

Conference Report

# Conference on Tobacco Taxation and the Illicit Trade in Tobacco Products



Leuven: 30 September and 1 October 2015

Organised by



With the support of



*The Smoke Free Partnership is a coalition of NGOs working exclusively on EU policy analysis linked to the implementation of the Framework Convention on Tobacco Control. Since its creation in 2006, SFP has helped lead campaigns on a number of important EU tobacco control policy areas, including smoke-free policies, the EU Tobacco Tax Directive, FCTC Article 5.3 Guidelines, FCTC Article 6 Guidelines, and the revised Tobacco Products Directive. The World Health Organisation recognised the SFP for its tobacco control work by awarding it a World No Tobacco Day Award in 2011, SFP was also awarded the 2015 Luther L. Terry Award for outstanding global achievement and exemplary leadership in Tobacco Control.*

**SFP MAIN PARTNERS:**



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**TABLE OF CONTENTS**

Abstract ..... 3

Basics of Tobacco Taxation ..... 4

Public Health Effects of Tobacco Taxation ..... 6

Electronic Cigarettes Taxation ..... 7

The demand for tobacco products in the EU:  
 Implications for the revision of the tax directive ..... 10

Excise Duties on Manufactured Tobacco Products: What Next? ..... 12

Implementation of Articles 15 and 16 of the Tobacco Products Directive ..... 13

Why Does the EU Need a Protocol to Fight the Illicit Trade in Tobacco Products? 15

Panel Session ..... 16

Illicit Trade ..... 17

FCTC Articles 6, 15 & 5.3: an Unhappy Marriage? ..... 20

Annex ..... 23

“77 participants from Government representatives from Ministries of Health, Finance and Customs across 11 countries, the European Commission (DG SANTE, OLAF and DG TAXUD), members of the European Parliament and the WHO as well as leading academics and representatives of European tobacco control NGOs”

## ABSTRACT

The Smoke Free Partnership, with the support of the International Union against Tuberculosis and the European Commission, organised a two-day workshop in Leuven, Belgium on September 30<sup>th</sup> and October 1<sup>st</sup> 2015, titled “Taxation and illicit Trade in Tobacco Products: What next at EU level?”. The meeting took place as the institutions of the European Union are preparing for crucial discussions and decisions: on a possible revision of the Tobacco Tax Directive; on how to implement the provisions of the revised Tobacco Products Directive, particularly in relation to the establishment of a tracking and tracing system for tobacco products; and on the ratification of the World Health Organisation’s Illicit Trade Protocol, a subsidiary treaty under the Framework Convention on Tobacco Control.

There were 77 participants in the conference, from Government ministries across eleven countries, the European Commission (DG SANTE, OLAF and DG TAXUD), members of the European Parliament and the World Health Organisation as well as leading

academics working on tobacco control and related issues and representatives of European tobacco control NGOs. Participants were in the following proportions: NGOs (54%), Government organisations (27%), academics (6%), European Commission (5%), European Parliament (4%), WHO (3%), media (1%). A full list of participants is given in the Annex. The broad range of participants and range of expertise led to a well-informed, lively and valuable discussion which will help inform the key decisions on taxation and illicit trade listed above.

“Ministries of Finance often treat tobacco as an ordinary consumable commodity without fully appreciating how important taxation can be in curbing smoking levels”

**Florence Berteletti** (SFP Director) explained the context and background for the conference. She stressed that, whilst price and tax measures are an appropriate and powerful tool for governments to use, both to reduce smoking prevalence, increased revenues and re-balance health inequalities, the realities of modern governmental mechanisms result in less-than ideal taxation levels to



curb tobacco use. One of many important reasons why this was the case is because, whilst national Health Ministries might understand the positive benefits of taxation, taxation levels themselves are usually controlled by governmental Ministries of Finance. Unfortunately, there may be little or no communication between the Health and Finance Ministries, resulting in the Ministries of Finance having little understanding of the implications of taxation on health, or even on government revenue. Furthermore, Ministries of Finance usually treat tobacco either as a revenue generating resource and an ordinary consumable commodity, without perhaps fully appreciating or understanding the full social and economic costs of smoking, or how important taxation

can be in curbing smoking levels. Finally, tobacco industry has a very strong interest in convincing Governments not to pursue high tobacco tax policies, and therefore invests considerable lobbying energy in defeating tobacco tax proposals. Frequently, this involves arguing that tobacco tax increases would lead to rise in illicit trade in tobacco products and a decline in tax revenues. Although neither of these arguments has a good basis, tobacco control advocates may lack the experience or access to detailed information on tobacco taxation to resist these lobbying efforts effectively. Florence Berteletti explained that the aim of the conference was to develop a greater understanding of a number of key issues around tobacco taxation, including the economics of taxation (i.e. what makes up the price of tobacco products & method to estimate tax as a share of price), how changes in taxes/prices impact on the prevalence of tobacco use and consumption of tobacco products, and on deaths and disease from smoking and other

national costs, how industry manipulates prices and different tax structures and their effects on tobacco tax revenue. Florence Berteletti also said that the conference would explore, the types, causes and effects of illicit tobacco trade and how they may be countered, the type of research needed to inform policy decisions on tobacco tax and illicit trade as well as the policy context and processes at national and European level.

The conference is reported by summarising the presentations made by each speaker, and by summarising comments and contributions from attendees, without attribution (Chatham House rules). The following sessions were moderated by SFP Vice President, Deborah Arnott (Action on Smoking and Health UK), Alison Cox, SFP Board member (Cancer Research UK) and Susanne Løgstrup, SFP Treasurer (European Heart Network).



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**Alison Cox, SFP Board member**  
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**Susanne Løgstrup, SFP Treasurer**  
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## Basics of Tobacco Taxation

The presentation addressed four principal questions:

- Why is tobacco taxed?
- What are the different types of tobacco tax?
- What is the impact of tobacco taxes on tobacco product prices?
- What form of tobacco tax should we be seeking?

The primary motive for tobacco taxation historically, and still in many countries today, is the efficient generation of revenue.<sup>1</sup> In most countries, tax still accounts for a relatively low proportion of tobacco prices. Demand for cigarettes is relatively inelastic in a sense that the demand for



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them responds to price changes, but to a lower degree than the change in price. This is due to their addictive nature and the lack of close substitutes.

<sup>1</sup> "Sugar, rum and tobacco are commodities which are nowhere necessities of life, which are become objects of almost universal consumption, and which are therefore extremely proper subjects of taxation" Adam Smith, Wealth of Nations, 1776

**“The tobacco industry has a very strong interest in convincing Governments not to pursue high tobacco tax policies and invests considerable lobbying energy in defeating tobacco tax proposals”**

Another key motive for tobacco taxation, particularly in high income countries but increasingly in middle and low income countries as well, is the promotion of public health. Article 6 of the Framework Convention on Tobacco Control states that *“price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons.”* In richer countries, the introduction of tobacco control measures may mean that while smoking prevalence rates fall overall, they fall most quickly among higher income social classes, creating a driver of health inequality. Tobacco taxation can help reduce this inequality.

Finally, tobacco taxes can be levied to help cover the external costs of tobacco use, including the costs imposed on non-users. These include increased health care costs (including care provided through public spending), lost productivity from diseases and death caused by exposure to tobacco smoke, and possibly “externalities” that result from addiction and time inconsistent preferences.<sup>2</sup> The FCTC Article 6 Guidelines state the key public health policy in relation to taxation: *“When establishing or increasing their national levels of taxation Parties should ... make tobacco products less affordable over time in order to reduce consumption and prevalence.”*

There are many type of tobacco taxes:

- Taxes on the value of tobacco crop
- Customs duties on the import or export of tobacco leaf or tobacco products (declining in importance)
- Sales or value added taxes
- Taxes that are “implicit”, given that the Government controls tobacco production or distribution (and can therefore set prices as a monopoly)
- Tobacco excise taxes, (which can include special consumption taxes, sin taxes, surcharges etc).

In countries with developed tobacco tax structures, the typical retail price of cigarettes to consumers is made up of production costs; profit margins for the producer, wholesaler and retailer; specific excise tax, ad-valorem tax and VAT or sales tax. In general, tobacco control advocates should prefer a higher proportion of tobacco taxation to be made up of specific taxes (based on quantity, not weight

– for example a specific amount of money per cigarette or per pack of 20 cigarettes), rather than “ad valorem” taxes, which are based on the value of tobacco products (for example on a percentage of the manufacturer’s price or retail price). If ad valorem tax is used, it should be applied to retail price.

The FCTC Article 6 Guidelines state that: *“Parties should consider implementing specific or mixed excise systems with a minimum specific tax floor, as these systems have considerable advantages over purely ad valorem systems.”* The advantage of specific taxation is the ability to narrow the price gap between luxury and economy brands (which leads to a positive impact on public health), and the generation of more stable revenue stream. Complex tax structures are more difficult to administer, create more opportunities for tax avoidance and evasion, and are therefore less effective in achieving public health goals.

There are policy recommendations on what the overall level of tobacco taxation should be. In the past, the World Bank has suggest tax should account for between two thirds and four fifths of overall price. The World Health Organisation has recommended regular increases in taxes, so that the price increases by at least 5% over inflation every year. The Article 6 Guidelines suggest an increase on a regular/ annual bases equal at least to the level of inflation and the income growth with the goal to reduce the affordability of tobacco products over time. Overall, cigarette excise taxes should account for at least 75 percent of retail prices.

Even in high tax jurisdictions such as the UK and Ireland, there is no sign that tax levels have risen to the point where revenues start to fall, contrary to continued predictions from the tobacco industry.

The actual impact of tobacco taxes on tobacco use depends in large part on the impact of taxation on the overall prices of tobacco products. This will typically depend on several factors including:

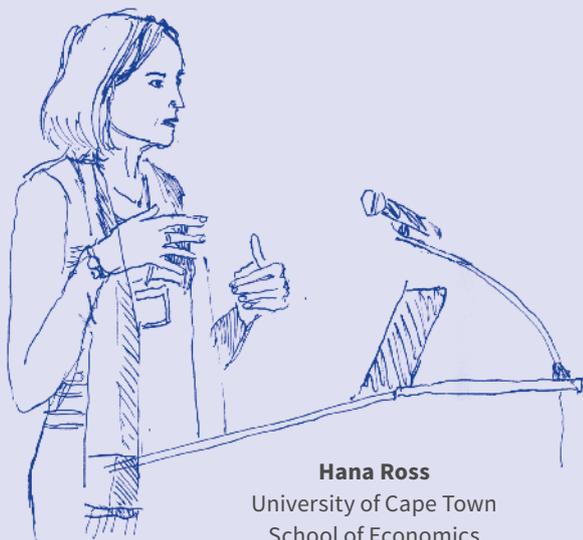
<sup>2</sup> Externalities are an increasing concern of modern behavioural economics. In this case, there is a conflict between what smokers would like for themselves today, and what they would like tomorrow. Faced with the trade-off between the short-term pleasures of smoking and the long-term health damages of doing so, smokers typically discount the latter and continue to smoke. “Tomorrow’s self” might well prefer to quit smoking, but tomorrow never comes, and the present self continues to consume tobacco. This may help explain why many smokers say they would like to quit, but do not do so, or fail when quit attempts are made.

- The structure of tobacco product market (whether it is fully competitive, or dominated by an oligopoly or monopoly)
- The cost of tobacco product production
- The tobacco industry's price-related marketing efforts (for example the promotion of economy brands to attract and retain younger consumers)
- The potential for individual tax avoidance and large-scale tax evasion such as organized smuggling of tobacco products.

Most current evidence indicates that in higher income countries tobacco tax increases result in comparable or larger tobacco product price increases. This means that the industry is passing on all the tax increases

to the consumer. In addition, the industry often use the occasion of a tax increase to increase their prices. This behaviour is called "overshifting". The industry can also increase prices unevenly across brands. For example, it can increase prices more on premium brands compared to economy brands in order to keep the more price sensitive consumers such as young people and people with relatively low income as their customers. There has been a fall in the overall affordability of tobacco products in at least some EU accession countries (e.g. Romania and Bulgaria), because they have had to raise tax levels in line with EU tax policies. On the other hand, the affordability in the Czech Republic and some other EU countries has actually risen due to fast income growth.

## Public Health Effects of Tobacco Taxation



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Smoking has devastating health effects impacts on nearly every organ of the body. It also affects third parties: there is no risk-free level of exposure to secondhand smoke. Between a half and two thirds of lifetime smokers will be killed by their habit, and around a quarter are killed in middle age (between 35 and 69 years old), losing 10 to 20 years of life. 6.3 million people a year currently die from smoking-related disease. However, quitting before 40 can avoid almost all (90%) of the excess risk. Therefore tobacco control policies that prompt smokers to quit as young as possible have potentially very large public health benefits. One of the most important policy levers for this purpose is tobacco taxation.

Increases in tobacco product taxes and prices can:

- Induce current users to try to quit (although this is difficult and most single quit attempts fail, many

users will eventually succeed in quitting over the long term)

- Keep former users from restarting
- Prevent potential users from starting
- Preventing transition from experimental to regular use (taxation is particularly effective in this regards)
- Reduce consumption among those who continue to use
- Lead to other changes in tobacco use behaviour, including substitution to cheaper products or brands, and changes in buying patterns.

About half of the impact of price on overall consumption is the result of changes in prevalence rates. A 10% price increase reduces prevalence by between 1% and 2.5% in high-income countries, and between 2.5% and 5% in low and middle-income countries (although the evidence from low and middle-income countries is not as rich as for high income countries). Examples of elasticity in middle income countries include -0.80 in Bulgaria, -0.34 in Estonia, and between -0.19 and -0.4 in Turkey.

These figures suggest that there is large scope for tobacco tax rises to both improve public health by reducing prevalence, and increase tax receipts with consequent benefits to public finances. Tax rises are likely to be the single most effective policy in reducing tobacco consumption, but will be less effective if they are not accompanied by a range of other policies, as set out in the FCTC.

## Issues Raised in Discussion (Both Presentations)

Issues and questions raised in discussion were:

- What research and information could help EU policy-makers' make good policy decisions on tobacco tax? Providing research evidence on the impact of higher tobacco taxes on public health and tax revenue, and ensuring that it is effectively communicated to policy-makers should be a priority for SFP.
- SFP should help policy makers involved in tobacco taxation to become aware of the potential benefits of tobacco taxes in reducing health inequalities, reducing tobacco uptake and increasing revenues (at the same time).
- There is some concern in finance ministries in high tax countries that they may be close to the "sweet spot" where taxes are at the ideal point for revenue maximisation. One way to address this concern is to improve tax administration to prevent tax avoidance and tax evasion.
- A good tax system can also reduce downtrading, where consumers move to cheaper brands of cigarettes or to RYO as prices rise. Such behaviour reduces the public impact of higher tobacco tax.
- Article 6 guidelines suggest that to reduce affordability it is necessary to raise taxes by at least the amount of inflation and income growth. However, taxes should not be reduced if incomes fall (as for example in Greece).

**"Even in high tax jurisdictions such as the UK and Ireland, there is no sign that tax levels have risen to the point where revenues start to fall, contrary to continued predictions from the tobacco industry"**

- Although tobacco taxes are likely to be regressive (lower income groups contribute more to tobacco tax revenue compared to higher income groups), tax increases are progressive as they disproportionately motivate lower income individuals to reduce tobacco use reducing their changes of facing high costs associated with smoking.
- The main factors driving illicit trade are not tax differences (or even price differences, although this can be a driver). The degree of illicit trade is more affected by the general state of each economy, the level of resources devoted to enforcement including tax administration and in some cases issues of corruption.
- One advantage of specific taxation is that it makes calculating tobacco tax income much easier (based on a count of sticks sold, rather than complex calculations involving prices, which the industry can manipulate).
- The tobacco industry is split on the issue of specific versus ad valorem taxation, depending on the brand mix of the individual companies in a specific country. PMI generally favours specific taxation, for example, while BAT favours ad valorem.

## Electronic Cigarettes Taxation

Electronic cigarettes are gaining popularity in EU countries. According to a pan-European survey, the percentage of the EU population aged 15 and above who tried electronic cigarettes or other electronic nicotine delivery systems (ENDS) at least once increased from 7% in 2012 to 12% in 2014.<sup>3</sup> France had the highest prevalence of electronic cigarette ever use (21%), followed by Cyprus (17%) and Estonia (15%).

Euromonitor, a market research company, estimates that just in five years the EU market for ENDS increased more than ten-fold, from 0.2 billion euro in 2010 to 2.2 billion in 2014.<sup>4</sup> The largest EU electronic cigarette markets were the UK (0.6 billion euro in



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3 [Attitudes of Europeans towards tobacco and electronic cigarettes](#): Special Eurobarometer 429, May 2015



2014), Italy, Poland, and France (0.3 billion euro each in 2014).

However, there is little research that describes or explains the key economic dynamics surrounding use of these products.

**“The pattern across the EU is lower sales of manufactured cigarettes and higher sales of Roll-Your-Own (RYO)”**

Possible measures to regulate use of electronic cigarettes are a matter of extensive study and debate. Part of the tobacco control community is concerned about possible negative health effects of electronic cigarettes and their potential for being a gateway to combustible cigarettes, and therefore call for electronic cigarettes to be included in existing tobacco control regulation. The use of electronic cigarettes might have adverse health effects, including potential harm from exposure to propylene glycol and other compounds and substances in e-liquids. Nicotine is addictive, poisonous in large doses, can affect the cardiovascular system adversely, may precipitate or aggravate diabetes, and may promote cancer growth or spread under certain conditions. Nicotine exposure also impairs brain development from fetal through adolescent developmental stages. Some evidence suggests that teenagers smoking electronic cigarettes would have never become addicted to nicotine if electronic cigarettes had not been readily available. A recent large repeated survey among high school students in Los Angeles showed that those who had ever used electronic cigarettes were almost four times

more likely to report combustible tobacco use over the next year.

Another part of the tobacco control community, however, argues that regulators should not treat electronic cigarettes the same way they treat traditional tobacco products, because electronic cigarettes are a potentially lower-risk alternative to cigarette smoking. Some scholars even argue that a public health policy encouraging current smokers of combustible cigarettes to switch to electronic cigarettes could rapidly reduce tobacco-related death and disease and that such a public health breakthrough would more likely occur if electronic cigarette prices were sufficiently lower than prices of combustible cigarettes, so that the users of harmful combustible cigarettes are incentivized to shift to using less harmful electronic cigarettes.

Because electronic cigarettes are new and the products themselves are widely varied, full evidence on risks remains to be established. Early evidence, however, suggests they are substantially less harmful than combustibles. Because aerosol appears to be less harmful than cigarette smoke, they may substantially reduce health risks for those who switch from regular cigarettes to electronic cigarettes, but cannot quit. Moreover, future policies, such as ingredient regulations, can make electronic cigarettes safer to use.

Electronic cigarettes may also be an effective cessation aid for current smokers of combustible cigarettes. They are mainly smoked by current tobacco users. Surveys in Italy, Germany and Spain found their use to be more than ten times more prevalent among current tobacco smokers than among never smokers. Of EU tobacco users who also tried electronic cigarettes, 48% reported that electronic cigarettes helped them to reduce their tobacco use or even to stop tobacco use completely, while only 4% reported increasing combustible tobacco use due to electronic

4 Euromonitor International. Passport Database. London, UK; 2015.

cigarettes. However, controlled studies have not yet verified the efficacy of electronic cigarettes as cessation devices.

Taxation could potentially address the concerns of both opponents and proponents of electronic cigarettes. Excise taxes might help Governments to deter any surge of new nicotine addiction caused by electronic cigarettes, while still enabling those Governments to take advantage of the harm reduction potential of electronic cigarettes and other ENDS (Electronic Nicotine Delivery Systems). The crux of this approach is that taxes on ENDS could be used to raise prices so as to deter ENDS initiation by never users, while concomitant greater tax increases on regular cigarettes could incentivize switching from combustible products to ENDS.

Researchers from the Economics and Health Policy Research at the American Cancer Society were among the first to conduct studies on electronic cigarette taxation and the first to do so in Europe. They obtained data from the Nielsen Company on electronic cigarette and regular cigarette sales for six EU markets: Estonia; Ireland; Latvia; Lithuania; Sweden and the United Kingdom. These six countries were the only countries for which reliable data on electronic cigarette sales were available. The company collected the data directly from electronic scanners in participating retail outlets. In most countries, the participating stores include hypermarkets, supermarkets, grocery stores, convenience stores, and gas stations. The data covered the period from December 2011 to November 2014.

The findings from this exploratory study suggest that electronic cigarette users are responsive to price and therefore that tax policies that alter electronic cigarette prices will be effective in changing their use. The results demonstrate that for every 10% increase in electronic cigarette prices, sales of electronic cigarettes drop by approximately 8.2% in the short term and 11.5% in the long term. This suggests that electronic cigarette demand is more price responsive than the demand for regular cigarettes. Estimates of the price elasticity of cigarette demand in high income countries average -0.4, while the study found the price elasticity of electronic cigarette demand to be around -0.8. The data was aggregated at market level and thus does not provide any information on who the users of electronic cigarettes are. Therefore, they do not support estimates of price elasticities for separate sub-populations. However, since it is well established that youth and lower-income individuals are particularly responsive to cigarette price policies,

**“To measure progress in tobacco tax policy, policymakers will need to focus on *affordability*, a measure that simultaneously takes into account changes in product prices and income”**

it is expected that the same will be true for electronic cigarettes, and that electronic cigarette taxes would be particularly effective in deterring electronic cigarette initiation among youth.

Since the study focuses only on electronic cigarette demand, it provides no direct evidence on the effects of electronic cigarette prices on sales of regular cigarettes. However there is some evidence that electronic cigarettes and regular cigarettes are substitutes, with higher cigarette prices being associated with increased electronic cigarette sales. This finding might suggest that increasing price differences between regular cigarettes and electronic cigarettes, by further increases in taxes on regular cigarettes, could drive smokers of combustible cigarettes to electronic cigarette use, with potential benefits to their health.

Some jurisdictions are just beginning to experiment with different tax structures: specific tax on the volume of e-liquid (e.g. Italy), specific tax on nicotine content (e.g. Maine proposal), and ad-valorem tax (e.g. Minnesota). In Italy, 1 mL of e-liquid is assumed to be equal to 5.63 combustible cigarettes, and tax is therefore applied at € 0.37344 per mL. A potential effect is that companies making highly-concentrated, cig-a-likes would have a competitive advantage. Currently these are mainly tobacco companies, whose cig-a-like products consume much less e-liquid than open tank systems. In Maine, USA, a state bill proposal suggests a specific tax on nicotine content of electronic cigarettes. A potential effect of this policy is the creation of a market full of weak products that only stoke nicotine cravings rather than satisfy them. In Minnesota, USA, vapour products are currently taxed at 95% of the wholesale price of the product, in line with other established non-cigarette tobacco products. A potential effect of this policy is that manufacturers of cheaper, potentially lower-quality, devices could gain a competitive advantage.

Differential taxation for different nicotine-containing products may make sense from a harm-reduction perspective, but only when coupled with other effective tobacco control measures. In the context of differential tax rates for electronic cigarettes and

regular cigarettes, it appears particularly important to include other measures, such as measures to ensure that e-cigarettes are safe to use and that they satisfy the needs of combustible tobacco smokers who would like to switch to e-cigarettes. Provisions of the revised Tobacco Product Directive provide guidelines for such further policies, while allowing countries to go beyond the Directive's minimum requirements.

### Issues Raised in Discussion (respondent: Hana Ross)

Issues and questions raised in discussion were:

- Because we still do not know enough about any potential harms of electronic cigarettes, should they be taxed at the same rates as the other tobacco products?
- If not, how high should taxes on these products be? Assuming that they are a lower-risk product compared to regular cigarettes, could a high level of taxation encourage users to switch (or revert) to regular cigarettes?
- Should these products be included in the EU Tobacco Tax Directive, or left to discretion of the Member States. At present it is not clear whether the Commission will recommend that electronic cigarette taxation should be included in the revised Tax Directive.

- It was suggested that the level of taxation on cigarettes and RYO is a more important public health issue than electronic cigarette consumption.
- It is not yet clear how the price elasticity reported in the presentation was estimated (the relevant research has not yet been published).
- In the United States, using electronic cigarettes is still more expensive than smoking tobacco cigarettes, therefore price signals do not currently encourage shifting, even if there would be a public health gain. It was suggested that in Lithuania and some other EU countries they are cheaper than cigarettes.
- The tobacco industry is developing tobacco products which are heated but not smoked (i.e. not a product of combustion). There is no independent data on the health implications of such products.
- A key question is not whether electronic cigarettes are less harmful than cigarettes, but what the availability of these products will mean for smoking prevalence rates. Currently in the UK, electronic cigarette sales are increasing, but smoking rates are falling, and child initiation is also falling. Appropriate taxation (if that can be determined) might be used to send appropriate public health signals.
- It is likely that the profit margins on cigarettes remain much higher than on electronic cigarettes and related devices.

## The demand for tobacco products in the EU: Implications for the revision of the tax directive

Between 2000 and 2014 there was a substantial reduction in sales of cigarettes and RYO across the European Union. However, while there has been a large reduction in sales in some states (for example, Portugal, where sales fell by around a half over the period) in some other states, such as the Czech Republic, there was actually a sales increase. In general the pattern across the EU is lower sales of manufactured cigarettes and higher sales of RYO.

Demand for tobacco products is driven by several factors. These include:

- Income - lower income smokers tend to use cheap tobacco products. However, there are differences in patterns across the EU, for example Belgium, which is richer than the EU average, has a larger than average share of RYO

- Taxes and (relative) prices, which has the effect of generating price advantages for some products over others.

There are two fundamental aspects of EU tobacco taxes. The first is the minimum tax burden per quantity for *each* product category, which determines the minimum price at which the product can be marketed. The second is the differences in minimum tax burden per quantity *across* product categories. This has the



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effect of generating price differences that may lead to “downtrading” from premium to cheap cigarettes or to other cheaper products.

Spain provides a useful case study illustrating the effects that tax policies can have on the structure

of the demand for tobacco products. The following tables show calendar differences in the application of minimum taxes to different tobacco products as well as differences in their tax burdens:

### The roll out of minimum taxes per quantity in Spain (calendar differences)

	Cigarettes	Fine Cut Tobacco	Cigars and Cigarillos
2005 and earlier	0	0	0
February '06 to November '06	55	0	0
November '06 to June '09	70	0	0
June '09 to December '10	91.3	50	0
December '10 to July '12	116.9	75	0
July '12 to December '12	119.1	80	32
December '12 to July '13	123.97	85	34
Since July '13	128.65	96.5	41.5

Note: For cigarettes, cigars and cigarillos, € per 1000 units

Note: For fine cut tobacco, € per kg.

### The roll out of minimum taxes per quantity in Spain (& standardised rates differences)

	Cigarettes	Fine Cut Tobacco	Cigars and Cigarillos
2005 and earlier	0	0	0
February '06 to November '06	1.10	0	0
November '06 to June '09	1.40	0	0
June '09 to December '10	1.83	0.70	0
December '10 to July '12	2.34	1.05	0
July '12 to December '12	2.38	1.12	0.64
December '12 to July '13	2.48	1.19	0.68
Since July '13	2.57	1.35	0.83

Note: € per equivalised pack of 20 units

While the introduction of minimum taxes has had positive effects, such as increasing the price floor of cigarettes, their asynchronous and unequal (in terms of tax burden) application across products has tilted demand towards roll your own tobacco, whose share of total sales has increased from 9% in 2009 to 17% in 2013.

Would it have been possible to avoid this undesired effect? If there had been uniform tax treatment across products, the market for tobacco would probably not be as segmented as it now is. There has been a shift from within product (i.e. cigarettes) segmentation to across product segmentation. The possibilities for downtrading are even greater than at the start of the century.

Unfortunately Directive 2011/64/EU does not solve this deficiency. It requires a minimum tax content of 90 € per 1000 units for cigarettes, and for fine cut tobacco either 47 € per kg or 46% of average price of fine cut brands. This could create two problems. First, fine cut may be taxed by value rather than quantity. Ad valorem taxes are less effective at creating a price floor, and it would therefore be good policy to make a minimum per quantity the only option. Secondly, the minimum taxes per quantity imply that, for the burden to be equal across products the average RYO stick should use 1.91 grams of fine cut. In fact the average RYO in an EU stick uses 0.75 grams of fine cut. Therefore the minimum tax per quantity should be raised substantially, to 120 € per kg.

In conclusion, Directive 2011/64/EU contains loopholes that encourage tax advantages for fine cut tobacco. These tax advantages lead to price advantages and shifts in demand from cigarettes to RYO, which in turn reduces the public health effects of increasing cigarette taxes. A revised Directive should eliminate such loopholes and avoid the creation of new ones. An attempt should also be made to adjust minimum rates by cost of living differences across states.

### Issues Raised in Discussion

Issues and questions raised included:

- Brands are the main means of price segmentation within a product class (i.e. cigarettes). If all cigarette packs looked the same and there was no other form of advertising then the ability of tobacco companies to segment markets via branding would be reduced, which explains the industry's strong opposition to standardised packaging. Taxes on quantity (specific taxes) contribute in the same direction by creating a price floor and compressing the distribution of prices, as seen in the case of Spain. But ad valorem taxes work in the opposite way, because they magnify producer price differences and lead to a wider consumer price spectrum.

- Under the existing Tax Directive Member States can still set their own tax rates, as far as they respect the directive framework. Some already use their autonomy to set high specific taxes for all products.
- Member states can also prevent sales at less than cost price (intended to keep young people and others on low incomes smoking).
- However, the Directive still needs revision, in order to ensure that all Member States set a tobacco tax structure that actively promotes public health and eliminates the possibility that tax advantages are created for certain products (e.g. RYO tobacco). Another possibility would be to adjust the minimum tax rates by differences in cost of living across countries.
- The minimum level of tax on RYO should be raised in the revised tax Directive, to help all Member States follow the example of Finland.
- Tax rates should be harmonised as far as possible across countries, at a dissuasively high level.

## Excise Duties on Manufactured Tobacco Products: What Next?

### Relevant EU legislation is:

- Directive 2008/118/EC on common provisions on excise duties (including Manufactured tobacco)
- Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco (including provisions on product categories, the structure of excise duty, and minimum overall excise duty rates)

Under Article 19 of Directive 2011/64/EU requires the Commission to submit every four years a report to the Council of Ministers, and, where appropriate, a proposal concerning the rates and the structure of excise duty laid down in the Directive. The Directive must also be examined under the REFIT programme, REFIT is the European Commission's Regulatory Fitness and Performance programme, intended to make EU law simpler and to reduce regulatory costs, thus "contributing to a clear, stable and predictable regulatory framework supporting growth and jobs".

In June 2014, DG TAXUD received an independent report of a study on "the measuring and reducing of

*administrative cost in imposing excise duties on tobacco products".* The purpose of the study was to:

- Analyse any weaknesses in EU legislation on tobacco taxation
- Consider the administrative costs of the current tax structure
- Look at levels of compliance and security.

The study was discussed in draft at a Round Table event, and the final report made 16 recommendations for improvements, covering:

- Revisions in definitions of tobacco products (including new product categories)
- The structure of excise duty (Including Minimum Excise Duty)



**Thomas Carroll**

Head of Unit, Indirect Taxes other than VAT, DG TAXUD

- Other topics (including the excise movement and control system across the EU)

In 2015, a Fiscalis Project Group (Tobacco) was established to consider the possibility to include raw tobacco and of electronic cigarettes in the scope of excisable products. Four meetings have been held, involving representatives of 20 Member States. The Project Group reports to the Indirect Tax Expert Group on indirect taxes other than VAT (the lead Commission Department is DG TAXUD). Conclusions and recommendations from the Fiscalis Project Group are advisory only.

The Commission will prepare a report to meet the requirement of Article 19 and the REFIT programme by the end of this year. The report will not consider tax rates in any detail. It will be submitted to the Council of Ministers and the European Parliament. In 2016, an impact assessment will be prepared on any possible

revisions of Directive 2011/64/EU. The assessment will include a public consultation.

### Issues Raised in Discussion

Issues and questions raised in discussion were:

- If electronic cigarettes are to be considered in relation to the revised Tax Directive, there would have to be some consideration of tobacco tax rates, because the differential between the two would be crucial.
- Health protection remains a crucial consideration in relation to the Tax Directive.
- The Commission notes that some tobacco tax rates will not work their way through the system until 2020, and considers that this will make it impossible to measure their impact in relation to any revision to the Directive.

## Implementation of Articles 15 and 16 of the Tobacco Products Directive

Illicit tobacco products do not comply with the requirements of tobacco product regulation, in particular with respect to ingredients and labelling rules. Illicit products also create low priced supply and make tobacco products more affordable, in particular to young people. They undermine the free circulation of compliant products on the Internal Market and put at risk health policies of Member States aimed at curbing tobacco consumption, and they reduce tax revenues by about €10 billion a year across the EU.

Using Euromonitor data, we can give the following estimates for illicit trade in 25 countries (excluding Cyprus, Luxembourg and Malta):

	2009	2010	2011	2012
<b>Total consumption</b> (million sticks)	734,627	705,303	665,389	635,639
<b>Illicit trade total</b> (million sticks)	64,397	73,664	65,612	66,883
<b>% penetration of illicit trade</b>	11.39%	13.88%	12.60%	12.79%

There are various technical means by which genuine tobacco products can be marked and monitored as they move from production to retail sale. These include:

- Tracking systems, which involves marking products with a unique identifier, so that they can be monitored from the point of production up to the point of sale to the customer, including each step of the process, creating a time and location history for every step
- Tracing systems, which provides the capacity to identify the past or current location of an item
- Overt security features, which can be verified by sight, including colour changing inks, holograms, latent images, watermarks and security threads
- Covert security features, which are not instantly recognizable or interpretable by sight, and require authentication tools and/or specialized knowledge to verify them.



**Filip Borkowski**  
Team Leader for  
Tracking & Tracing Systems,  
DG SANTE Tobacco Unit

Examples of security features already in use include:

- Marks readable under ultra-violet light
- Microprint
- Holograms
- “Fingerprinting”, and
- Colour shifting ink

Article 15 of the revised Tobacco Products Directive requires that all unit packets of tobacco products manufactured in or destined for the EU market are marked with a unique identifier, and that their movements are recorded throughout EU. The system covers all economic operators involved in the trading of tobacco products, from the manufacturer to the last economic operator before the first retail outlet.

Article 16 of the TPD requires that all unit packets of tobacco products, which are placed on the EU market, carry a tamper proof security feature composed of visible and invisible elements.

Article 8 of the FCTC Illicit Trade Protocol requires Parties to establish a global tracking and tracing regime, comprising national and/or regional tracking and tracing systems (controlled by the Parties) and a global information-sharing focal point (at the FCTC Secretariat).

The European Commission is required to:

- Determine the technical standards for the establishment and the operation of the tracking and tracing system
- Determine the technical standards for ensuring that the systems used for the unique identifier and the related functions are fully compatible with each other across the EU
- Set out the key elements of the data storage contracts
- Define the technical standards for the security features (which may rotate) and adapt them to scientific, market and technical developments.

The Commission (DG SANTE) has therefore commissioned a feasibility study by an external contractor, whose report was published on 7 May 2015. The review concluded that the full traceability of tobacco products in the EU is achievable, that there are a many solutions available in relation to security features, and that whichever option is adopted the economic and social benefits are likely to outweigh the costs.

The feasibility study presents four potential solutions for traceability and four for security features. The traceability options are:

- Option 1: an industry-operated solution, with direct product marking carried out by tobacco manufacturers who would be free to select an independent data storage provider
- Option 2: a solution operated by a third party responsible for the product marking process on the production line, with one central independent data storage provider
- Option 3: each Member State selects between Option 1 and 2 regarding the entity responsible for product marking (manufacture or independent solution provider), and the system operates with multiple independent data storage providers
- Option 4: a unique identifier is integrated with a security feature and affixed in the same process as that security feature, and the system operates with (a) independent data storage provider(s).

The security feature options are:

- Option 1: a security feature using similar authentication technologies to a tax stamp
- Option 2: fewer semi-covert elements as compared to Option 1, where the co-presence of a unique identifier is regarded as equivalent to the semi-covert level of protection
- Option 3: fingerprinting technology is used for both the semi-covert and covert levels of protection
- Option 4: a security feature is integrated with a unique identifier (as for Option 4 on traceability).

The Commission launched a stakeholder consultation after publication of the feasibility study, which ran from 7 May 2015 to 31 July 2015.<sup>5</sup> The stakeholders included tobacco manufacturers, wholesalers and distributors, providers of possible technical solutions, government and non-governmental organisations. The consultation sought opinions on the four options for a tracking and tracing system and on the four options for the security features, as well as on the published cost/benefit analysis. There were over 100 responses.

The feasibility study will be followed with an implementation study intended to set specific objectives both for the tracking and tracing system and security feature, to assess the options proposed in the Feasibility Study, to propose the best design for

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<sup>5</sup> [http://ec.europa.eu/health/tobacco/consultations/2015\\_tpd\\_consultation\\_en.htm](http://ec.europa.eu/health/tobacco/consultations/2015_tpd_consultation_en.htm)

system architecture and interfaces, including for the independent data storage, incorporating proposed minimum technical standards. There will be further public consultation in the first half of 2016, an Impact Assessment will be prepared in the second half of 2016, and implementing and delegated acts will be adopted in mid-2017. The tobacco industry will have to deploy the new system (for both cigarettes and RYO tobacco, by 20 May 2019).

### Issues Raised in Discussion

Issues and questions raised in discussion were:

- Responses to the consultation on the tracking and tracing system will be analysed, together with legal analysis, to see what the Directive and Protocol requirements for the system to be independent will mean in practice.
- An effective tracking and tracing system can help protect the integrity of the supply chain, but there will remain a need to enforce against illicit and covert manufacturing

**“Because of their liability for seizure payments, the tobacco companies have a clear incentive to classify seized cigarettes as counterfeit product”**

- The Commission considers competition (and anti-monopoly) an important principle in establishing the different elements of the system, and would prefer an open system whenever possible.
- The Commission is likely to hire an external contractor to work on preparation of the implementation study and other elements of the project, partly to ensure that specified deadlines are met.
- The impact assessment is necessary because the expense and complexity of the system require it to mitigate and control risk.

## Why Does the EU Need a Protocol to Fight the Illicit Trade in Tobacco Products?

Control of the supply chain is essential to combatting the illicit tobacco trade, and this in turn is essential to tobacco control more widely. This requires co-operation between Governments, as specified in the Illicit Trade Protocol.

The presentation gave details of three criminal cases co-ordinated by OLAF, which demonstrate the need for key supply chain controls in the ITP. These are:

- Control of tobacco manufacturing equipment
- Due diligence (“know your customer”)
- Supply to countries only commensurate with demand in those countries
- Tracking and tracing
- Record keeping
- Control of “inter-mingling” in Free Zones
- International co-operation.

OLAF works with US Customs to share information on and track movements of illicit tobacco, and this has helped with effective investigations and action in important cases, for example the seizure of 120 million illicit cigarettes imported by ship from the Philippines into the Republic of Ireland (inter-mingled with animal

feed products). In this case, OLAF and Irish investigators were able to travel to the Philippines but procedural issues in lack of assistance delayed action beyond the statute of limitations, making prosecution impossible.



**Austin Rowan**

Adviser to the EU Office de Lute Anti-Fraud (OLAF)

OLAF has an important role to play in co-ordinating enforcement action between Member States, an example being an investigation of illicit production in Poland, following a request for assistance from the German authorities to OLAF. One problem with illicit production is that the substantial costs of setting up production facilities (more than one million euros) can be easily met with one lorry load of illicit cigarettes, because profit margins are so high. In this case, the fine cut tobacco being used in manufacturing was imported into Lithuania from Brazil, but was originally classified as “waste tobacco”. This illegal production facility was running one production line and starting

two more, and operating at full capacity would have cost the EU in lost taxes about 6 million euros a week.

The third example was from 1998, involving a roll on roll off ferry operating in the Black Sea, which had been purchased specifically for the purpose of moving illicit cigarettes. Investigators observed it dropping eight trucks full of illicit cigarettes, originally manufactured by RJ Reynolds, at a port near Barcelona, taking only fifteen minutes to complete the drop. Spanish Customs stopped the ship the next

day in international waters, and the captain then claimed that his ship had been subject to an act of piracy. The quantity involved was 8,000 master cases, or 80 million cigarettes. OLAF officers and colleagues from Greece and Spain went to RJ Reynolds in the US, who were able to provide details of place, date and time of manufacture, but could not say who had originally been sold the cigarettes. The case shows the vital importance of tracking and tracing and record keeping.

## Panel Session



Inge Grässle MEP said that more than half of the illicit cigarettes in the EU market are produced by the major four manufacturers (Project Sun and Project Star data). She said that she did not see why there were not adequate controls on the producers of cigarette papers and acetate tow, since there were only a small number of both. She hoped that a good tracking and tracing system might be applicable to other products in addition to cigarettes.

Professor Gilmore said that tobacco industry profits were rising, even though sales were declining. Europe is a highly profitable region. Profits rise because the industry “overshifts” taxes, in other words it raises prices over and above each tax rise. However, it simultaneously argues that tax rises will increase illicit trade: this is highly misleading. If it genuinely believed that high prices drove illicit, it would not increase its prices so much – it’s profits are such it doesn’t need to. But at the cheap end of the cigarette market the industry keeps cigarette prices cheap by absorbing the tax increases. It does this to help attract and retain young smokers and those on lower disposable incomes. Member State action on this and to narrow the price gap is constrained by the existing Tobacco Tax Directive.

Gilles Pargneaux MEP said that ratification of the Illicit Trade Protocol was supported by the European Parliament. He has been appointed by his political group as rapporteur on ratification, and also chairs a working group on tobacco industry interference in policy-making. The fight against illicit trade is primarily a public health measure, because it would protect young people in particular from being attracted to cheap tobacco products. The ratification process would be an opportunity to expose the lobbying behaviour of the industry.

Issues and questions raised were:

- Why is ratification of the Protocol proving relatively difficult? Answer: unanimity in the Council is never easy to achieve, and there are parallel processes for the UK, Ireland and Denmark and for the other Member States.
- How much of the Protocol is duplicated in provisions of the TPD? Answer: Article 15 of the TPD effectively implements Article 8 of the Protocol, relating to tracking and tracing.
- Manufacturing machinery is not covered by the TPD.
- On cigarette papers and acetate tow, the INBs on the Protocol discussed these issues extensively, but a number of European countries were strongly opposed to including them in the Protocol.
- The existing tax directive does have loopholes, but was the product of complex negotiations between the Member States. Closing these loopholes in a revised Directive will require that Member State Governments can reach a consensus on action.
- Action is required to restrict or abolish duty free cigarettes.
- Italy and Spain have among the lowest tobacco taxes in the EU, but still have a serious problem with illicit trade. Tobacco control advocates need to



**Inge Grässle**

Member of the European Parliament



**Professor Anna Gilmore**

University of Bath



**Gilles Pargneaux**

Member of the European Parliament



**Austin Rowan**

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**Filip Borkowski**

Team Leader for Tracking & Tracing  
Systems, DG Sante Tobacco Unit

develop more systematic research on the lack of a direct relationship between tax levels and the extent of illicit trade.

- Because of the requirements of the TPD, it will be illegal to sell cigarettes in the European Union after the implementation date if they do not have a tracking and tracing system that meets TPD requirements.
- The issue of ad valorem taxation was raised: orthodox economic theory would suggest that this is an appropriate form of taxation for monopolistic or near-monopolistic products. One possible solution

may be to cap the price that tobacco companies can charge, while taxes rise – this would increase revenues while cutting profits. The gap in price between luxury and ultra-economy brands in the UK, for example, has widened over time, which would suggest that specific tax rises should be a priority.

- It may be that the provisions of the TPD, and the revised Tax Directive, will make the extension of the legal agreements unnecessary, this is an issue that will require further discussion in the EU decision-making process.

## Illicit Trade

There are three basic types of illicit cigarettes:

- Known brands that have been “diverted” into illicit channels (for example, by being smuggled from a low tax to high tax jurisdiction)
- Illicit manufactured cigarettes (including counterfeit)
- Illicit new cigarette brands, mainly or exclusively destined for the illegal market.

Cigarette seizures in the EU peaked in around 2000 (at more than six billion a year), when the European Union began legal actions against tobacco manufacturers, alleging their complicity in illicit



**Luk Joossens**

Advocacy Officer, Association  
of European Cancer Leagues

trade. The action against PMI was dropped in 2004, in return for a legally binding agreement between the company, the Commission and the Member States. A similar agreement was signed with JTI in 2007, and with BAT and Imperial Tobacco in 2010. In 2010, BAT and Imperial Tobacco also signed similar agreements. All 28 Member States are currently Parties to the agreements, whose key features were base payments to the EU and Member States for previous lost tax revenues because of illicit trade, and an obligation to make future payments where there are seizures of the companies' products in illicit channels. However, seizure figures suggest that the launch of the original legal action had an immediate large effect on illicit trade, while the subsequent agreements had much less (or even no) effect.

**“There is a lack of independent publicly available data on the origins and brands of illicit tobacco products and the size of the illicit market across the EU”**

Because of their liability for seizure payments, the tobacco companies have a clear incentive to classify seized cigarettes as counterfeit product, because no payments are made in these circumstances. From the original PMI agreement in 2004 until the end of October 2013, there were no independent analyses of seized tobacco products, and all determination of whether they are counterfeit or not has been made through examination by the major manufacturers. It is significant that World Customs Organisation data on seizures in Europe show that 155 million counterfeit cigarettes were recorded as seized in 2011, 400 million illicit whites, and 1,297 billion regular brand cigarettes. However, 92% of seizures in the EU in 2011 of cigarettes apparently branded as PMI were classified under the agreement process as counterfeit.

Documents on the PMI website show that André Calantzopoulos, the CEO of PMI, gave a presentation in November 2013, which estimated the global size of the illicit cigarette market in 2012 at 315 billion units, broken down as follows:

<b>Illicit whites</b>	42%
<b>Contraband</b>	39%
<b>Under-declaration</b>	18%
<b>Counterfeit</b>	1%

The tobacco industry has used the threat of illicit trade (and particularly of counterfeit products) to try to block the introduction of standardised (“plain”) packaging of cigarettes and tobacco products in Australia, the UK, and other jurisdictions. However, in his report to the UK Government on the public health evidence on standardised packaging, Sir Cyril Chantler noted that since the introduction of the policy in Australia “hardly any counterfeit standardized packages have been found to date.” A representative of the tobacco industry told the Chantler Review team that his company had actually seen a reduction in the quantity of counterfeit products. In its 2013/14 annual report, the Australian Customs and Border Protection Service reported decreases since 2012/13 in several illicit trade indicators: the weight of tobacco seized fell from 183 to 178 tonnes, and the number of cigarettes seized from 200 to 147 million sticks.

The available evidence suggests that the overall level of illicit trade is not directly linked to tax levels. For example, the UK has one of the highest rates of tobacco taxation in the world, but the level of illicit trade, according to HM Revenue and Customs evidence, has roughly halved since 2000. This reduction is substantially the result of more resources and money being devoted to the issue by HMRC and UK Border Force, tougher supply chain legislation, and joint strategic work by enforcement agencies.

Across the world, the share of country tobacco markets taken by illicit trade is generally higher in poorer countries, although their tobacco prices were generally lower. Joossens, Raw et al estimated in 2010 (using 2007 data) that the illicit market share in low income countries (World Bank income group) was 16.8% (while the average legal price per pack of 20 cigarettes was \$1.13), the illicit market share in middle income countries was 11.8% (average legal price \$1.89), and high income countries the illicit share was 9.8% (average legal price \$4.91). The ability and willingness of countries to investigate, interdict and enforce against illicit tobacco has more impact on its overall market share than the level of tobacco prices. In the EU, data from 2010 suggests that illicit trade is not directly related to tobacco prices, but is more prevalent in countries with a land or sea border with Ukraine, Russia, Moldova or Belarus.

Currently, there is a lack of independent publicly available data on the origins and brands of illicit tobacco products and the size of the illicit market across the EU. Tobacco industry-funded research such as KPMG's Project Star generally exaggerates the extent of illicit trade. For example, although Project Star reports are published, the methodology behind them is based on specific terms of reference known only to PMI and KPMG.

The development of an EU-wide tracing system for tobacco products, as mandated under the revised Tobacco Products Directive (and the global system required under the FCTC Illicit Trade Protocol) has the potential to help tackle illicit trade. However, the tobacco industry is currently promoting its proprietary alphanumeric coding system (Codentify) as the technical solution for the tracing system, and the European Commission consultation on the requirement for a tracing system suggests that it has a significant chance of being adopted.

Codentify is controlled and operated by the industry through the Digital Coding and Tracking Association. In June 2014, the DCTA signed an agreement with Lithuania to use the Codentify system in that country, which stated that: "using data of a digital tax verification/authentication system for purposes of excise administration and prevention of illegal turnover of tobacco products, as well as evaluation of the system may guarantee compliance with upcoming regulation (Protocol to Eliminate Illicit Trade in Tobacco Products)". The agreement also stated that: "DCTA remains holder of any and all intellectual property rights in the Digital System and/or other technologies proprietary to DCTA. The Ministry of Finance of the Republic of Lithuania acknowledges that it will not acquire any such intellectual property rights".

The FCTC Secretariat has reported that: "the tobacco industry actively promotes its own technology solution, Codentify, which it claims complies with the Protocol. However, based on desktop research, it appears that this system does not meet the requirement of Article 8.2 that the tracking and tracing system has to be "controlled by the Party".

There alternative technologies to Codentify: for example, 2d bar codes. 2D bar codes are already used on many consumer products, such as food, alcohol, pharmaceuticals and tobacco products. They are machine readable (by phones and other devices) and can be placed at high speed on production lines. There are multiple suppliers to 2d bar codes, independent of the tobacco industry. Tobacco control organisations should try to prevent the tobacco industry from

**"The available evidence suggests that the overall level of illicit trade is not directly linked to tax levels"**

seeking to "control" the TPD and Protocol in relation to illicit trade. There is also an urgent need to develop more independent data on the nature and extent of illicit trade across the EU.

### **Issues Raised in Discussion**

Issues and questions raised in discussion were:

- Counterfeit product from China is a major problem, products are of variable quality.
- Project Star and Project Sun are of no present value in relation to establishing seizure payments. KPMG does disclose tobacco industry funding, but does not disclose the details of its agreement with PMI and this makes its methodology very difficult to assess.
- If the legal agreements between the EU and PMI (and then the other three major manufacturers) are not renewed, how will information on seizures be established and shared across the EU, and how will lost tax revenue be returned to the EU and Member States?
- SFP needs to press the Commission to provide the Parliament with the assessments of the legal agreements that it asked for on 3 April 2014. These need to provide the Commission's view on the results, including any financial or public health benefits, achieved under the current agreements, and any problems and shortcomings.
- SFP also needs to seek to establish the current state of play of negotiations on a renewed agreement (with PMI), any planned schedule, and intentions on informing the European Parliament.
- Cross border tobacco shopping is a significant problem inside the EU, and the number of small seizures appears to be rising.
- Seizure data does not necessarily establish an overall trend in illicit trade. For example, fewer enforcement officers will likely mean fewer seizures, while more effective investigations may lead to more seizures.
- There are various ways to make independent measurements of illicit trade, and some are low or modest costs. SFP and its allies could assist by sharing this information.

## FCTC Articles 6, 15 & 5.3: an Unhappy Marriage?

(Names of and information on organisations involved in the TI lobbying web can be found at the University of Bath's Tobacco Tactics website)

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

Article 5.3 is a vitally important provision of the FCTC, which was included because of the long record of the tobacco industry lying about the health effects of smoking and about the addictive properties of nicotine, and of (frequently corrupt) lobbying of Governments around the world to resist and delay tobacco control measures.

**"The tobacco industry controls price rises by making its own price increases just after the announcement of the tax increase by the Governments"**

In 1995, Steve Parrish, then PMI's Senior Vice-President of Worldwide Regulatory Affairs said: *"Our goal is to help shape regulatory environments that enable our businesses to achieve their objectives in all locations where we do business. Our overall approach to the issues is to fight aggressively with all available resources, against any attempt, from any quarter, to diminish our ability to manufacture our products efficiently, and market them effectively"*. This neatly encapsulates the industry's approach.

Not surprisingly, the World Health Organisation's Committee of Experts on Tobacco Industry Documents reported in July 2000 that *"the tobacco industry has operated for years with the express intention of subverting the role of governments and of WHO in implementing public health policies to combat the tobacco epidemic"*. Despite Article 5.3, the 2014 Conference of the Parties to the FCTC found that *"tobacco industry interference is still the single greatest impediment to progress in reducing tobacco use"*. Tobacco control should be seen as a continuing struggle against an active and well organised industry, whose lobbying and political activities are often

disguised, obscured or invisible.

The reality is that many countries have struggled to implement Article 5.3. This in part because the tobacco industry is using its massive resources to counter and adapt to 5.3. The tobacco industry is still extremely profitable, with profits actually rising even as sales fall. In the UK, tobacco firms have margins of up to 68%, compared to margins of between 12% and 20% for other consumer staple firms. This provides enormous resources which can be used to try to frustrate tobacco control and to pursue new and expanding markets, generally in low and middle income countries.



**Anna Gilmore**

Professor of Public Health  
University of Bath and UK Centre  
for Tobacco and Alcohol Studies

The industry has also specifically tried to cause confusion over and undermine the impact of Article 5.3. It has done this in a number of ways. For example, it has sent correspondence and briefings to politicians and officials arguing that Article 5.3 is in contravention of commitments to good governance and Better Regulation including mandatory requirements for consultation. Such efforts fail to mention that the tobacco industry played a key role in securing the EU's Better Regulation system including the provisions on EU stakeholder consultations and did so because they identified this as a key way of making it harder to pass public health policies. The industry argues, misleadingly, that 5.3 contravenes these regulatory systems because it *prohibits* consultation with industry. It does not. Article 5.3 in fact requires that consultation with the industry should be limited to what is strictly necessary, be transparent and accountable.

It has then gone on to mis-use stakeholder consultations both by manipulating the number of responses to consultations and by submitting highly misleading evidence in the hope that this will then be used in the impact assessments, another requirement of Better Regulation that industry pushed for. In the UK objections to the consultation process are a key part of the industry's judicial review case against the UK Government over standardised packaging. In support of this, the UK "smokers' rights" organisation FOREST (almost exclusively funded by the tobacco

## “An excellent example of a tobacco industry front group is the International Tax and Investment Centre (ITIC)”

industry) has said that “two-thirds of respondents to the Government’s 2012 consultation, which attracted over 665,000 responses, opposed plain packaging.... it’s scandalous the government is pressing ahead with the policy”. Not only does this misleadingly imply that the stakeholder consultation should be seen as an opinion poll but it fails to acknowledge that 98% of responses to the consultation on standardised packaging which opposed the policy were produced through tobacco industry funded campaigns. In other words, this opposition was effectively manufactured by the tobacco companies.

The industry also creates evidence to support its objectives. In the UK it funded numerous (non-peer reviewed) research reports to claim that standardised packaging will harm the economy, increase illicit trade, and fail to reduce smoking rates. Review of the evidence that the industry cited in its consultation responses indicates that the standard of industry evidence is incredibly low. For example, a detailed examination showed that *all* the ‘evidence’ industry cited to claim that plain packs would increase illicit and harm business had been commissioned by the industry or was simply the opinion of third parties they had funded, none of it was peer reviewed. yet in only three out of thirty-six pieces of evidence were links with industry revealed (in cases where this was unavoidable).

This is not an isolated example. Ongoing research based on systematic reviews of the evidence (including many papers based on tobacco industry documents) shows that the industry routinely manipulates evidence to suit its own purposes. Its efforts include the following:

- Production – producing a skewed evidence base
- Amplification – disseminating this evidence as widely as possible to mass media and decision makers
- Suppression – contesting public health evidence and attempting to silence public health opponents
- Credibility – avoiding the industry’s poor reputation by “fronting”, using third parties to conceal industry links to information and evidence.

Another key tactic the industry uses to oppose policy and undermine Article 5.3 is the use of third parties - organisations that the industry partly or entirely funds and sometimes controls and even organisations it has deliberately set up to look independent. Two sets of leaked PMI documents outlining its strategies for opposing the EU Tobacco Products Directive and plain packs in the UK both identified the use of third parties as key to success.

“Third party media messengers” used by the industry in the UK include:

- Retail trade associations and independent retailers
- Business associations
- Think tanks
- Anti-illicit trade groups
- Researchers
- International business organisations.

Third party “fronts” are particularly problematic for the effective implementation of FCTC Article 5.3, because they can give the impression, to the public and to opinion formers and decision makers, that there is widespread opposition to tobacco control policies, and the arguments advanced by these groups do not suffer from the credibility problems of the tobacco industry. Exposing links between third parties and the industry can also be time consuming and difficult. For example, some apparently independent think tanks and research organisations that support industry positions refuse to disclose their sources of funds (for example the Institute for Economic Affairs), although the IEA and others are known to have received industry funding in the past.

An excellent example of a front group is the International Tax and Investment Centre. It was founded in 1993. It is funded by all four of the major international tobacco companies, and they are represented on its board of directors. The ITIC employs high level ex-officials in tax and revenue services, for example Mr Dave Hartnett, former head of corporate tax and the Inland Revenue. The ITIC has access to ministries and international bodies that the tobacco industry directly no longer enjoys, including the World Customs Organisation, the Director General of DG TAXUD and MEPs. The ITIC Bulletin for September 2013 reported the establishment of a Tax Academy at the Vienna University of Economics and Business, stating that the ITIC was “*most grateful to JT International who provided expert advice ... and made a two year sponsorship commitment to finance the start-up and secretariat infrastructure*”. The WHO Director of Prevention of Non-communicable Diseases has said that *ITIC has published extensively in favour of the tobacco industry’s false positions on excise taxation, investment and illicit trade in tobacco products ... ITIC have used their international conferences, such as in Moscow in 2014 and in New Delhi [in 2015] to lobby*

*Government officials against tobacco taxation. WHO urges all countries to follow a non-engagement policy with ITIC.”*

It should be remembered that although the industry routinely claims that tax (and consequent price) rises will increase the levels of illicit trade, in fact it has been raising prices by more than the increases in tobacco taxation, as the following table from the UK shows:

**UK Real Cigarette Price Increases:  
November 2006 – November 2009**

Brand segment	% Price increase attributable to tax	% Price increase attributable to industry
Premium	45%	55%
Mid-range	44%	56%
Economy	44%	56%
Ultra-Economy	56%	44%
All combined	52%	48%

The evidence shows that the industry is not afraid of price rises in themselves, and knows that price is not in fact the main driver of the level of illicit trade. The industry wants to control price rises, and make its own price increases, to increase its already very high level of profitability.

In conclusion, the tobacco industry is:

- Still lying about the impact of its policies
- Misusing stakeholder consultations
- Manufacturing evidence and failing to disclose conflicts of interest
- Increasingly using third parties to disguise its activities
- Using its growing profits to lobby against public health policies.

The way to prevent this is to effectively implement Article 5.3. The Guidelines on implementation provide detailed information on how to do this and so do a number of reports on implementation prepared by NGOs. Many of these can be found on the Smokefree Partnership website.

**Issues Raised in Discussion**

The following issues were raised in discussion:

- There were around 160 lobbyists for PMI alone working on the TPD, and only 5 or 6 public health lobbyists at EU level, but in general the tobacco control movement was successful in defeating the industry’s efforts to weaken TPD provisions.
- The industry is achieving some success in persuading decision-makers that standardised packaging will worsen illicit trade, although there is no evidence that this is the case. However, several EU countries including the UK, Ireland and France are proceeding with or seriously considering the policy.
- Tobacco control organisations need to ensure collaborative information-sharing across the EU, particularly since the industry is highly organised at the transnational level.
- The tobacco industry is presenting itself as part of the “solution” to illicit trade, when they are of course the architects of the problem.
- In some EU countries, active health ministries committed to tobacco control are strongly pressing other Government departments to observe the principles of Article 5.3, and they need support from tobacco control organisations outside Government. WHO meetings at country level on Article 5.3, with national Government, local government organisations and others, have been useful in raising awareness of Article 5.3 obligations.



# ANNEX

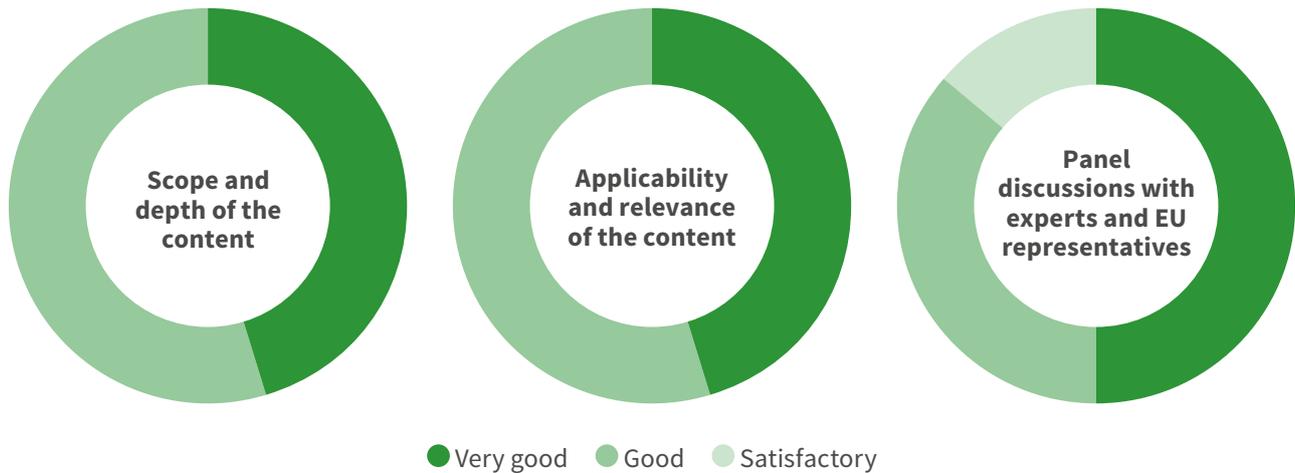
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## How would you rate the agenda and discussion of the conference?

Answered: 22. Skipped: 0



It has been a long time since I have been at a conference at which there was **such participation from the audience**. The agenda and the different subjects and where they fit on the agenda **encouraged the audience to fully participate** in all presentations. In addition, the chairs of each “session” did an **excellent job in balancing the enthusiasm**

**of the audience while still allowing time for a full response from the panellists.**

A lot of **useful information** that is worth considering.

It was **terrific to have representatives from the EU Commission and the EU Parliament.**

## Do you think that attendees of the conference were a good mix (NGO representatives, Ministries of health and finance, tobacco experts)?

Answered: 22. Skipped: 0



I thought that **the different and quite varied presentations blended well together** and therefore led to enthusiastic participation from the audience. **Indeed there was a good mix of people with different positions.** It is important that conferences allow experts with often different views on subjects to make their position clear as this encourages audience participation. This point is verified by the huge audience participation at this conference.

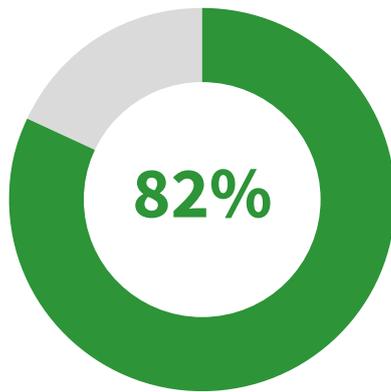
I appreciated a lot to be part in this conference. It is not easy for the health sector to get information from other sectors such as the finance and fiscal ones. **It was a good opportunity to reinforce this collaboration.**

It would have hit the jackpot to have somebody from the national authorities to speak about their problems/hopes/needs.

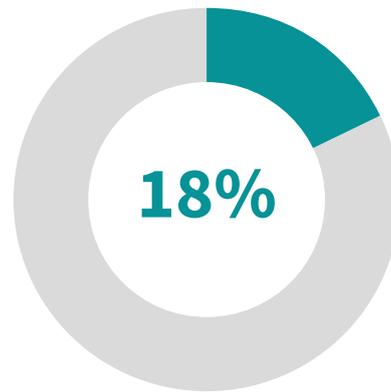
**This is what we need.**

## Would you have considered it useful if Ministries of finance would have also made presentations?

Answered: 22. Skipped: 0



YES



NO

Yes, it would have been beneficial if the various Ministry representatives from several Member States were a little more responsive during the discussions. Presentations from MOF officials would have provided an added bonus in relation to discussions.

It is important to understand how the finance sector sees tobacco taxation. It is important to show them the arguments of health. Tobacco is usually seen by economy sector as a “commodity” without risk for consumers. This view needs to be changed.

Their positions are sometimes relatively different than what we heard in a normal “health based conference”. It’s good to know it and good to hear it to better understand their concerns.

Especially in our case, it would have been interesting to challenge the industry-driven idea of applying only specific tax in tobacco taxation.



## What output from the conference do you consider most valuable for your work?

The opportunity to reflect on the contradictory information provided by the tobacco industry and the health sector.

The opportunity to share views between NGO representatives, Ministries of health and finance and tobacco experts.

Different perspectives about economy and health regarding tobacco tax.

Inspirational for other policy areas.

Lots of evidence based information and the presence of MoF made it possible to discuss issues that we only discuss amongst ourselves. This was really something new and of great value. This is what governments actually should do to educate finance people, journalists etc about tobacco and alcohol as risk factors for health and not only consider it as a way to get money for the budget.

I appreciated the possibility to discuss these issues from different points of view from competent authorities/institutions. The most useful for my work was information regarding Implementation of Articles 15 and 16 of the Tobacco Products Directive and E-cigarette taxation.

Sharing information and knowledge with experts on taxation. Co-operation with representatives from finance and customs authorities.

It gave me an insight into the importance of the implementation of FCTC article 5.3 and an overview of the Tobacco question. It was also important to know the opinion of the European Commission for possible modification of the Tobacco Tax Directive.

The presentation by Anna Gilmore on 5.3 was the most valuable to me.

Discussions about the structure of tobacco taxation.

It was interesting to observe the point of view of public health experts regarding the taxation of tobacco products.

The update on the situation in EU and the discussion about the research needs.

Plan our advocacy tasks for TTD revision.

Opinions of experts from different sectors and presented data.





With the support of



SFP staff



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