphs by Gilmore

Figure 10. WCO Latest Available Global Data Showing the % of Cigarettes Seized by Type



Source: WCO data taken from the WCO Illicit Trade Report 2012.(141) Based on data of seizures of all quantities. Analysis and graphs by Gilmore

Other Evidence of Ongoing Tobacco Industry Involvement

These data suggest that, at best, the TI is failing to control its supply chain: how else could such large numbers of tobacco-company products end up on the illicit market? Growing evidence from diverse sources, including industry whistleblowers,(142) investigative journalists,(143) researchers,(144) and government investigations, suggests that TTC involvement may, however, be less passive.(85, 122, 145) UK government reports highlight that the

tobacco industry has continued to oversupply its products to low-tax jurisdictions, in the knowledge that these products would leak back into the UK.(15, 76, 85, 145)

The National Audit Office noted that 2011 estimates showed “actual supply of some brands of hand-rolling tobacco exceeded legitimate demand by 240 per cent.”(85) The Public Accounts Committee argued the need “to put a stop to the abuse of exports by tobacco manufacturers.” Approaches should include naming and shaming those who fail to co-operate.(106) In line with these conclusions, BAT was recently fined £650,000, reduced on appeal to £100,000, for over exporting hand-rolled tobacco to Belgium, which then found its way back to the UK.(146-148) While such fines are small compared to industry income, the maximum penalty is a more substantial £5 million and the threat of such supply chain fines can be used by HMRC to encourage change in TTC behavior.

The Role of Civil Society in Supporting Evidence-Based Government Policy on Tax and Illicit and Addressing TI Misconduct

The tobacco industry in the UK, as elsewhere, has increasingly used the threat of illicit tobacco to argue against tobacco tax increases and other tobacco control policies, perhaps most notably plain packaging. Such arguments can hold sway given governments’ fears about potential revenue losses. Civil society in the UK, including close collaboration between researchers and NGOs, has long played a key role in exposing tobacco industry misconduct and countering the industry’s misleading data and arguments. This has enabled the advancement of evidence-based government policy.

Refuting industry arguments that tax increases drive illicit trade. The tobacco industry consistently argues that high taxes inevitably lead to high levels of illicit, ignoring the strong correlation between the level of corruption and tobacco smuggling, as well as the role of enforcement.(62) Although in some jurisdictions industry arguments have been successful in influencing policy,(58) in the UK, civil society organizations, working with the media, were able to expose the tobacco industry’s facilitation of the smuggling of its own products, spurring parliamentary committees to carry out Inquiries.(63, 149, 150) These Inquiries led to reports containing strong recommendations to Government and further negative publicity about tobacco industry misbehavior both within the UK(151) and internationally (108, 110). As a result, tobacco industry claims that tobacco taxes are the sole driver of illicit trade have been met with skepticism.

Despite initial civil-society successes, however, the TI continued to argue that tax increases spur illicit trade.(152) More recent research on tobacco industry profitability and pricing played a key role in showing that, in fact, half of recent cigarette price increases in the UK were due to the tobacco industry’s raising its own prices over and above tax increases.(153) This result suggested that, since tobacco firms were still able to increase profits by raising prices, additional scope remained for the UK to raise its tobacco taxes, despite already imposing some of the highest tobacco taxes in the world.(153)

Exposing the misleading nature of industry data and how firms use this data to scaremonger and confuse. In recent years, the tobacco industry has increasingly commissioned its own data on illicit tobacco to try to underpin its arguments that tax drives illicit trade. Much of these data come from empty pack surveys (EPS), where discarded cigarette packs are collected, assessed, and categorized.(154) While such surveys can, if conducted properly, provide useful data on non-domestic goods (i.e., products which have not paid local duties), they cannot in fact determine which of those products are legal (for example, duty-free products brought into the country by tourists, students, or workers from abroad) and which are illegal (i.e., illicit). Hence, these surveys cannot directly measure the illicit tobacco trade. Moreover, the TI and those doing surveys for it are notoriously opaque about their methodologies, generally volunteering no details (152) and refusing to provide clarification when asked.(155)

Nevertheless, in the UK, the TI has presented EPS data to the press in such a way as to give the impression that they reliably measure the illicit tobacco market. Consequently, media stories based on TI data have been found to routinely exaggerate the scale of the illicit tobacco trade.(154) Such efforts, alongside alarming and misleading videos on TTC websites(156) and TI misrepresentation of government data (the industry routinely cites the upper rather than mid-point government estimate of illicit in its reports (154)), are designed to create confusion about illicit. (154, 157)

Other industry-funded data have been produced by major accountancy firms such as KPMG, Deloitte, and PricewaterhouseCoopers (134-140, 158-162), with European data produced by KPMG based on modelled estimates. Independent evaluation shows that, by inputting EPS and other data provided by the TI into its model with no external validation, KPMG tends to overestimate illicit.(73) Further, at the moment when standardized packaging was being debated in the UK, KPMG changed its methodology in just two countries (Italy and the UK) in a way that led to a sudden overestimate of illicit trade levels in these two markets. The firm's report was released early, accompanied by a press release highlighting this ostensible sudden increase, in an apparent attempt to influence policy decisions about standardized packaging.(73) Only once an independent critique of this methodology change (73) was made public did KPMG reanalyze its data (a year later) and produce a lower, more realistic estimate.(163)

Elsewhere, the TTCs have commissioned KPMG or other accountancy firms to prepare reports on the illicit tobacco trade which have, almost without fail, also been shown to exaggerate levels of illicit compared with independent data.(73, 144, 154, 155, 164-190) There is growing consensus, therefore, that such reports are produced primarily to serve TI interests. (73, 164, 191, 192)

Exposing the poor quality of tobacco industry evidence that standardized packaging drives illicit. Most recently, the industry argued that standardized cigarette packaging would fuel illicit trade and ultimately lead to policy failure and adverse social and economic consequences.(152, 154, 164, 169) The number of media stories citing industry data on illicit was shown to increase rapidly following the UK government's announcement that it was

considering the option of standardized packaging, at a time when levels of illicit were in fact falling.(154) As usual, industry arguments sought to exploit policy makers' fears of losing revenue through an expansion of the illicit tobacco trade.

Independent analyses showed that these arguments had no foundation (193) and that industry "evidence" on this issue amounted to little more than anecdote and the opinion of persons in the industry's pay.(164) Subsequent analyses commissioned by the UK and Irish governments supported the conclusion that there was no convincing evidence that the introduction of standardized packaging would lead to an increase in illicit tobacco.(97, 194-196) Both governments proceeded to introduce plain, standardized packaging.

Exposing industry third parties. Much of the questionable data we have discussed is collected by individuals and organizations paid by the tobacco industry. It is generally these individuals and entities, rather than the tobacco companies funding them, that are given prominence in press stories.(197) Many of these figures are ex-policemen that the industry pays to provide it, in industry spokespersons' own words, with a "credible voice."(198-203) Such efforts create an aura of respectability and independence.

Similarly, analysis of the industry's "evidence" that standardized packaging would increase illicit showed that most of the findings has been produced by industry third parties. The TI almost entirely failed to disclose this circumstance in its submissions to government.(164) For example, TI submissions cited evidence from the Tobacco Retailers Alliance, the British Brands Group, and the Anti-Counterfeiting Group, without mentioning that all of these organizations were created (and in some instances entirely financed by) the tobacco industry itself.(164)

Numerous other individuals (see e.g. 204, 205) and organizations, the latter including retailer front groups (206), research organizations (207-209), and think tanks (210, 211) with close links to the tobacco industry, have repeatedly argued that tobacco control will increase illicit trade. Most recently, in 2017, an All Party Parliamentary Group (APPG) on Illicit Trade, which has links to the tobacco industry, was set up "to investigate and raise awareness of illicit trade in Britain, support closer working with parliamentarians to bring fresh impetus and ideas to tackling illicit trade and to highlight the impact on local businesses, high streets and communities" (212, 213).

All Party Parliamentary Groups (APPGs) are informal cross-party groups that have no official status within Parliament. They are run by and for Members of the Commons and Lords, though many choose to involve individuals and organizations from outside Parliament in their administration and activities. In March 2018, the APPG on Illicit Trade launched its formal inquiry into the state of such commerce in the UK. The report on the group's findings was published in July 2018. The report recommended the creation of a UK Anti-Illicit Trade Group, which would see the government working together with industry to tackle the illicit trade challenge.⁶ The APPG report also echoed arguments described above that taxes

⁶ The APPG report can be consulted via the following link: Illicit trade in the UK. All Party Parliamentary Group on Illicit Trade. 2018. Available from <https://connectpa.co.uk/wp-content/uploads/2018/07/Illicit-Trade-APPG-report-2018LRi.pdf> [Accessed 14 August 2018].

introduced to reduce the consumption of unhealthy commodities, such as the soft drinks levy implemented in 2018, increase illicit trade. The report notably failed to mention the ITP, which will be essential in informing future strategies to tackle the illicit tobacco trade. The report was funded by PA Consulting, which has previously advised British American Tobacco on tobacco tracking and tracing initiatives, and Coca Cola.

It is impossible to exhaustively analyze the tobacco industry's complex third-party networks here. However, the website www.TobaccoTactics.org, with help from tobacco advocacy organizations such as ASH, publishes details on third-party links (157, 204, 214-216), so that civil servants, politicians, journalists, and others can learn more about tobacco industry practices and front groups and determine whether particular individuals and organizations may be acting on the tobacco industry's behalf. Through initiatives of this kind, civil society has increased the transparency of policy making and helped Government live up to its obligations under Article 5.3 of the WHO FCTC to protect tobacco policy from the commercial and vested interests of the tobacco industry.(18, 217)

Civil society support for evidence-based policy. In 1993, a pre-budget submission by a group of health organizations called for unique treatment of tobacco because of its health consequences and for a commitment to real increases in tobacco taxes, not just in the forthcoming budget, but for the longer term. In response, in the 1993 Budget, the Government introduced the tobacco tax escalator discussed above, explicitly to reduce smoking prevalence as well as raise revenue.(218) Confronting a large and rapidly growing illicit cigarette market in the 1990s, the UK Government tackled illicit trade by introducing a tough enforcement strategy rather than by cutting taxes.(16) Health organizations provided support for the Government's policy choice, which withstood vigorous lobbying efforts by the tobacco industry.

The Finance Minister, who is responsible for tobacco taxation and illicit trade, meets with the tobacco industry but also with civil society, as do other officials responsible for these policy areas. Representations from advocacy organizations, working with the research community, (163, 219-222) are taken seriously, and their recommendations are often adopted. From 2004 onwards, civil society organizations argued (in particular via ASH budget submissions) that the tax escalator should be reintroduced. In 2009, taxes were again increased above inflation, and the tobacco tax escalator was restored in 2010.

As noted, a diverse body of research examining tobacco industry profitability, pricing, evidence, data, and conduct has been used to refute the industry's misleading arguments and expose its failure to control its supply chain.(11, 58, 72, 73, 122, 153, 154, 164, 189, 223-226) This research has played a key role in enabling tobacco control policies, including high tobacco taxes, to advance. A 2009 cost-benefit analysis of the Illicit Trade Protocol was influential in ensuring that the UK supported its development and committed to ratification.(83, 116)

In 2010/11, civil society argued that, since the illicit market share of handrolled tobacco was declining, the gap between taxation of manufactured cigarettes and the much lower

taxation of handrolled tobacco needed tackling.(227) In the 2011 Budget, taxation on handrolled tobacco was increased above the standard tax escalator of 2% by a further 10%, then rose again in 2016 by an additional 3%. Research brought forth additional evidence on the behavior of the tobacco industry in gaming tax levels and causing a widening price gap between expensive and cheaper products, with implications for inequalities in smoking (11, 228). These findings were used to successfully advocate for the introduction of a Minimum Excise Tax. (220, 229) Following a consultation in 2014, the Minimum Excise Tax was introduced in 2017. (A general election in the intervening period initially delayed its implementation.)(230)

Evidence shows that prices are not a principal driver of illicit tobacco trade in Europe, and that supply-side factors are a more important determinant (189). Civil society has effectively used these findings, along with evidence that the tobacco industry itself remains involved in illicit activity, to persuade the UK government to renew the tobacco tax escalator in the current parliament.(50, 73, 222, 233)

1.7 CASE STUDY METHODOLOGY

This case study has been compiled using documents and data that are in the public domain. A full reference list is provided in Annex I. Fresh North East contributed information on regional partnerships, and HMRC were consulted to ensure the accuracy of information including that presented on fiscal marks and anti-counterfeiting technology.

2. Lessons Learned and What Else Can Be Done to Improve Results

2.1 LESSONS LEARNED

Tobacco taxation and strategies to reduce the illicit trade go hand-in-hand as measures which are intended both to improve public health and protect and increase government revenues. The UK experience underlines that eradicating smuggling is an issue of enforcement. Cutting tobacco taxes is not an effective method of reducing the illicit trade.(58)

The overarching approach should encompass predominantly supply-side measures that aim to tackle the illicit trade at home and overseas. Strategies should aim to disrupt supply and distribution chains, reducing the rewards and increasing the risks and penalties associated with the illicit trade of tobacco. In the case of illicit products that cross borders, an end-to-end approach and collaboration with international fiscal and law enforcement agencies is warranted.

There is a need to identify the size and nature of illicit trade using accurate data that are independent of industry, and to monitor this over time. Setting targets for key indicators can act as a motivator and mechanism for determining success. In the UK, regular monitoring has enabled evaluation of the effectiveness of the national strategy and highlighted emerging challenges; the strategy has been regularly refreshed in response to new threats.

Good governance serves to support the implementation and continued development of the illicit tobacco strategy. In the UK, active implementation of Article 5.3, on the publication of strategies and monitoring data in the public domain, ensures transparency. Reports published by the NAO and PAC have highlighted gaps in the strategy and its enforcement.

Despite efforts to tackle illicit tobacco in general, and tobacco industry illicit in particular, there is extensive evidence that the tobacco industry remains heavily involved in the illicit trade in the UK and funds the production and dissemination of misleading data about the illicit tobacco market. It is essential that measures to control the supply chain be fully enforced. Civil society (both academia and NGOs) plays a key role in providing unbiased evidence, including on industry pricing, profits, and conduct. Civil society voices advocate for stronger and more innovative evidence-based policy measures.

Strong policies on tax and the illicit trade are necessary but not sufficient to reduce smoking prevalence. They should be used as part of a comprehensive set of measures to tackle the burden of tobacco use.

2.2 WHAT ELSE CAN BE DONE?

The UK anti-smuggling strategy has achieved impressive results, but illicit tobacco continues to undermine efforts to reduce tobacco use in the UK, and the revenue losses associated with illicit tobacco remain substantial. Recent increases in the illicit market share of manufactured cigarettes are a particular concern.

When the UK government first introduced its anti-smuggling strategy, targets were set for a reduction in the tobacco market share accounted for by illicit tobacco. These targets committed the government to reduce the illicit market share from 22% in 2001-2 to 13% by 2007-8.^(16, 78, 234) These figures established a clear and transparent benchmark of what success meant, and helped maintain the incentive for agencies to invest resources in this effort. However, these targets expired at the end of 2008. In the 2008 joint HMRC UKBA strategy, no formal targets were set. Reference was made to a partnership agreement that foresaw sustaining the level of the illicit market at the target set for 2007-8, implying that no further progress beyond this level was expected.^(80, 234) The 2011 strategy was likewise vague about outcomes, stating only that the objective was “to achieve further sustainable downwards pressure on the illicit market in cigarettes and HRT through to 2015.”⁽⁸¹⁾

The latest strategy committed to “hold the cigarettes illicit market share at or below 10 per cent” and to “contain the illicit market share for hand-rolling tobacco and reverse the recent upward trend.”⁽⁸³⁾ In recent years, as smoking prevalence has declined significantly, the illicit market has come to represent a larger share of the total market, even though in absolute terms the illicit market has not grown significantly.⁽¹²⁶⁾ Given the joint objectives of public health and finance, to reduce smoking prevalence and minimize revenue losses, it would be more appropriate to define new objectives in terms of cutting revenue losses, rather than reducing the market share of illicit tobacco.

The evidence is clear that tobacco industry illicit remains a significant problem. It is essential to improve control of the illicit supply chain, as stipulated by both the EU Tobacco Products Directive and the Illicit Trade Protocol. Authorities must also ensure that implementation of the ITP remains independent of industry.⁽¹²²⁾ In addition to maintaining and reinforcing existing strategies, policy makers can weigh additional measures that may reignite reductions in the illicit market and halt or reverse the revenue losses associated with illicit trade growth. We will briefly review several of these policy options now.

Detailed Data Collection and Publication

Article 20 of the FCTC sets out requirements in relation to monitoring and surveillance of the tobacco industry. The government collects some data from the industry, but access to these data is currently only allowed if the industry gives its permission, which clearly limits the usefulness of the arrangement. The collection and publication of detailed data on tobacco sales, profits, marketing, and research would, among other benefits, facilitate independent academic analyses of market developments. Such unbiased analyses, in turn, could inform the development of tobacco control and tax policy, aiding the identification and understanding of illicit market trends over time at local level. Publication of the following data in an easy-to-use format are recommended.⁽²²²⁾

At national and international level on an annual basis:

- » Profits
- » Taxes (excise duties and corporation tax)

At national level, on a monthly basis:

- » Brand-specific price and sales data for all products
- » Marketing spend by category
- » Research spend by subject area

At local authority level

- » Sales data by product type for all products

Regional Partnerships

As described above in section 1.2, regional partnerships to reduce the illicit trade in the UK have been successful. Key components of regional activity have included social marketing campaigns to reduce demand, local trading standards teams, and partnership working between local enforcement colleagues and national partners in HMRC.

Despite the NAO's calling for further roll out of such regional partnerships,⁽⁸⁵⁾ the only partnership of this type that is currently functioning is in the North East; other partnerships in the South West and North West have disappeared due to cuts in funding. There is a need for greater encouragement and funding for regions to collaborate across boundaries to tackle the illicit tobacco market.

Effective regional collaboration relies on adequate funding of trading standards staff to protect consumers. Given that the financial benefit from reducing the illicit market and so increasing revenues accrues to central government and to HMRC, it would be appropriate for additional funding to be provided by HMRC, unless and until measures which require tobacco manufacturers to foot these costs are implemented.

Supply Chain Licensing

Better control of the illicit supply chain is essential to reducing illicit trade; a supply chain licensing scheme covering the full tobacco supply chain, including manufacturers, wholesalers, retailers, importers, and exporters, has been recommended by a number of organizations.⁽²²²⁾ A positive licensing scheme – whereby businesses have to demonstrate that they meet the required standards – could help to drive out those involved in the supply of illicit tobacco at all levels of the supply chain, protect the business of legitimate retailers, and help to protect tax revenues. The UK government rejected a positive tobacco licensing scheme for retailers in 2017; however, public support for tobacco retailer licensing is strong, and retailers have also been found to be supportive.^(222, 235)

The license fee would generate a revenue stream to support administration and enforcement. Requiring the tobacco manufacturers to meet the costs of licensing would spare retailers, who make limited profits from selling tobacco, from having to pay more than a small administrative fee. If the cost is passed on to consumers by manufacturers, this should encourage quitting or shifting to less harmful products such as e-cigarettes.

Negative licensing schemes/registration for retailers have been implemented in some parts of the UK; however, this type of legislation does not involve prior assessment of whether retailers are fit to sell tobacco. Furthermore, if there is no license fee, there is no revenue stream to support administration and enforcement.

3. Implications for Other Countries

Many of the lessons just outlined may be relevant to other governments seeking to tackle the problem of illicit tobacco. The overarching approach of focusing on supply-side measures, enlisting the support of all relevant government agencies, and cooperating and collaborating with other countries and international agencies is recommended for all countries. The fundamental components of an illicit tobacco strategy are improved detection and enforcement and stronger penalties for those involved in the illicit tobacco trade.

In most settings, tackling the illicit trade is the responsibility of customs and tax administrators. The oligopolistic nature of the tobacco industry means that some key aspects, such as tax collection and controlling tobacco industry illicit, should be feasible as long as key legislative frameworks are in place and are enforced. Appropriate human resources measures and technologies, supportive judicial systems, and increased collaboration and coordination between customs and enforcement agencies within and between countries have been identified as essential mechanisms for improving agencies' effectiveness in combating illicit trade.⁽²³⁶⁾

Controlling the illicit tobacco trade requires investment in technology – such as x-ray scanners to identify illicit products in cargo – but also significant investment in human resources in the form of intelligence networks and coordination and communication within customs. (236) As the UK case demonstrates, domestic and international activity and collaboration with a range of stakeholders at home and abroad is warranted.

Given the potential for substantial profits from the illicit trade, there is, however, a high risk of corruption in settings with poor governance; several studies have highlighted the association between corruption and the illicit tobacco trade.(236) Government commitment to combating the illicit tobacco trade is essential. Assessing the scale of the problem is a key step in highlighting the potential benefits of investing in a strategy to tackle the illicit tobacco trade. The UK experience demonstrates that the benefits of measures to tackle the illicit trade significantly exceed the costs when implemented effectively.

Policymakers must be aware of the role of the tobacco industry in the illicit tobacco market and its efforts to mislead the public and decision makers regarding the causes, effects, and scale of the illicit trade. Strategies to tackle the illicit trade must be developed and implemented independently from the tobacco industry, in line with Article 5.3 of the FCTC.

Cultural acceptance of the illicit trade may also contribute to the problem.(237) Demand-side activity to inform the public about the criminal nature of illegal trade, the implications of illicit tobacco, and the consequences of being caught engaging in such illegal activities has been shown to be effective in the UK.(102)

Ratification of the ITP is a key step which will place legal obligations on governments to implement national measures that would strengthen control over the supply chain, including through the implementation of tracking and tracing of tobacco products. While significant up-front investment is required, the long-term return on investment in activity to combat the illicit trade, along with increased tobacco taxes, is substantial. All the more so, given that the Protocol recommends cost recovery from the tobacco industry. Governments should seek guidance from other governments and international organizations to ensure that appropriate measures are commissioned, which may in some cases initially require external financial support.

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“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

