SMUGGLING
THE TOBACCO INDUSTRY
AND PLAIN PACKS

A report by Luk Joossens

Some examples of existing packs

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Introduction
The tobacco companies are speaking with one voice: plain packaging will increase the amount of illicit tobacco in the UK. This argument is very weak.

The track record of the tobacco industry, the make-up of the illicit market today, the evidence that all existing packs are easy to forge and the real causes of the illicit tobacco market mean that the tobacco industry’s claims do not make sense.

The tobacco industry’s case
The world’s leading tobacco company, Philip Morris International, says plain packs create “significant incentives to counterfeiters and smugglers”1. Japan Tobacco International says the UK illicit tobacco market is “booming”2, while Imperial Tobacco told MPs that plain packs are “good for criminals”3.

British American Tobacco outlined its case in more detail:
“We believe a policy designed to make tobacco less accessible to youth could actually end up having the opposite effect — by increasing the black market and making the products cheaper and more accessible. Generic packaging would make it harder to prevent smuggled and counterfeit products entering a market, eroding government tax revenue and disrupting efforts to tackle the illegal trade in tobacco products that plays a significant role in funding international crime and terrorism”4.
UNDERSTANDING TOBACCO SMUGGLING

The role of the tobacco industry in smuggling - Canada and the European Union

The tobacco companies’ concern about illicit trade is remarkable, since it comes from an industry with a long history of involvement in smuggling operations. Since 2004, the four major international tobacco companies have paid billions of dollars in fines and payments to settle cigarette smuggling litigation in Europe and Canada.

Evidence of the direct and indirect involvement of the tobacco industry in this large scale fraud is well documented, through the industry’s internal documents, their own admissions and court judgements. In July 2008 and April 2010 in Canada, five tobacco companies pleaded guilty and admitted “aiding persons to sell or be in possession of tobacco products manufactured in Canada that were not packaged and were not stamped in conformity with the Excise Act”. They included Imperial Tobacco Canada (wholly owned by British American Tobacco), Japan Tobacco International, Rothman’s Benson and Hedges (wholly owned by Philip Morris International since 2008) and RJ Reynolds (RJR), whose parent company is 42% owned by British American Tobacco. Northern Brands International Inc., a company related to RJR, pleaded guilty to a conspiracy offence under the Criminal Code.

In 2012, Japan Tobacco International was accused of smuggling activities in the Middle East and is now under official investigation by the European Anti-Fraud Office, OLAF. In the UK, the role of the tobacco industry became evident when the cigarette smuggling problem emerged some 15 years ago.

The role of the tobacco industry in smuggling - the United Kingdom

Tobacco smuggling became a serious problem in the UK at the end of the last century. HM Customs and Excise, now part of HM Revenue and Customs, estimated that the illicit cigarette market increased from 3% in 1996-97 to 21% in 2000-01. In 2000-01 and 2001-02 it totalled about 16 billion cigarettes, half of them smuggled Regal and Superkings, an Imperial Tobacco brand.

The nature of large scale organised smuggling at the time is well illustrated by the case of these two brands. They were exported in huge quantities to places where the intended market was unclear as they had no market share in those countries. They were then illegally imported through smuggling networks back into the UK. HM Customs estimated that in 2000-01 as much as 65% of the 12 billion Regal and Superkings exported by Imperial were smuggled illegally back into the UK. From October 2000 to September 2002 a third of all Regal and Superkings were exported to Moldova, Latvia, Russia (including its enclave between Poland and Lithuania, Kaliningrad), Afghanistan and Andorra.

These export practices came under scrutiny in the UK Parliament’s Public Accounts Committee hearings in May and June 2002, when members of the committee questioned the Imperial Tobacco Chief Executive:

Committee member George Osborne said:

“One comes to the conclusion that you are either crooks or you are stupid, and you do not look very stupid. How can you possibly have sold cigarettes to Latvia, Kaliningrad, Afghanistan and Moldova in the expectation that those were just going to be used by the indigenous population or exported legitimately to neighbouring countries, and not in the expectation they would be smuggled? You must know - you only have to read a newspaper every day, a member of the public could tell you -
these are places which are linked to organised crime, that the drugs trade passes through all of these countries, that prostitution passes through all these countries. Did you not know that?15

**Effective government action**

Since the hearings in May 2002, exports of Superkings and Regals to suspect markets have fallen greatly, and the illicit cigarette market in the UK dropped from 20% in 2001-02 to 16% in 2002-03. Regal and Superkings seizures, which represented over one billion cigarettes in 2000-01 (half of all seizures) were less than five million in 2006-07, just 1% of seizures of genuine UK brands16.

In 2000 the UK Government also announced an anti-smuggling action plan, which included scanners for container detection, prominent fiscal marks on packs, increased punishment, confiscation of offenders’ assets, more customs officers, and a campaign to increase public awareness17, all of which helped to reverse the level of smuggling in 2000-01 and 2001-02.

The UK Finance Act 2006 places a legal duty on tobacco manufacturers not to facilitate smuggling, and manufacturers who fail to take sufficient steps to prevent their products being smuggled into the UK face fines of up to £5 million18.

The UK strategy to tackle illicit trade has been continuously updated and has involved strong cooperation between different agencies, such as HM Revenue & Customs and the UK Border Agency. The approach includes more resources for improved intelligence, risk profiling, tasking and coordination to detect and disrupt the supply of illicit tobacco products19. This policy has been successful, as the illicit UK cigarette market was reduced from 21% in 2000-01 to 9% in 2010-1120.

**The changing nature of the illicit tobacco trade**

The illicit tobacco market in the UK has changed significantly since 2000. Historically it was made up of genuine UK brands of tobacco smuggled into the UK but is now a mix of genuine UK and non-UK brands of cigarettes, hand-rolling tobacco, counterfeits, and increasingly, illicit whites21. Illicit whites are produced in a rather open manner at well known locations, mostly outside the EU, such as the Russian enclave of Kaliningrad, Ukraine, Cyprus and the United Arab Emirates. Illicit whites are only (or mainly) intended for the illegal market of another country.

The manufacture of illicit whites has the appearance of being in accordance with national legislation and the local authorities do not appear to care that their products are being smuggled. This means that the manufacturers can buy sophisticated cigarette making machinery without risk of confiscation and so a good standard of quality in the production process can be achieved. In 2009-10, illicit whites accounted for 46% of large scale cigarette seizures in the UK22.

**Case study: Jin Lings**

The best known illicit white brand in the UK and the rest of Europe is Jin Ling. It has a Chinese name but is manufactured in Russia and its appearance is in accordance with Russian domestic law, with the look and the taste of the American blend Camel. It is destined for the illegal market in the EU.

In the last five years, Jin Ling has rapidly become one of the most seized cigarette brands in the European Union23. Jin Ling is produced in the free zone of Kaliningrad, which means it has relief from customs duties, formalities and procedures24. Jin Ling is exported outside the control of customs, and materials for the production of cigarettes are imported without the payment of customs duties.
Are illicit cigarettes more dangerous to health?

Counterfeit cigarettes are illegally manufactured and are sometimes described as being more dangerous than legally produced cigarettes. It remains unclear whether they are more harmful to people’s health than duty paid cigarettes. This is because the health damage to smokers is not only determined by the content of the cigarettes, but also by the way they are smoked and how deeply they are inhaled. ‘Differential puffing’ means so-called ‘light cigarettes’ are inhaled more deeply and so are as dangerous as other cigarettes.

However, counterfeit cigarettes are not a standard and uniform product. Some counterfeits are made of good quality tobacco whereas others may include musty raw tobacco processed with sulphur and carbamide to look better, which might lead to more toxic substances in some illicit cigarettes.

While the content of some counterfeit cigarettes raises concern, the way smokers inhale and smoke counterfeit cigarettes is not known. HM Customs research in the UK revealed 78% of smokers said that counterfeit cigarettes do not taste the same as genuine ones, whilst 25% said the cigarettes themselves fell apart more quickly. Smokers reported that “they smell different, they taste different, they’re too harsh and they don’t draw easily.”

Aside from tasting bad, several young smokers in focus groups in Scotland reported becoming ill after smoking counterfeit cigarettes, with mention of colds, chest infections and sore throats. “You get a cold or you get ill after smoking four or five.” (Male, 18–24 years, C2DE)

All these factors might influence the smoking behaviour of counterfeit users, for example, they may inhale less deeply or smoke fewer cigarettes.

Highlighting the dangers of counterfeit cigarettes may risk communicating an unintended message that genuine cigarettes are normal and safe. According to British American Tobacco Nigeria for instance, “Tobacco use is risky, but counterfeit cigarettes are lethal.” Scientists have identified about 4,000 different chemicals in tobacco smoke of the “regular” cigarettes. Focusing on the hazardous chemicals in counterfeit cigarettes may mean that “regular” cigarettes are seen as safe, while in fact they contain 70 carcinogenic chemicals and are responsible for six million avoidable deaths each year.

The definite health concern of illicit cigarettes is not their toxicity, but their lower price, which may lead to increased tobacco use. If the illicit tobacco trade were eliminated, smoking would become less affordable and so there would be a consequent fall in consumption and tobacco related deaths. Based on 2005-06 figures, Professor Robert West has calculated that if the UK eradicated tobacco smuggling the increased prices and consequent fall in consumption would lead to the prevention of 4,000 premature deaths.

Both genuine and counterfeit cigarettes are extremely toxic products. There are no safe cigarettes and there is no safe level of smoking.
WILL PLAIN PACKAGING LEAD TO MORE SMUGGLING?

The definition of a ‘plain pack’
In general, the tobacco industry describes a plain pack as a white or single colour pack with a text warning. For example, Japan Tobacco International has run a series of adverts where plain packs were presented as below:

![Plain pack example](image)

This kind of picture suggests that all packs would look the same and would be easy to copy. In fact, plain cigarette packets will always have large pictorial health warnings and such packs will therefore be as difficult to counterfeit as any other pack.

Counterfeiting existing packs
The tobacco industry claims that plain packs would be easier to counterfeit. But they know that all packs, including those with tax stamps, are easy to counterfeit. A cover story in Business Week in 2005 described the counterfeit trade: “Counterfeiters are now so proficient that forensic experts are sometimes needed to spot bogus products”\(^3\).

The counterfeiters are able to provide top quality packaging at low prices in a short time. The quality of counterfeit cigarette packs has substantially improved from the 1990s, making it difficult to distinguish counterfeit from genuine cigarette packs. As early as 2004, research from HM Customs and Excise revealed that the outside pack was the least likely indicator of the carton being counterfeit\(^3\). Even the tax stamps with more sophisticated security features used in other parts of the EU are easy to counterfeit.
In 2010, the four major transnational tobacco companies signed an agreement to collectively promote Codentify, a system for ‘track and trace’ where a visible and unique code printed onto tobacco packaging identifies each package. This would get rid of tax stamps.

Mark Hill, Senior Anti-Ilicit Trade Engagement Manager at Imperial Tobacco said that tax stamps are outdated, because they are easy to falsify: “The overt security features on the stamps are easily and successfully copied by counterfeiters within a matter of weeks – in a quality to fool most consumers.” In a 2012 brochure on Codentify, Philip Morris International confirms that packaging is easy to counterfeit: “Paper-based tax stamps and fiscal markers are easily counterfeited, despite the inclusion of innovative holograms, special inks and elaborate design details. Evidence shows that counterfeiters can make copies of even the most sophisticated paper stamps in three weeks.”

The least one can say is that the tobacco industry is very inconsistent in their main argument that plain packs will be easy to copy. On the one hand they claim that plain packs are easy to counterfeit, on the other they insist that counterfeiters already copy all paper-based material at short notice, even the most sophisticated tax stamps. The reality is that all packs are easy to counterfeit and that plain packaging will not make any difference.

The real causes of the illicit tobacco trade

Demand and supply
It is clear that factors other than plain packaging drive illicit trade. Results from focus groups among young adults in Glasgow in 2010 have shown that the participants would not change their illicit tobacco purchasing behaviour if cigarettes were sold in identically coloured plain packs. The demand for illicit tobacco was related to price and availability, but not to packaging.

Similarly, research in the North of England concluded that buyers are significantly motivated to purchase illicit tobacco because of price, convenience (such as buying in bulk), and availability (for example, being offered them in a social situation such as in the pub).

While the demand for illicit tobacco products is strongly influenced by its reduced price, the attractiveness for the suppliers is more complex. Although a high tax margin may provide the initial incentive to smuggle, the data show that it is not the overriding factor. Other important factors include the ease and cost of operating in a country, industry participation, how well organized crime networks are, the likelihood of being caught, the punishment if caught, corruption levels, and so on.

Illicit trade is the outcome of classic demand and supply: demand by smokers for cheaper cigarettes and supply by both legal and illegal tobacco manufacturers looking for more profit, more sales, increasing market shares or new markets. It is facilitated by corruption, the presence of criminal networks and weak government enforcement capacity.

The low costs of manufacturing illicit cigarettes
Supplying the illicit market is attractive to companies and traders because of the low cost of manufacturing. This can be as low as 5 US cents a pack in Paraguay, 20 US cents for a Jin Ling pack in Kaliningrad, or 20 US cents for a Chinese counterfeit pack. Philip Morris International acknowledges that production costs are low and estimates the cost for a Chinese counterfeit pack at 15 pence. It is difficult to know exactly the production costs of Chinese counterfeit, but discussions with EU customs officials suggest a manufacturing cost for a counterfeit pack ranging from 10 to 15 pence.
The low manufacturing cost has two major consequences: the potential profits for selling illicit tobacco are very high and the potential savings from reducing the costs of manufacturing illicit cigarettes are very low.

Evading tax by diverting tobacco products into the illicit market generates a considerable profit margin for illicit traders. Organised smugglers can buy a container of Jin Ling cigarettes in Russia (on which they pay no taxes) for US$100,000. The value of such a container in the EU is on average US$2 million, an enormous profit margin\(^43\). In the UK the potential profit is up to three times higher.

**Little scope for further reducing the manufacturing costs of illicit cigarettes**

Reducing the manufacturing costs of illicit cigarettes is therefore difficult. Research commissioned and sponsored by PMI has claimed that plain packaging without the different features of the brand (for example, logos, relief drawings, images or other embellishments) would significantly cut production costs\(^44\). But production costs cannot be cut significantly further and make up a very small proportion of the price of an illicit cigarette.

If the production cost of a counterfeit pack is 10 to 15 pence, the packaging cost could be estimated at 2 to 6 pence and possible savings to those costs at 1 to 3 pence. It is therefore not credible that the introduction of plain packaging could make any meaningful difference to pricing, since it could reduce the costs at most by a few pence.

**Taxation and smuggling**

The industry has argued that plain packaging will lead to more price competition among unbranded packs, lower prices and increased consumption. A possible measure to counter this effect would be to increase taxes, which would again increase illicit trade, according to the tobacco industry\(^45\).

Governments can increase taxes to annul the effect of the price reduction. This will not lead to an increase of smuggling if tax enforcement and tax administration is maintained. The difference between duty paid and illicit cigarettes will not change.

It is a false assumption that higher taxes would lead to more smuggling: smuggling is more common in low tax countries than in high tax countries.

Estimates of the illicit trade from 84 countries in 2007 have shown that the proportion of the cigarette market is overall lower in high income countries than in low income countries\(^46\). Corruption has been shown to be a strong predictor of levels of tobacco smuggling, with inadequate laws and law enforcement as well as geography also playing a role. Price levels therefore do not predict levels of illicit trade\(^47\).

Recent research on illicit tobacco in 18 European countries, conducted in 2010 through the Pricing Policies and Control of Tobacco in Europe (PPACTE) project, showed that the illicit tobacco trade had no significant association with the duty-paid cigarette price. Smokers from countries where a 20-cigarette pack of Marlboro costs less than €3 were more likely to be cigarette tax evaders. The data also showed that illicit trade is more frequent in European countries with a land or sea border with Ukraine, Russia, Moldova or Belarus, which are major suppliers of cheap and illicit cigarettes\(^48\). These findings are in line with a European Commission report that those four former Soviet countries are major sources of illicit cigarettes and alcohol in the European Union\(^49\). Packaging has never been mentioned in the peer-reviewed literature as a key factor for smuggling.
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The full report can be downloaded from:
www.cruk.org/tobacco

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