

CONFRONTING ILLICIT TOBACCO TRADE:



A GLOBAL REVIEW OF COUNTRY EXPERIENCES

EUROPEAN UNION: CONFRONTING ILLICIT
TOBACCO TRADE: AN UPDATE ON EU POLICIES

TECHNICAL REPORT OF THE WORLD BANK GROUP
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Confronting Illicit Tobacco Trade: An Update on EU Policies

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Chapter Summary

The illicit tobacco trade is of pressing concern to the European Union (EU). It results in lost revenue for governments and taxpayers, as well as undermining health policies. The European Anti-Fraud Office (OLAF) estimates that the illicit trade in tobacco products drains EUR 10 billion annually from EU and national budgets. Despite control efforts, the prevalence of cigarette smuggling in the EU has remained broadly stable since 2005. Detected illicit tobacco production within the EU is also on the rise. Meanwhile, the involvement of organized crime groups in illicit tobacco trade in the EU has become increasingly evident.

The EU has recently taken action to strengthen its institutional framework, specifically focusing on tackling crime. Enforcement against organized crime when this is connected to the protection of the EU's financial interests will soon be steered by the European Public Prosecutor's Office (EPPO). Linked to the establishment of the EPPO, the European Commission has proposed to adapt and strengthen OLAF's legal framework for

¹ See disclaimer at the end of the chapter.

investigations. Steps have also been taken to strengthen sanctions against those guilty of defrauding the EU's financial interests, including public officials involved in corruption affecting the financial interests of the Union (for example, in relation to cigarette smuggling).

The EU played a strong role in negotiating the Protocol to Eliminate Illicit Trade in Tobacco Products. Tackling cross-border smuggling requires international cooperation, and the Protocol will facilitate this engagement. Along with the Protocol, the EU's tobacco control policy has been shaped by the Union's 2014 Tobacco Products Directive (TPD).

The traceability of tobacco products is envisaged under TPD Article 15. Traceability of finished products can be construed as the ability to track a product forward through specified stages of the supply chain down to the consumer, and simultaneously to retrace the history and locations of the product back to its origin. The newly introduced EU system of tobacco traceability requires all unit packets of tobacco products manufactured in or imported into the EU to be marked with a unique identifier and their movements to be recorded throughout the supply chain. Information on recorded movements will be stored by third-party data storage providers independent from the tobacco industry. This data will be fully accessible to EU and Member State authorities for enforcement purposes.

In functional terms, the new EU tracking and tracing system is primarily characterized by its broad coverage of the supply chain, including the collection of data on the supplies dispatched to retail outlets. The system design embeds several elements that together provide public authorities with full control over operations. In this respect, the key aspects are the independence from the tobacco industry of the generation of unique identifiers and of the system's data storage, along with the independence criteria and rules on structuring and reporting traceability data. An impact assessment conducted by the European Commission anticipates multi-billion-euro social and economic benefits from the traceability system. Expected benefits will stem mainly from (1) better collection of taxes and (2) at least a partial reduction in the artificially cheap supplies of illegal tobacco products that have been found to affect the uptake and general prevalence of tobacco consumption.

1. Introduction

The illicit tobacco trade is of pressing concern to the European Union (EU). It results in lost revenue for governments and taxpayers, as well as undermining health policies. It is closely linked to organized crime gangs and as such causes significant societal damage.

The EU has been at the forefront in fighting cross-border illicit tobacco trade over the past years. The illicit tobacco trade tends to have a cross-border dimension, so unified and coordinated action at EU level among various agencies can facilitate the steps taken to tackle the problem more effectively.

In this respect, the European Commission published a comprehensive strategy to step up the fight against cigarette smuggling.² This report elaborated measures to address the incentives behind the illicit tobacco trade, controlling the legal supply chain and strengthening enforcement. This was followed by a report on the implementation of these measures and the impact on the illicit tobacco landscape in Europe.³

This chapter will outline certain aspects of the scope and scale of the illicit tobacco trade at EU level, as well as the institutional and regulatory framework designed to tackle this phenomenon. The newly introduced EU tracking and tracing system will be outlined in detail.

2. Scope and Scale of the Illicit Tobacco Trade at EU Level

The illicit tobacco trade encompasses the smuggling of genuine tobacco products (contraband), counterfeit tobacco products, and so called "illicit whites," as well as the illegal manufacturing of tobacco products within the EU.⁴

For the purposes of this overview, "contraband cigarettes" refers to authentic goods imported or exported illegally, evading regulatory duties. "Counterfeit cigarettes" refers to production under a certain brand without the brand owner's approval. "Illicit whites" are cigarettes legitimately manufactured in one country and subsequently smuggled into and sold in another country, typically without a legal distribution network in that country.

The illicit tobacco trade, by its nature, is a clandestine activity which is constantly evolving, increasing the challenge of estimating its scope with accuracy. A relatively comprehensive picture of the illicit market is needed at EU level to assist in improving strategic activities, such as threat assessments. The European Anti-Fraud Office (OLAF) recently launched a research study tender to identify a methodology for improving the measurement of the illicit tobacco market.⁵

OLAF currently estimates that the illicit trade in tobacco products drains EUR 10 billion⁶ annually from EU and national budgets, relative to the situation if all smuggled tobacco products had been sold legally and appropriately taxed. From a purely economic perspective, the magnitude of these losses is very significant and deprives governments of the opportunity to use the foregone revenue for other policies.

² COM(2013) 324 final.

³ COM(2017) 235 final - Progress report on the implementation of the Commission Communication "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013)."

⁴ COM(2013) 324 final – "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products – A comprehensive EU Strategy," p. 4.

⁵ Supplement to the Official Journal of the European Union, 2018/S 044-095213.

⁶ The estimation is based on seizures reported by the Member States, which amounted to 4.5 – 4.6 billion cigarettes per year between 2005 and 2011 – see COM(2013) 324 final, p. 4.

OLAF monitors tobacco seizures across the EU as reported by Member States. This can result in a more comprehensive picture of what illicit tobacco is being seized in the Member States. Seizure reports can give insight into the scale of the problem faced, as well as reflecting and informing the activity of customs and other law enforcement agencies.

Cigarettes remain the most-seized tobacco product at EU level, amounting to 3.78 billion in 2015.⁷ According to seizures reported by the Member States to OLAF, over a five-year period, seizures of cigarettes far outweigh seizures of other tobacco products.⁸ This is perhaps unsurprising, given that an EU survey conducted in 2017 shows that boxed cigarettes are clearly the most popular tobacco product in all Member States.⁹ The European Commission also found that cigarettes accounted for 24 percent of all detained articles (not just tobacco-related articles) at the EU external border in 2016.¹⁰

Despite efforts to curb the problem, overall the prevalence of illicit cigarette smuggling in the EU has remained broadly stable since 2005.¹¹ Smuggling of genuine product in large-scale seizures has decreased in the past years,¹² but does still remain a problem EU-wide. In the past years there has been an increase in the prevalence of cheap whites, which dominate large-scale seizures reported by Member States to OLAF.¹³

Detected illicit tobacco production in the EU is also on the rise. This may be a response to increased controls at the EU border and a lower risk of detection by customs.¹⁴ These illicit factories within the EU itself pose a significant threat and tend to have huge production capacities. For instance, an illegal factory dismantled in March 2018 in Ireland had the capacity to produce a quarter of a million cigarettes per hour, according to a press release by the Revenue Commissioners in Ireland.¹⁵ Illicit factories require access to raw materials, machines, and expertise. It is clear that law enforcement agencies will have to diversify their efforts to tackle illicit production, in addition to their focus on the transportation of illicit goods across the EU border.

For some years now, the involvement of organized crime groups in the illicit tobacco trade in the EU has become evident. These groups often utilize sophisticated cross-border networks. The illicit tobacco trade cannot be disassociated from its connections as a major source of revenue for organized crime groups and even terrorist organizations.

⁷ COM(2017) 235 final, p. 5.

⁸ *Ibid.*

⁹ Special Eurobarometer 458: Attitudes of Europeans towards tobacco and electronic cigarettes, summary, p. 5.

¹⁰ Report on EU customs enforcement of intellectual property rights, Results at the EU border 2016, Directorate-General for Taxation and Customs Union, p. 10.

¹¹ COM(2017) 235 final, p. 7.

¹² COM(2017) 235 final, p. 8.

¹³ *Ibid.*

¹⁴ Europol and the European Union Intellectual Property Office, "2017 Situation Report on Counterfeiting and Piracy in the European Union," p. 38.

¹⁵ Revenue Department, Republic of Ireland, "Revenue and An Garda Síochána dismantle illicit cigarette factory in Jenkinstown, Co. Louth." March 15, 2018. <https://www.revenue.ie/en/corporate/press-office/press-releases/2018/pr-150318-illegal-cigarette-factory-jenkinstown-louth.aspx>

Not only is the illicit tobacco trade funding criminal organizations, but their involvement can increase the difficulty of detecting illicit tobacco trade. In cases of large-volume smuggling, the criminals involved tend to be experienced and go to great lengths to conceal their activities, including establishing legitimate businesses and various other concealment tactics. Smuggling of lower-volume amounts is increasing¹⁶ and can be even more difficult to detect.

The deep entrenchment of organized crime groups in the illicit tobacco trade is not yet well known among the general public in Europe. A Eurobarometer survey in 2016¹⁷ noted that a majority of EU citizens surveyed do not realize that smuggled cigarettes are a main source of revenue for organized crime. The enduring public perception that the illicit tobacco trade is a victimless crime is cause for concern. This disconnect between perception and reality needs to be tackled effectively in order to raise awareness of the serious criminal activities benefitting from the proceeds of the illicit tobacco trade. Greater public awareness should correspondingly reduce the demand for illicit tobacco products.

The incentives behind the lucrative business of illicit tobacco trade can be largely linked to its perceived low-risk, high-reward nature as a comparatively safe activity with high profit yields.¹⁸ This risk level is in part linked to substantially divergent administrative and criminal sanctions for tobacco smuggling at Member-State level.¹⁹ High profits are linked to the substantial price divergence of tobacco products among EU Member States, which smugglers can exploit. Although prices have converged over the last decade,²⁰ there are still appreciable differences. The weighted average price for a pack of 20 cigarettes ranges from EUR 2.55 to EUR 10.07.²¹ This is even more pronounced when considering the price difference with some of the EU's neighboring countries, where weighted average prices can be as low as EUR 0.43.²²

3. Institutional Framework

In terms of operational activities to tackle the illicit trade in tobacco products, it is clear that robust enforcement by customs, police, and border forces will always play a central role. This is primarily the task of customs. However, customs authorities rely on close cooperation with other enforcement agencies, including the police, in tackling organized crime. This is also reflected at EU level, with several institutions currently involved in fighting the illicit tobacco trade.

¹⁶ Europol and the European Union Intellectual Property Office, "2017 Situation Report on Counterfeiting and Piracy in the European Union," p. 43.

¹⁷ Special Eurobarometer 443: Public perception of illicit tobacco trade, summary, p. 6.

¹⁸ European Union Serious and Organised Crime Threat Assessment, SOCTA 2013, European Police Office, p. 26.

¹⁹ COM(2017) 235 final, p. 4.

²⁰ Eurostat: Price convergence in the EU-28 by product groups https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Price_convergence_in_the_EU-28_by_product_groups_2007_-2017.png

²¹ Weighted average price of cigarettes in Bulgaria and Ireland, respectively. See KPMG Project Sun 2017, Executive summary, p. 13.

²² Weighted average price of cigarettes in Belarus. See KPMG Project Sun 2017, Executive summary, p. 13.

OLAF has a unique mandate²³ to investigate matters relating to fraud, corruption, and other offenses concerning EU revenue. According to its annual report, OLAF supported the seizure of over 1 billion cigarettes in 2016 and 2017.²⁴ An example of such support is a complex fraud scheme involving an international contraband network that OLAF recently uncovered. The fraud involved the export to non-EU countries of cigarettes that were subsequently smuggled back into the EU, to be sold without payment of the applicable EU taxes. OLAF assisted law enforcement agencies in Italy and Germany in dismantling the network.²⁵

OLAF also engages in Joint Customs Operations (JCOs), which are implemented by national customs authorities. JCOs are operations of a limited duration targeting smuggling of goods and can be very effective in coordinating targeted customs checks at European level.²⁶

JCO "Magnum II" is such an example. Organized by OLAF, it involved 14 Member States, the European Border and Coast Guard Agency (FRONTEX), and the European Police Office (EUROPOL) and culminated in 11 million cigarettes being seized over a two-month period.²⁷

EUROPOL²⁸ is also active in this area and, upon request,²⁹ supports the Member States' law enforcement agencies in combating serious crime against the financial interests of the Union. This includes fighting against illegal manufacture and distribution of tobacco products in the EU. Tackling excise fraud, with the aim of disrupting the capacity of organized crime groups involved, is a priority for EUROPOL. EUROJUST²⁹ supports cooperation between the competent judicial authorities of the Member States in order to render their investigations and prosecutions of serious crimes more effective. FRONTEX³⁰ also coordinates operations with EU Member States to tackle cross-border crime at the EU border. This includes working with customs authorities to tackle the smuggling of tobacco products.³¹

Effective cooperation among these institutions involved in fighting the tobacco smuggling phenomenon at EU level is of particular importance.

3.1 Strengthening Institutions

The EU has recently taken action to strengthen its institutional framework, specifically focusing on tackling crime. Enforcement against organized crime will soon be steered by the European Public Prosecutor's Office (EPPO).³² The establishment of EPPO aims to alter

²³ Regulation (EU, Euratom) 2013/883 Official Journal of the European Union L 248, 18.9.2013, p. 1–22.

²⁴ The OLAF report 2017. https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2017_en.pdf

²⁵ OLAF Press release 02/2018 https://ec.europa.eu/anti-fraud/media-corner/news/27-03-2018/convictions-italy-major-international-contraband-case-uncovered-olaf_en

²⁶ https://ec.europa.eu/anti-fraud/policy/joint-customs-operations-jco_en

²⁷ OLAF Press release no. 18/2017 https://ec.europa.eu/anti-fraud/media-corner/news/05-12-2017/joint-customs-operation-magnum-ii-real-time-intelligence-exchange-leads_en#_ftn1

²⁸ Regulation (EU) 2016/794 Official Journal of the European Union L 135, 24.5.2016, p. 53–114.

²⁹ Regulation (EU) 2017/1939 Official Journal of the European Union L 283, 31.10.2017, p. 1–71.

³⁰ Regulation (EU) 2016/1624 Official Journal of the European Union L 251, 16.9.2016, p. 1.

³¹ <https://frontex.europa.eu/media-centre/news-release/23-smugglers-arrested-drugs-and-cigarettes-seized-during-frontex-led-operation-Plk7rS>

³² Council Regulation (EU) 2017/1939 OJ L 283, 31.10.2017, p. 1–71.

current patterns, which can involve coordinated operational activities at EU level but fragmented judicial prosecutions at national level. The EPPO will be tasked with fighting criminal offenses against the EU budget. As recognized in the Office's establishing regulation, investigation and prosecution of such offenses at national level can be insufficient. At the time of writing, 22 Member States are participating in the EPPO.

Linked to the establishment of the EPPO, the European Commission recently put forward a proposal³³ to adapt and strengthen OLAF's legal framework for investigations. OLAF will continue to investigate and cooperate with national authorities and other agencies. These initiatives aim to ensure a more robust legal framework for tackling fraudulent activities, including those related to the illicit tobacco trade.

3.2 Strengthening Sanctions

At EU level, steps have also been taken to strengthen sanctions for those involved in defrauding the Union's financial interests. This is intended to have a deterrent effect on potential criminals. The Directive on fighting fraud against the Union's financial interests by means of criminal law ("PIF Directive")³⁴ contains several provisions which are relevant to tackling the illicit tobacco trade. The PIF Directive harmonizes sanctions among Member States regarding crimes affecting the financial interests of the Union, for example establishing that countries' maximum prison terms for serious cases must be at least four years. Moreover, the PIF Directive includes the involvement of organized crime groups in offenses as an aggravating circumstance. This is frequently the case for the illicit tobacco trade.

The PIF Directive also strengthens sanctions for officials involved in corruption, explicitly adding the acceptance of bribes to the definition of corruption.³⁵ This is relevant for border crossings, where corruption may still be an issue, given the high volume of illicit goods making their way into the territory of the EU. Member States have until July 2019 to adopt laws in line with the Directive.

4. Regulatory Framework: Tobacco Products Directive and Protocol to Eliminate Illicit Trade in Tobacco Products

The EU is now on the threshold of a new phase in its regulatory framework, with some major initiatives specifically aiming to tackle the illicit tobacco trade. Smuggling by its nature is a clandestine activity aimed at evading controls. Nonetheless, tightening loopholes in the regulatory framework has previously had an impact on the illicit tobacco trade, and this remains an area in which regulatory action is required.

³³ COM/2018/338 final.

³⁴ Directive (EU) 2017/1371 of the European Parliament and of the Council. Official Journal of the European Union L 198, 28.7.2017, p. 29–41.

³⁵ Article 4 (2) a. "passive corruption."

4.1 Protocol to Eliminate Illicit Trade in Tobacco Products

The Protocol to Eliminate Illicit Trade in Tobacco Products ("FCTC Protocol"),³⁶ to which the EU is a Party, is the first tailor-made multilateral treaty to specifically tackle the illicit tobacco trade and will enter into force on September 25, 2018.

The Protocol is an international treaty linked to the World Health Organization's Framework Convention on Tobacco Control. The EU played a strong role in negotiating the Protocol. Tackling cross-border smuggling requires cross-border cooperation and, in this respect, the Protocol will facilitate international engagement. The Protocol acts as an additional legal framework for the exchange of operational information in the form of general information sharing,³⁷ enforcement information sharing,³⁸ mutual administrative assistance,³⁹ mutual legal assistance,⁴⁰ and tracking and tracing information.⁴¹

The Protocol offers an excellent framework for international cooperation. However, bilateral engagement with countries remains an important aspect on two levels. Given that low tobacco prices in some of the EU's neighboring countries can drive smuggling activity into the EU, engagement to adjust pricing in order to better protect countries' own fiscal interests can still be harnessed. Bilateral law enforcement cooperation will remain an important facet of international engagement.

In terms of supply chain control, the Protocol offers new substantive provisions. The tracking and tracing provisions⁴² and establishment of a centralized global information-sharing point will allow authorities to monitor the legal supply chain and easily identify products being diverted into the illegal market.

The Protocol also lays down other substantive control mechanisms. For example, it foresees provisions⁴³ to ensure that the movements of tobacco producing machinery will be controlled. This is another area in which regulation may have an impact on the illicit trade. Sanctions can also play a role here, as seizure of a tobacco-producing machine or other manufacturing equipment may be more of a disincentive than simple payment of a fine. This provision, once implemented by Parties to the Protocol, should prevent the diversion of tobacco-producing machinery into the illicit market, or at least make such diversion more difficult, facilitating law enforcement.

³⁶ Council Decision (EU) 2016/1749 Official Journal of the European Union L 268, 1.10.2016, p. 1–5; Council Decision (EU) 2016/1750. Official Journal of the European Union L 268, 1.10.2016, p. 6–9.

³⁷ Article 20, General information sharing.

³⁸ Article 21, Enforcement information sharing.

³⁹ Article 28, Mutual administrative assistance.

⁴⁰ Article 29, Mutual legal assistance.

⁴¹ Article 8 (4.1).

⁴² Article 8.

⁴³ Article 6 and Article 8.

4.2 Tobacco Products Directive

The adoption of the 2014 Tobacco Products Directive (TPD)⁴⁴ marked a pivotal development in tobacco control policy in the EU. The traceability of tobacco products is envisaged under Article 15 of the TPD.⁴⁵ The TPD envisages the traceability of cigarettes and roll-your-own tobacco products as of May 20, 2019, and of all other tobacco products as of May 20, 2024.⁴⁶ It will allow public authorities in the EU to control the whole supply chain of tobacco products. The implementation of the traceability system provided for under TPD Article 15 will also enable the EU and its Member States to fulfil their international obligations under Article 8 of the FCTC Protocol.

4.3 Concept of Traceability

Traceability of finished products can be construed as the ability to track a product forward through specified stages of the supply chain down to the consumer, and simultaneously to retrace the history and locations of the product back to its original production line.⁴⁷

There are two distinct but closely related elements in the concept of traceability. These are tracking and tracing. Tracking is a part of traceability that consists of monitoring the current whereabouts of a product and simultaneously creating a time and location record for all consecutive movements of that product. Tracing is the ability to identify the past locations of a product, which allows for verifying the product's route, all the way back to its origin.

For proper operation, every traceability system must be able to uniquely identify individual products. It is only thanks to unique identification, achieved by marking a product with a unique code (also known as a unique identifier, or UI), that it becomes possible to unambiguously register that product's movements. The basic record of a movement can be reduced to three simple bits of data: the product's unique code, location, and time. Later on, provided it is stored in a single database system, the history of movements can be easily recreated by looking at consecutive locations of a given product, sorted by time.

4.4 Specificity of Tobacco Traceability

Traceability of products is a well-established concept. Multiple traceability systems are used in today's economy, in domains such as pharmaceuticals or food products. The most obvious

⁴⁴ Directive 2014/40/EU of the European Parliament and of the Council. Official Journal of the European Union L 127, 29.4.2014, p. 1–38.

⁴⁵ Article 15 of the TPD required the European Commission to lay down secondary legislation determining technical details for the establishment and operation of the system of traceability, as well as to ensure its interoperability across the EU. See Commission Implementing Regulation (EU) 2018/574 and Commission Delegated Regulation (EU) 2018/573, Official Journal of the European Union, L 96, 16 April 2018.

⁴⁶ In parallel, Article 16 of the TPD requires the establishment of the system of security features for the tobacco products as an additional measure to fight the illicit trade. The relevant technical standards for the operations of such a system are laid down in Commission Implementing Decision (EU) 2018/576, Official Journal of the European Union, L 96, 16 April 2018.

⁴⁷ According to the ISO definition coined for the purpose of standardizing quality management systems.

and best-known examples are provided by parcel services, where each parcel is traceable, and consumers can easily verify the location of their parcels via the service provider's web interface.

It is important to distinguish the different reasons for which traceability systems may be rolled out within a supply chain. For instance, traceability may be introduced for logistical reasons, to improve supply-chain function, as in the case of parcel services; or for product safety reasons, to manage potential product recalls; or finally for regulatory reasons, with goods' being tracked and traced because of their particular characteristics or status.

The traceability of tobacco products is being implemented for the latter reasons. Given the comparatively elevated tobacco excise duties applied in many jurisdictions to discourage consumption, tobacco products are potentially very profitable for illicit traders. Such traders are able to achieve very high margins by offering the non-taxed product at a substantial discount from the official post-tax price. High profitability of illicit trade also creates immediate economic incentives for misusing the traceability system, for example by duplicating identifiers or misreporting logistic events. In addition, the addictive nature of tobacco means that illicit trade may contribute to creating new demand for legal products. Consumers initially prevented by their age or economic status from purchasing legal tobacco products can be initiated with illicit products. But it is also likely that such consumers will eventually turn to legal tobacco products.

For reasons of good governance, the traceability of tobacco products cannot be entrusted to the tobacco industry. Moreover, traceability has to take place at the lowest level of a unit packet of tobacco product, since it is known that, if needed, illicit traders can easily disaggregate any higher level of packaging and distribute the tobacco products in loose unit packets.

4.5 Scope and Basic Description of the EU System of Tobacco Traceability

The EU system of tobacco traceability requires all unit packets of tobacco products manufactured in or imported into the EU to be marked with a unique identifier and their movements to be recorded throughout the supply chain. Information on recorded movements will be stored by third-party data storage providers independent from the tobacco industry. This data will be fully accessible to EU authorities, i.e., the competent authorities of EU Member States and the European Commission, for enforcement purposes.

Under the EU traceability system, the generation of unique identifiers, as well as of all other codes required for pre-registration of economic operators, facilities, and machines, is entrusted to designated "ID issuers," who are also required to be financially and legally independent of the tobacco industry. Their role is vital, as they are in fact the guardians of uniqueness, which is a "must" condition for any traceability system. Each EU Member State is responsible for the appointment of an ID issuer for its territory.

Once appointed, ID issuers will receive, from manufactures and importers of tobacco products, requests to generate the unique identifiers. Manufacturers or importers will have to supply pre-defined information relating to the product and production line. The ID issuers will then generate batches of unique identifiers and deliver them to the ordering manufacturer or importer.

On the production line, manufacturers will complete the unique identifier with a "time stamp" (i.e., a marking indicating the date and time of manufacture of the tobacco product). The unique identifier will then be applied to the unit packet, after being encoded in an authorized data carrier. The unique identifier will take the form of a machine-readable, optical, one- or two-dimensional barcode. Still on the production line, the unique identifier's application must be verified to ensure its readability. An anti-tampering device, capable of creating an unalterable independent record of this verification process, must previously have been installed. This additional record will be accessible to the public authorities for potential investigations and inspections.

Correctly marked unit packets can then be tracked and traced throughout the supply chain. In most cases, these will be aggregated into bigger packages, such as cartons, master cases or pallets, known as "aggregated packaging." Tracking at aggregated packaging level is permitted, provided the unit packets remain traceable. This requires separate aggregated-level unique identifiers, electronically linked to each lower-level unique identifier. Recording product movements at aggregated packaging level is intended to alleviate the operational burden on economic operators (in particular wholesalers and distributors), who would otherwise need to scan each unit packet being handled.

Transportation between different facilities is also subject to a clear set of rules. Each dispatch and arrival must be recorded and reported to the repositories system, up to the point of dispatch to the first retail outlet, i.e., the first place where the products will be made available to consumers.

All recorded information must be submitted to the independent third-party data storage facility. Clear timeframes for the transmission of traceability data to the data storage are laid down: in general, it should take place three hours from the occurrence of a reportable event, and 24 hours prior in the case of dispatch and trans-loading of tobacco products. To ensure the correct transmission of traceability information, the transmission messages have to contain the information pre-defined both in terms of its format and content. For example, the message reporting the arrival of tobacco products at a facility has to contain the "economic operator identifier code" of a submitting party, the "facility identifier code" of that specific facility, the time of arrival in the pre-specified format, and the list of unique identifiers received under the delivery in question.

4.6 Key Characteristics of the EU System

The EU system of tobacco traceability is the first of its kind. It is the first regional system designed to accommodate a range of distribution structures, both concentrated and dispersed supply chains. It is a relatively open system, in which multiple providers can offer competitive technological solutions subject to meeting the set of basic requirements stipulated in the legislation. At the same time, the EU system is characterized by a high level of protection against any attempts at manipulating the data.

The following characteristics of the EU system of tobacco traceability are particularly worth highlighting:

As indicated, the **EU system of tobacco traceability will span the entire supply chain**. The routine reporting obligations cover all the economic operators involved in the manufacture and distribution of tobacco products up to the point of dispatch to the first retail outlet. In practice, this means that the sales of tobacco products at retail outlets will be approximated with the data from the dispatch messages sent by the suppliers of retail outlets.

The public authorities' **control over the EU system is provided by the combination of several measures** that jointly protect this system against any undue interference:

- » Only **independent ID issuers** are allowed to generate the unique identifiers necessary for marking the unit packets. The unique identifiers have two features which will further strengthen the level of control: at the moment of their generation, the unique identifiers have to be related to a specific product presentation and a specific production line, and they have to be preloaded into the repositories system before being delivered to the tobacco industry. This means that the unique identifiers will contain meaningful information from their inception, and the tobacco industry will be constrained in the use of the identifiers to the pre-declared product presentation and production line.
- » All the data will be stored by **independent data storage providers**. The repositories system will include a **central dataset** which will provide for the full overview of all actions occurring in the whole system at any given moment. The authorities will be granted full, uninterrupted, physical and electronic access to the repositories system. The providers of data storage are required not only to store the data, but also to provide several services to the authorities, including a possibility of bulk downloads, executing a full range of searches, automatic alerts, and regular reports. The authorities will be able to configure and subsequently reconfigure all these services, depending on their actual needs. In contrast to the full access by the authorities, the tobacco industry will not be allowed to access the repositories without the authorities' prior permission. Such access will be granted only in duly justified cases.
- » The flow of traceability data is fully structured in terms of its content and format. The legislation contains a **message dictionary** that specifies all key messages that the economic

operators are obliged to send to the repositories system. The repositories system will be based on a common data dictionary.

- » The legislation also contains a set of rules as to when a given message has to be sent. Importantly, **it will not be possible to dispatch or trans-load any tobacco products without prior notification** of such a logistic event. The high density of reporting events, including the transactional operations (e.g., issuing of an invoice), guarantees that each product will have to be reported several times over its life cycle within the supply chain.
- » On the production line, the verification of the marking process will be additionally protected with an **anti-tampering device** which will create an independent, auditable record, which will exist on top of the data stored in the repository system. The EU Member States will have full access to this record.
- » The high quality of data is further strengthened by the obligatory **pre-registration and coding of all economic operators, facilities (including retail outlets), and machines**. These codes, along with the unique identifiers for unit packets, will provide for "seeding" of all further data that are required to be reported in the system. In other words, it will be impossible to successfully report any logistical or transactional operation without making a reference to the obligatory set of codes and identifiers.
- » Last but not least, ID issuers or data storage providers are required by the legislation to be independent from the tobacco industry. The legislation indicates a **set of rules detailing the conditions of independence** in legal, organizational, decision-making, financial, and personal terms. These rules are laid down to assist public authorities in the verification of third-party providers.

Thanks to the structured approach to the management of traceability data, **the EU system will be able to easily export the data to other systems**, be it internally, for example as a means of cross-validation with the Excise Movement and Control System (EMCS),⁴⁸ or externally, via the global information-sharing focal point, which the FCTC Secretariat is supposed to establish under Article 8 of the FCTC Protocol.

As regards the data carriers in which the unique identifiers will be encoded and subsequently marked on the products, the EU system relies on the international standards, and therefore other Parties to the FCTC Protocol will be able to decode the data carriers with any standard equipment, including most modern smartphones.

Finally, it is important to stress an additional fact. Despite the intensity of the design phase, in which the European Commission took the lead to safeguard the system's full compliance with European and international law, and to protect the design process from the influence of vested interests, **the EU system does not overburden public authorities**. On the contrary, it presents them with a new and efficient tool of control. The bulk of the initial investment, as

⁴⁸ EMCS is a computerized system for monitoring the movement of excise goods under duty suspension in the EU.

well as the subsequent operational costs, have been shifted to the tobacco industry, in line with Article 8 of the FCTC Protocol. The European Commission's Impact Assessment, which was carried out for the purpose of preparing the secondary legislation, indicates **multi-billion-euro social and economic benefits** expected from introducing the traceability system. The two main benefits stem from better collection of taxes and at least a partial reduction in the artificially cheap supplies of illegal tobacco products that have been found to affect the uptake and general prevalence of tobacco consumption.⁴⁹

4.7 Examples of Practical Applications

The EU system will enable public authorities to detect several types of fraud, both within and outside the legal supply chain. The following cases can serve as examples:

- » Appearance of duplicated unique identifiers, detectable at the central level of the repositories system, which indicates an inflow of illicit products in one of the two suspected points within the supply chain. Since all the products are tracked, the system can automatically detect when the same unique identifier appears in two distinct locations at the same time. The tracing functionality will further help in establishing which of the two products is original and which is a duplicate;
- » Discovery of a marked product outside the legal supply chain, in which case the traceability system can assist in finding the point of that product's diversion into the illicit market. A unique identifier can be used for constructing a basic query to the repositories system in order to extract all the data relating to that unique identifier, including its last known location, which in this case is likely to be the point of diversion;
- » Abnormal fluctuations in the manufactured or stored quantities of products, detectable at the central level of the repositories system, which can guide the public authorities to potential points of product diversion or other illegal activities. For example, if a given warehouse accumulates a stock of products without forwarding any products to the next destination, such a warehouse may warrant an on-spot inspection to verify the anomaly observed in the traceability data;
- » Abnormal fluctuations in quantities delivered to retail outlets, detectable at the central level of the repositories system, which can guide public authorities to individual retail outlets or to geographic clusters of retail outlets where illicit trade may be taking place. The latter example may be linked to a situation in which illicit traders start distributing their products in a given geographic area, for example suburban town X, which in turn negatively affects the sales of the legal outlets in that area as compared to the historic levels of sales.

⁴⁹ The Impact Assessment can be consulted at: https://ec.europa.eu/health/sites/health/files/tobacco/docs/tt_ia_en.pdf

5. Conclusions

In functional terms, the EU tracking and tracing system is primarily characterized by its broad coverage of the supply chain, including the collection of data on the supplies dispatched to retail outlets. High priority has been given to the overall design of the system, which embeds several elements that together will provide public authorities with full control over the system's operations. In this respect, the key aspects are the independence of the generation of unique identifiers and of the data storage from the tobacco industry, along with the independence criteria and rules on structuring and reporting traceability data.

The EU system represents a scalable example of a system of tobacco traceability that is sufficiently flexible to be implemented both at the regional and the single-country scale. It avoids unnecessary reliance on a single provider, which in the long term may paradoxically reduce public authorities' ability to shape and control the traceability system. It is based on a strong policy case, where substantial social and economic benefits are expected if the system is properly rolled out.⁵⁰

Disclaimer

The information and views set out in this article are those of the authors and do not necessarily reflect the official opinion of the European Union. Neither the European Union institutions and bodies nor any person acting on their behalf may be held responsible for the use which may be made of the information contained therein.

⁵⁰ For further information on the EU system of tobacco traceability and its implementation, see: https://ec.europa.eu/health/tobacco/tracking_tracing_system_en

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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

