

January 27, 2016

Subject: Parliamentary Joint Committee on Law Enforcement – Inquiry into illicit tobacco

1. About BASCAP

Counterfeiting and piracy have become a global epidemic, leading to a significant drain on businesses and the global economy, jeopardizing investments in creativity and innovation, undermining valuable trademarks associated with recognized brands, and creating consumer health and safety risks. In response, the International Chamber of Commerce launched Business Action to Stop Counterfeiting and Piracy (BASCAP) to connect and mobilize businesses across industries, sectors and national borders in the fight against counterfeiting and piracy; to amplify the voice and views of business to governments, public and media; and to increase both awareness and understanding of counterfeiting and piracy activities and associated economic and social harm.

2. Declaration of Interest

For the purposes of this submission, BASCAP, a member based, subscription-based, non-profit association acknowledges that its membership comprises, inter alia companies engaged in the manufacture and sale of tobacco products. Nonetheless, the views provided here are registered on behalf of the cross-sector representation of BASCAP member companies equally concerned about the illicit tobacco trade.

3. BASCAP's advocacy against illicit trade

BASCAP has an ongoing policy of advocating about the dangers of illicit trade. BASCAP believes that the drain caused to the global economy by illicit trade is significant and worsening. By way of illustration of BASCAP's efforts, we worked closely with the UN Interregional Crime and Research Institute in drawing up a joint report advocating the confiscation of the Proceeds of Crime legislation as an effective tool for governments to implement in their fight against illicit trade.

Also, BASCAP's 2013 "Controlling the Zone" report called for increased regulation and better management of Free Trade Zones (FTZs). The report included recommendations on how to control illicit trade and how to enhance Intellectual Property Protection in the FTZs.

BASCAP has consistently warned that the involvement of organized criminal groups into the channels of illicit trade poses not just a serious economic threat, but also a threat to the health and safety of consumers. We have highlighted the nexus between illicit trade and organized crime networks give rise to inter-linkages with other criminal activities such as money laundering and terrorist financing.

BASCAP notes that illicit tobacco consumption in Australia has increased in recent years and then remained broadly stable for the last year or so. We are also concerned that there has been a significant increase in the

consumption of unbranded tobacco (illegally grown or imported loose tobacco, which is locally known 'chop chop'). Our views and observations are set out below for the Committee's consideration.

4. Nature, prevalence and culture of illicit tobacco use in Australia

BASCAP believes that the level of illegal consumption of tobacco in Australia is worryingly high. The growth in the illicit tobacco trade has been exacerbated by regular hikes in tax on tobacco along with legislative measures such as plain packaging. We believe our concerns are borne out by the following data:

a) KPMG reports on Illicit Tobacco in Australia¹

Significantly, KPMG discovered that Australia's illegal tobacco market has risen to 14.3% of total tobacco consumption from 2012 to June 2015, almost entirely offsetting the decline in the legal tobacco market resulting in broadly stable total tobacco consumption.

The growth in the illicit market therefore defeats the health objective of tobacco control measures while causing significant unintended consequences, such as decreasing government revenues and transferring that wealth to the organised criminal syndicates involved in the illicit tobacco supply chain in Australia and overseas.

Other findings of the KPMG studies were:-

- Consumption of illegal tobacco products was estimated to be 14.3% of total tobacco consumption in H1 2015, up from 11.5% in 2012;
- The overall level of tobacco consumption in Australia was estimated at 17.5 million kilograms in H1 2015, of which 2.5 million kilograms were estimated to be illicit;
- Since 2013, there has been an increase in unbranded tobacco consumption in Australia.

b) Australian National Accounts 2014

Australian National Accounts for 2014 showed that the rate of decline for tobacco expenditure slowed from 2.9% in 2010 to 0.9% in 2013. It seems to us that the decline in the rate of expenditure on legitimate tobacco products was brought about because of:

- A significant fall in the price of tobacco following the commoditization and resultant price competition caused by the introduction of plain packaging, combined with the continuation of the gradual declining trend in tobacco consumption that has been underway for decades (see reference to the National Drugs Strategy Household Survey 2013 below); and
- An increase in the use of illicit tobacco. Importantly, the increase of illicit tobacco was greater than decline of legal tobacco, either as expenditure or generally (at a historical rate of 3%).

c) AIHW National Drugs Strategy Household Survey 2013 (NDSHS)²

The latest NDSHS collected information on unbranded tobacco consumption and for the first time, awareness and purchase of non-plain packaged tobacco products, both proxy measures different forms of illicit tobacco. The survey found that almost one fifth of smokers surveyed had seen tobacco non-

¹ http://kpmg.co.uk/creategraphics/2015/10_2015/LTM_H1_2015_Report/index.html#6/z

² <http://www.aihw.gov.au/alcohol-and-other-drugs/ndshs/2013/tobacco/>

plain packaged products within the last 3 month and around half of those had purchased such a product. Noting that the AIHW itself acknowledges underreporting of tobacco consumption in its consumer survey and this is likely to be much higher with respect to illicit consumption, this would indicate approximately a quarter of a million Australians purchasing an illicit tobacco product. When combined with the fact that one-third of adult smokers were aware of unbranded tobacco and around half of those had smoked it during the course of their lifetime, there is every reason to believe that Australia has an enormous illicit trade problem.

BASCAP also observed that the AIHW measure for the long term trend of daily smokers has continued at about the same rate gradual decline, despite the introduction of plain packaging and significant excise tax increases during that period. Further, the survey revealed a worrying increase of the observed smoking rate for 12-17 year olds from 3.8% to 5.0% between 2010 and 2013, which may be caused by the excise increases and plain packaging during this period. These figures suggest that this vulnerable age group may have turned to the illicit tobacco trade as a source of cheap tobacco which has the brand appeal of being different from plain packaging as has been reported in the media. It is somewhat paradoxical that the age group which the Australian Government seeks to protect through measures such as increased excise duty and plain packaging is the very age group most at risk from illicit tobacco.

d) Oxford Economics and the International Tax and Investment Center

In a comparative study on illicit tobacco in the Asia-Pacific region³, UK based Oxford Economics and the International Tax and Investment Center estimated that total tobacco consumption in Australia was up in 2013 compared to 2012. The same report also estimated that tax revenue losses in Australia due to illicit trade in 2013 was in the region of \$1.3 billion dollars.

e) Empty Pack Survey (EPS) Australian Sampling Plan 2015⁴

While the EPS revealed that only 0.19% of manufactured cigarettes consumed in Australia were from counterfeit flows, the survey showed an increase from Q4 2014. Worryingly, the first instances of major international manufacturer counterfeit plain packs were discovered in February 2015.⁵ Further, there is anecdotal evidence that plain packaging has brought about a proliferation of 'plain pack' illicit white and grey market brands which are no longer distinguishable from the legal market because all packs look the same, preventing effective law enforcement and deceiving consumers into thinking they are buying legal products.

5. Role of Commonwealth law enforcement agencies in responding to illicit tobacco growth

While BASCAP commends and fully supports Commonwealth law enforcement agencies in their work, we believe that official figures and recent seizures highlight the on-going problem of illicit tobacco.

We respectfully draw the Joint Committee's attention to the Australian Customs and Border Protection Service Annual Report 2012-2013. The report revealed that detentions stemming from the illicit tobacco trade nearly doubled from 45 persons to 76 persons between 2011-2012 and 2012-2013. Additionally, the number of cigarette sticks seized rose from 141 million to 200 million from 2011 to 2013. This corresponded to an AU\$26 million increased loss in tobacco excise duty to the Australian Revenue from AU\$125 million in

³ <http://www.oxfordeconomics.com/asia14>

⁴ Page 37 of KPMG report

⁵ 'Fake cigarettes spark counterfeit flood fear', The Australian, February 2015.

2011-12 to AU\$151 million in 2012-2013. Furthermore, Government figures show that seizures of illicit tobacco rose by 60% between 2011-2012 and 2012-2013 with 183 tonnes of tobacco and 200 million cigarettes detected by the authorities.

6. Involvement of organised crime

BASCAP believes there is a growing gulf between the legal tobacco trade and illegal tobacco which has been brought about by successive tobacco tax increases and other legislative measures such as plain packaging. This has resulted in a boon for black marketers who sell cheap illegal cigarettes and loose tobacco.

By way of illustration, there have been at least three very substantial seizures over the last three months alone:

- 1) On 30 September 2015, the Polaris taskforce in Sydney announced the seizure of 10 million cigarettes and 5.6 tonnes of tobacco, along with the arrest of 13 people⁶, and later announced further arrests.⁷ They also seized a quantity of cocaine, and millions of dollars in assets from amongst others, members of an outlaw motorcycle gang.
- 2) On 15 October 2015, an Australian law enforcement investigation led to the seizure of almost 10 tonnes of tobacco products from an organized crime syndicate in Melbourne.⁸
- 3) On 16 October 2015, the Minister for Immigration and Border Protection, The Hon Peter Dutton MP announce the creation of a dedicated strike force to target tobacco smuggling by organised crime following the seizure of 71 tonnes of tobacco in an attempt to evade around \$27 million in excise tax revenue, the largest ever seizure in a single operation.⁹

Following the latter seizure, the Minister stated:

“There are clear links to organised crime and we know that groups smuggling illicit tobacco into Australia are also involved in other illegal activities such as narcotics.”

While BASCAP commends and encourages the work of the Australian Border Force (ABF), it occurs to us that if black marketers are willing to smuggle such large consignments of illicit tobacco into Australia, they are simply responding to a growing demand for illicit tobacco brought about as a result of measures like plain packaging for tobacco products and increased excise duty on legal tobacco products.

Significantly, the Australian Crime Commission Report of 2013 stated:

“Involvement in Australia’s illegal tobacco market is perceived by organised crime groups as a low risk, high profit activity: they see it as a market in which large profits can be made with minimal risk of detection or significant penalties. Organised crime has sustained access to cheap tobacco product overseas, which can be illegally imported, avoiding tax obligations to supply the illegal tobacco market in Australia. Many of those involved in illegal tobacco importations are also involved in other illicit markets, such as drugs”.

⁶ <http://www.afp.gov.au/media-centre/news/afp/2015/september/media-release-thirteen-charged-illegal-tobacco-importation-syndicate-shut-down>

⁷ <http://www.afp.gov.au/media-centre/news/afp/2015/october/four-more-charged-over-illegal-tobacco-importation-polaris-joint-waterfront-taskforce>

⁸ <http://www.minister.border.gov.au/peterdutton/2015/Pages/tobacco-seized.aspx>

⁹ <http://www.minister.border.gov.au/peterdutton/2015/Pages/record-illicit-tobacco-seizure-leads-to-new-strike-team.aspx>

7. Other related issues - Dangers of illicit tobacco

As far back as 20th August 2007, the International Chamber of Commerce Counterfeit Intelligence Bureau (CIB) reported that counterfeit cigarettes have been known to contain a mixture of lethal substances well in excess of the toxins found in ordinary cigarettes. CIB pointed out that, when compared to legal cigarettes, fake cigarettes can contain five times the level of cadmium, six times as much lead, 160 percent more tar and 133 percent more carbon monoxide.

In May 2014, the American Bureau of Alcohol, Tobacco, Firearms and Explosives Fact Sheet on 'Tobacco Enforcement' stated:

"The trade of counterfeit tobacco products is also a rapidly growing global problem. Smokers tricked into buying fake cigarettes do not get the product they are expecting. While all cigarettes are dangers and cause disease, counterfeit cigarettes can contain higher levels of tar, nicotine and carbon monoxide than genuine cigarettes. Furthermore, many contain contaminants, such as sand and other packaging materials, including bits of plastic. Since these are illegally manufactured and imported cigarettes, consumers do not know what ingredients manufacturers use in these cigarettes. Counterfeit cigarettes pose a greater health risk to consumers for these reasons."

Globally, trade in counterfeit tobacco products continues to be a major challenge for global enforcement authorities. The World Customs Organization (WCO) has said that there has been "an unparalleled growth in illicit trade of tobacco products over recent years and we need to step up efforts to tackle this problem." The WCO's 2010 Tobacco Report included reporting from 67 of its 177 member customs administrations that 3.2 billion illicit cigarettes (sticks) were seized. The WCO reports that forged tobacco stamps have increased and this suggests an expansion of illegal cigarette production with a noted increase in illicit manufacture.

8. Other related issues – Plain Packaging and Illicit Trade

At the outset, the Department of Health has acknowledged that plain packaging could facilitate illicit trade:

"Manufacturers, importers, distributors and retailers of tobacco products, as well as the Australian Taxation Office, Australian Customs and Border Protection Service, the Australian Government more broadly, taxpayers and smokers would all be affected by any change to the trade in illicit products generated by the move to plain packaging... The efforts of the Australian Taxation Office and the Australian Customs and Border Protection Service to collect tobacco excise and customs duty could be affected by the design of plain packaging. Government revenues could be put at risk if the design of plain packaging made counterfeiting of tobacco easier and enforcement efforts less effective. Smokers' health could potentially be put at greater risk if they consume counterfeit products. This potential impact is hypothetical and cannot be costed."¹⁰

Other agencies of the Australian government have acknowledged this to be true:

¹⁰ "Cabinet In Confidence: Department of Health and Ageing, Regulation Impact Statement: Plain Packaging of Tobacco Products", 27 April 2010.

“[R]equiring plain packaging would make it easier for counterfeit goods to be produced and would make it difficult to readily identify those counterfeit goods.”¹¹

These warnings from the Australian Government have been proven to be true with the passage of time. Counterfeit and illicit white brands in plain packaging have flourished since 2012. One of the clearest examples of a specific aspect of the legislation having this impact, is the effective banning of security features by the Plain Packaging Act (The Act) and Plain Packaging Regulations 2011 (The Regulations). Part 2 of the Regulations provides for the “Requirements for retail packaging of tobacco products”. This detailed and restrictive provision sets out the exact physical features, colour and finish, trademarks and other aspects of retail packaging, failing to provide for security markings, codes or other security features which would enable products to be uniquely identified or otherwise secured. The Act and The Regulations also effectively ban any form of tracking and tracing regime, even though this was conceived of as being a global mandatory requirement in the Framework Convention on Tobacco Control’s Illicit Trade Protocol at the time The Act was first submitted to the Parliament.

Based on the figures set out in the KPMG Illicit Trade in Australia Report, contraband tobacco represents around one third of Australia’s illicit trade consumption, meaning this portion of the market represents around \$500 million in foregone excise tax that the government would otherwise have collected. The proliferation of plain packaged counterfeit and illicit white brands which have been caused by plain packaging represent additional foregone excise tax.

Throughout this submission, a number of references have been made to the impact of plain packaging on illicit trade. In addition those identified by the Australian Government and referred to above, it is appropriate to provide more detail as to the specific mechanisms by which this takes place:

- Plain packaging, working as intended, eliminates branding on tobacco products;
- Commoditised tobacco products without distinguishing features are marketed exclusively on the basis of price, causing intense price competition in the legal market and as against the existing illicit market;
- The availability and relative attractiveness of these lower price commoditised tobacco products, destroys brand loyalty and causes downtrading to cheaper brands or illicit products; and
- Ultimately increasing price pressures, exacerbated by excise tax rises, cause consumers to ‘fall off the bottom of the legal market into the cheaper illicit market.
- The easily availability of illicit products, often in branded packaging, makes them more attractive to consumers.

Such a change is the expected economic response to a measure such as plain packaging and has been borne out by the lived experience. In such a market, it is unsurprising that there has been a dramatic increase in illicit consumption of around 25% since the introduction of plain packaging.

9. Summary

BASCAP believes that the illicit tobacco trade in Australia is a serious and growing problem both in terms of total size and consequences. Recent seizures by law enforcement agencies are illustrative of the demand for illegal tobacco products which has arisen as a result of tax hikes on legal tobacco products and the implementation of measures like plain packaging. BASCAP believes that this worrying trend is only likely to

¹¹ IP Australia briefing note for Parliamentary Secretary for Information, The Hon Richard Marles MP and Minister for Industry and Innovation Senator the Hon Kim Carr, 23 September 2009.

get worse and we anticipate the seizure of even larger consignments of illicit tobacco than have occurred to date. This will only lead to a greater financial burden on the already hard pressed Australian taxpayer.

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