



PHILIP MORRIS LIMITED

Philip Morris Limited

Submission to the Parliamentary Joint Committee on Law Enforcement

Illicit Tobacco Inquiry

A decorative graphic consisting of several overlapping, semi-transparent blue triangles of varying shades, creating a dynamic, abstract shape that tapers to the right.

Excise Bill 1901

“I am of opinion that this clause as it stands will prevent the illicit manufacture of tobacco by storekeepers and others throughout the country.”

Henry Willis, Federal Member for Robertson
House of Representatives Hansard, 20 September 1901

Table of Contents

| | |
|---|----|
| Illicit Trade Inquiry..... | 3 |
| Our commitment: doing our part to put an end to illicit trade | 3 |
| Background to the illicit tobacco trade | 5 |
| What is the illicit tobacco trade? | 7 |
| What is the cause? | 7 |
| Price disparity encourages smuggling | 7 |
| Organised crime makes huge profits for little risk | 8 |
| Excessive taxation and regulation | 9 |
| Inadequate penalties and overstretched enforcement authorities..... | 10 |
| Lack of information and education | 11 |
| The history and characteristics of Illicit trade in Australia | 12 |
| Historical perspective | 12 |
| Culture of illicit tobacco in Australia | 13 |
| Risks associated with illicit tobacco..... | 16 |
| Measuring the size of the problem | 18 |
| KPMG Report Illicit Tobacco in Australia..... | 18 |
| Alternative Measures and Critiques of the KPMG Report | 19 |
| Quit Victoria Estimates..... | 19 |
| NDSHS Estimates | 20 |
| Moving beyond ‘the number’ | 20 |
| Law Enforcement, Policy & Regulation | 22 |
| Commonwealth Law Enforcement Agencies | 22 |
| Department of Health | 22 |
| Joint Taskforces | 23 |
| Revenue Enforcement Focus..... | 23 |
| State Law Enforcement | 23 |
| Organised Crime..... | 23 |
| Effectiveness of Commonwealth Legislation | 24 |
| Recommendations | 26 |
| General Recommendations..... | 26 |
| Agree on the scale of the problem: measure and monitor..... | 26 |
| Public & Private sector cooperation..... | 26 |
| Addressing Supply | 27 |
| Tough penalties and strong enforcement..... | 27 |
| Effective Policy to regulate the supply chain | 27 |
| Technology | 28 |

| | |
|--|----|
| Addressing Demand | 29 |
| Appendix 1: Illicit Trade in Australia in 1825: The Australian | 31 |
| Appendix 2: Addressing Critique of the KPMG Report..... | 34 |
| Endnotes..... | 37 |

Illicit Trade Inquiry

On 2 December 2015, the Parliamentary Joint Committee on Law Enforcement initiated an inquiry into illicit tobacco, with the following Terms of Reference:

“Pursuant to the committee's functions set out in paragraph 7(1)(g) of the Parliamentary Joint Committee on Law Enforcement Act 2010, the committee will examine the use and consequences of illicit tobacco in Australia, including the importation of contraband, counterfeit, and unbranded tobacco as well as domestically grown illicit tobacco.

In particular, the committee will examine:

- a. the nature, prevalence and culture of illicit tobacco use in Australia, including in indigenous, regional and non-English speaking communities;*
- b. the role of Commonwealth law enforcement agencies in responding to the importation, use, manufacture, distribution and domestic growth of illicit tobacco;*
- c. the loss of revenue to the Commonwealth arising from the consumption of illicit tobacco products;*
- d. the involvement of organised crime, including international organised crime, in the importation, distribution and use of illicit tobacco in Australia;*
- e. the effectiveness of relevant Commonwealth legislation; and*
- f. other related issues.”ⁱ*

Philip Morris Limited (PML) would like to thank the Committee for looking into this important issue and is pleased to provide this submission. We would be pleased to appear and present to a hearing of the Committee as appropriate.

Our commitment: doing our part to put an end to illicit trade

Philip Morris International (PMI), our parent company, is the leading international tobacco company, with six of the world's top 15 international brands. Our goals are to provide high quality and innovative products to adult smokers and reduce the harm caused by smoking while operating our business sustainably and with integrity. We aim to reduce the harm caused by smoking by supporting effective evidence-based regulation of tobacco products and through our investment in developing products with the potential to reduce the risk of tobacco-related disease.

Illicit trade in tobacco hurts our business, exposes consumers to substandard products which do not comply with regulations, robs governments and taxpayers of needed tax revenues, takes business away from legitimate retailers and helps fund criminal organisations. According to World Health Organization (WHO) estimates, the illegal, unregulated black market in cigarettes amounts to 600 billion cigarettes a year or 11% of global consumption.ⁱⁱ

The illegal tobacco trade is widely acknowledged not only by the WHO, but governments, law enforcement agencies and public health authorities around the world, along with the legitimate industry as a serious and complex problem, with broad and dangerous consequences. Calls for joint action and a multi-sector approach to eliminate this illegal activity are virtually unanimous and echoed by many.

Fighting illicit trade is a top priority for PMI. We are firmly committed to doing our part in the fight to eliminate the illegal tobacco trade. The stakes are high, and the threat to our business from the criminals behind this illegal activity is real. We sell our products in more than 180 countries around the world including Australia. It makes reputational and business sense for us to ensure that our products are legally sold in the markets for which they are intended.

We are a business with genuine interests to protect and advance in opposing, disrupting and preventing the illicit tobacco trade. Our reputation is invested in being a responsible corporate citizen

with a commitment to demonstrating this in high level strategic and everyday actions and our company's dedication to ethical conduct and regulatory compliance.

Moreover our commitments and investment in combatting illicit trade make good business sense. We lose revenue and market share due to the illegal tobacco trade. Every time an adult smoker in a high-price market such as Australia buys one of our premium brands smuggled from low-price markets, we lose multiples of the revenue we could have earned if the product had been sold in the intended market of sale.

These are the many reasons why we have long been at the forefront in combatting illicit tobacco, doing our part to put an end to the trade:

- Historically, our efforts focused on controlling the sales of our products to our direct customers. Over the many years that have followed, governments' views and expectations changed, requiring that we oversee the flow of our products even when out of our direct control. We have kept pace and continued to expand our controls further through the supply chain.
- Over time, we developed a deeper understanding of the unique nature of illicit trade and implemented a broad range of measures and technologies that are now recognised as effective solutions to further prevent the diversion of our products from the legal supply chain.

Fighting illicit trade remains a top priority for PMI, and we continue to invest significant resources to ensure strong controls in our supply chain, raise awareness, and enhance our understanding of the issue. This includes undertaking a broad series of measures to secure our supply chain to ensure that our products are protected and that consumers get the genuine high-quality product they expect:

- We support sensible, but strict regulations and enforcement measures to prevent all forms of illicit trade in tobacco products, including tracking and tracing, labelling, record-keeping requirements, and where appropriate, implementation of strict licensing systems.
- We implement strong controls in our own value chain, such as track and trace procedures, volume monitoring and customer due diligence procedures. These measures not only have yielded tangible results, but have also become the industry standard. For example, between 2006 and 2014, the volume of illegal PMI products seized in the EU has dropped by 85%.¹
- We work with more than 20 governments around the world on specific agreements and memoranda of understanding to address the illegal trade in cigarettes.
- We have invested over USD150 million to implement a state-of-the-art tracking and tracing solution to secure our supply chain. With this technology, we've tracked the movement of more than 500 million master cases of our products in over 120 countries.
- We have rolled out technology that enables the verification of the authenticity of tobacco products in more than 90 countries.
- We track the movement of our products along the supply chain in more than 700 locations.
- We have provided training to over 11,000 law enforcement officers worldwide in the last few years to help them conduct preliminary forensic analyses of cigarettes bearing our brands.

Illicit tobacco trade is a complex, global and growing problem that can only be solved by the industry, governments, law enforcement and civil society working together. Our significant experience, sincere commitment and global understanding are offered to the Committee by way of the observations and

recommendations made in this submission. No one organisation or institution can eradicate the illegal tobacco trade alone as it requires effective policies, continued focus and coordinated actions by all.

Background to the illicit tobacco trade

Tobacco products are among the most illegally trafficked goods in the world. The global black market is large and growing. In 2015, the WHO ran a global campaign dedicated to 'Stop illicit trade of tobacco products', stating:

"From many angles, the illicit trade of tobacco products is a major global concern, including health, legal and economic, governance and corruption..."

The illicit tobacco market may account for as much as one in every 10 cigarettes consumed globally, according to studies, including information supplied by the global customs community. The European Commission estimates that illicit trade in cigarettes costs the EU and their Member States over €10 billion annually in lost tax and customs revenue.

...the illicit trade of tobacco products is a means of amassing great wealth for criminal groups to finance other organised crime activities, including drugs, human and arms trafficking, as well as terrorism."ⁱⁱⁱ

As with the global trend, the illicit trade in tobacco products is a major issue for Australia, severely impacting small retail businesses and government revenues, while profiting criminals, including major organised crime networks.

There are very significant levels of illicit trade in Australia, not only through being a destination for smuggled products, but across all aspects of the supply chain. For example, there has been a resurgence in unlawful domestic growing by well-known organised crime groups who are vertically integrated and involved at every level of the supply chain, from farming to processing through to control of their own dedicated network of retail distribution, all wholly unlawful.

As such, the concerns raised by the WHO and others around the world are echoed locally by the Government and leading Commonwealth law enforcement agencies.

In 2012, the previous Government acknowledged the challenges of illicit trade and amended the *Customs Act 1901* to create criminal offences for the smuggling of tobacco products and for the conveyance or possession of smuggled tobacco products where the person conveying or possessing the goods knows they were smuggled, providing for a pecuniary penalty of up to five times the duty evaded in addition to up to 10 years imprisonment.

More recently, following an Australian Border Force (ABF) seizure of ten tonnes of tobacco products shipped by air cargo from the United Arab Emirates, on 15 October 2015 the Minister for Immigration and Border Protection, The Hon Peter Dutton MP, said:

"Combatting tobacco smuggling is a high priority for the Australian Government."^{iv}

The following day, the Minister announced a dedicated ABF strike team focused on illicit tobacco following the largest ever seizure of illicit tobacco in Australia. The 71 tonnes of loose leaf tobacco would have cost Australia over \$27 million in legitimate tax revenue had it been successfully smuggled in. The Minister said:

"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."^v

These and many other recent successes are not only a result of the Government's commitment, but a refocusing of law enforcement on illicit tobacco over the last few years. This is reflected in comments from Roman Quaedvlieg APM, then CEO of the Australian Customs and Border Protection Service (now Commissioner of the ABF) last year:

"We have established an Organised Crime Branch, and that is in recognition of the fact that transnational crime has become poly-criminal and polymorphous. In that, I mean by example that organised crime syndicates of a transnational nature, whether they are a resident here or offshore, are engaged in syndicated, sophisticated organised crime which transcends the entirety of the portfolio's spectrum of activities. For example, they may be involved in importation of narcotics, the details of which I have provided you just now. They may be involved in syndicated slavery. They may be involved in human trafficking for the purposes of sexual slavery. They may be involved in the organised importation of illicit tobacco. These are organised crime syndicates that are not just resilient but agile, nimble, flexible and working together with significant assets across the entirety of our areas of operation."^{vi}

In relation to the involvement of organised crime in illicit tobacco, Mr Quaedvlieg went on to say:

"...it is becoming a phenomenon which is much more than in the past as an involvement of serious and organised crime. Serious and organised crime will use the same infrastructural spine upon which it imports prohibited drugs to import tobacco. Let me give you some examples. Tobacco is one of our six primary operational priorities that I set in the middle of last year. In the six months of this financial year to date we have 51 active cases of illegal tobacco under investigation. We have made 46 detections of tobacco for some 80 tonnes of loose leaf tobacco and 20-odd million loose cigarettes. That has a revenue concomitant estimation of around \$52 million. We are seeing an increase in organised crime entities involved in this. I put it down partially to the fact that the excise in duty payable on tobacco is increasing. We are halfway through a four-year incremental increase to a tune of 12.5 per cent."

Following the two seizures referred to above announced by the Minister on 15 and 16 October 2015, Roman Quaedvlieg APM, now Commissioner of the newly formed ABF, said:

"We currently have an operational focus on the importation of illicit tobacco. This illegal activity not only leads to substantial revenue leakage but is increasingly being committed by serious and organised criminal entities which employ sophisticated methodologies and use profits from this activity to reinvest into other crime."

In the last three months alone, we have seized over 100 tonnes of illicit tobacco in Australian seaports and we have worked with our offshore partners and seized almost 60 more tonnes of illicit tobacco that was headed to Australia. The evaded excise on this quantity of tobacco, had it passed the border, would have been \$60 million."^{vii}

Illicit tobacco is also a focal point for the Australian Crime Commission, with their *Organised Crime in Australia 2015* report noting:

"Organised crime remains entrenched within the illegal tobacco market in Australia. It continues to perceive involvement in this market as a low risk, high profit enterprise..."

Since the closure of the legal domestic tobacco production industry in 2006, there has been an ongoing decline in the supply of domestically grown tobacco to the illegal market. However, in May 2014, the Australian Taxation Office Operation Garnet search warrants, with the assistance of the Australian Federal Police, resulted in the largest-ever seizure of illegal locally grown tobacco, located in regional Victoria. About 350,000 mature tobacco plants were seized, which were estimated to have an excise value of A\$15 million."

It is highly likely that the illegal tobacco market will remain attractive for serious and organised crime groups because of the very large profits that can be made with very low risk.^{viii}

What is the illicit tobacco trade?

The illicit trade in tobacco products is defined in Article 1 of the WHO Framework Convention on Tobacco Control (FCTC) as:

“any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase including any practice or conduct intended to facilitate such activity.”

Broadly speaking, illicit tobacco enters or is sold in a market in violation of excise, taxation and custom laws and other regulations, e.g., without payment of import duties, excise tax, or VAT, and in noncompliance with regulatory measures. Illicit tobacco can be genuine products manufactured by, or under the authority of, a trademark owner and sold without payment of applicable taxes, or else counterfeit cigarettes, meaning fakes that have been manufactured without the permission of the trademark owner.

While the KPMG Report Illicit Tobacco in Australia^{ix} (“KPMG Report”, discussed in detail below at page 18) and other publications provide fulsome definitions, the five broad illicit product type categories are set out below.

1. Contraband

Genuine tobacco products that are produced for lawful distribution in the market of intended destination but illegally diverted to a different market, almost always without excise duty paid.

2. Counterfeit

Tobacco products that have been manufactured and have a tobacco trademark applied without the permission of the trademark owner or rights holder.

3. Illicit Whites

Tobacco products that are generally legally produced in a market and which are smuggled into another market where they have limited or no legal distribution. Often, these brands are purpose made for smuggling.

4. Under Declaration

Tobacco products that are produced and distributed in the same country, a portion of which is not declared to the customs or domestic tax authorities and therefore no customs or excise duty has been paid.

5. Unbranded tobacco

Illegal loose leaf tobacco upon which no customs or excise duty has been paid. Known as ‘chop chop’, this form of illicit tobacco is relatively unique to Australia and is typically sold at retail in quantities of less than one kilogram or in boxes of 100 pre-filled tubes.

What is the cause?

The significant profits to be made by criminal organisations from selling illegal cigarettes are part of the reason, but other factors also explain the problem.

Price disparity encourages smuggling

The price of legitimate cigarettes varies tremendously across countries as a result of different tax rates and varying consumer disposable income levels. As shown in **Figure 1**, Australian cigarette prices are

amongst the highest in the world, largely as a result of high levels of taxation. This large disparity between countries incentivises smugglers to target high price countries such as Australia with smuggled tobacco products from lower price countries. Exponentially increasing trade and liberalising flows of people and goods through national borders has exacerbated the problem, significantly reducing the risk for criminal gangs by providing easier access and transportation links.

Figure 1: Price of a pack of 20 Marlboro cigarettes – Australia and selected market map, 2015^x



Organised crime makes huge profits for little risk

Smugglers diverting contraband from their intended market, producing counterfeits or illicit white products cheaply and smuggling them in Australia can make huge profits. Just one shipping container of illicit cigarettes smuggled from the Middle East or South-East Asia could easily generate over \$5 million in profit once landed and on the market in Australia. Following the Operation Minium seizure of nine million sticks of illicit Manchester cigarettes by the Polaris Joint Waterfront Taskforce announced on 30 September 2015, the law enforcement agencies involved advised:

“The cigarettes have a black market value of approximately \$5.4 million and it will be alleged the illegal importation would have avoided tobacco excise and Customs duties of about \$4.77 million.”^{xi}

To date, seventeen people have been arrested in relation Operation Minium, including an outlaw motorcycle gang member, Customs broker, imports manager, freight company operations manager and a Customs underbond warehouse manager, demonstrating the link between organised crime and corruption of the border management process.

Until the passage of the *Customs Amendment (Smuggled Tobacco) Bill 2012*, penalties for smuggling tobacco were theoretically limited to paying a penalty consisting of multiples of the duty evaded, unless some other offence could be made out. In practice, most of these penalties were never paid, with the offender declaring bankruptcy or otherwise avoiding payment.

For example, on 4 February 2013, the then Customs and Border Protection announced^{xii} a successful prosecution for offences relating to smuggling a container filled with 150,000 cigarette sticks and 12,926 kilograms of unprocessed tobacco leaf. A fine of \$7,954,914 was imposed for cigarette smuggling and importing prohibited tobacco. No custodial sentence was available.

However, following the new penalties introduced in 2012, fines levied for such offences have significantly reduced with custodial sentences also providing very little deterrent:

- The first prosecutions in July 2014 yielded sentences of 20 months gaol, to serve three months and a \$100,332 reparation for the defrauded revenue^{xiii};
- More recent prosecutions in August 2015 resulted in 15 months imprisonment, to serve three months, for evasion of duty and GST.^{xiv}

More broadly, the risk of investigations leading to prosecution is very low. The majority of tobacco seizures announced by law enforcement authorities prior to July 2015 do not indicate further investigations or advice of any arrests, which is significant given that the ABF's predecessor organisations and the Australian Taxation Office (ATO) alone have collectively seized hundreds of tonnes of tobacco each year.

Beyond the border, illicit tobacco retailing is highly profitable and virtually without risk. Following a raid in Western Sydney in August 2014, New South Wales Police seized over \$1 million in cash from the premises of a tobacconist and subsequently restrained bank accounts and assets worth tens of millions of dollars.^{xv}

Excessive taxation and regulation

Taxation and regulation play an important role as part of a broader public health policy to reduce smoking rates. However, when taken to an extreme, regulation and taxation of the legal, regulated market makes the unregulated and untaxed black market more attractive for criminals.

The National Tobacco Strategy 2012-2018 notes:

"It is important to ensure that increases in the price of tobacco are accompanied by efforts to prevent and minimise the illicit trade in tobacco."^{xvi}

While recommending a tax increase, the Henry Tax Review into Australia's Future Tax System considered the impact of taxation on illicit tobacco:

"Heavy taxation of any commodity increases incentives for the illegal supply of that commodity. For tobacco, this is a relatively minor problem at current levels of tax. However, if taxes rose significantly, there would be more incentives for illegal production and importation. This makes it more important for policy makers to use instruments other than taxation to address the costs of tobacco consumption."^{xvii}

Following the Henry Tax Review, the actual excise tax policy announced by the former Government was broadly consistent with the recommendation of the Cancer Council Australia and Heart Foundation joint submission to that review^{xviii}, being a 21% increase (actual increase was 25%) followed by a 50% increase (actual increase was 4 x 12.5%). However, even these organisations understood the direct link between excise tax increases and illicit trade:

“However, Cancer Council Australia and the National Heart Foundation of Australia recognise that an immediate 50% increase in price may not be feasible for two principal reasons:

- *A 50% increase in tobacco prices could lead to a significant increase in illicit tobacco trade, until policing capacity is upgraded; and*
- *Such an increase could be difficult for addicted smokers and their families on low incomes to absorb, without adequate investment in cessation support services and other tobacco control measures.*

We therefore recommend that tobacco excise in Australia be increased in two phases:

- *as an interim step, a 21% price increase (up 7.5c per stick); then*
- *following adequate investment in the control of illicit tobacco trade and support services for people trying to quit smoking, a 50% price increase on current prices (up 17.5c per stick).”*

Unfortunately, while their tax increase recommendation was taken up, their advice on illicit trade and the need for greater enforcement was not and their prediction that it would “lead to a significant increase in illicit tobacco trade” has been proven correct. Based on measurements of illicit trade in the KPMG Report on Illicit Tobacco in Australia, since 2012 after the introduction of Plain Packaging and the excise tax increases which have followed, illicit trade in Australia has increased by 25%.^{xix}

It is clear that tax increases that go well-beyond inflation rates give smokers the incentive to increasingly seek out less expensive products. Criminals have taken advantage of this trend by offering illegal tobacco products at a significant price discount compared to legal products. Intelligence provided by investigators engaged by PML indicates that illicit packs of smuggled or counterfeit Marlboro currently sell for \$12, a saving of nearly 50% compared to legal products. Chop chop is sold for around \$35 per box of 100 tubes, roughly a 66% discount to the legal price with loose chop chop sold in bags even cheaper still.

[Inadequate penalties and overstretched enforcement authorities](#)

While the profits may be comparable to drug smuggling or other serious crimes, as noted in the section ‘Organised crime makes huge profits for little risk’ above, the penalties for smuggling cigarettes are much lower. Coupled with the often limited government resources to combat the illegal tobacco trade, it is easy to see why cigarette smuggling has become an attractive proposition for criminals.

Despite the loss of revenue to the Commonwealth, law enforcement authorities have not received dedicated resources to combat the problem.

Recent announcements by Minister Dutton and Commissioner Quaedvlieg are a very positive step, however the ABF has limited resources, legal authority and means of regulatory enforcement beyond the border. In analysing their strategic environment, the ABF and Department of Immigration and Border Protection (DIPB) acknowledge the incredible challenges that they face:

“The total global economy will continue to grow, leading to increased border flows of people and goods. International air and sea passengers are projected to increase 19 per cent to 40 million by 2016-17. Imports are predicted to rise by 14 per cent in international mail, 22 per cent in sea cargo and 54 per cent in air cargo by 2017-18.

While greater volumes of trade and travel will have clear economic and security benefits for Australia, there will be heightened challenges to border compliance and control, particularly when border processes are streamlined in the interest of facilitation, and further impacted by limited time and resources.

All of this will occur against a backdrop of a global shift towards increased urbanisation. New and expanding cities will alter networks for trade and travel in an era of mass mobility shaped by a growing middle class. However, these same networks will be exploited by increasingly sophisticated domestic and transnational organised crime networks for the movement of and trade in illicit drugs and precursors, money laundering, illicit tobacco and firearms, as well as inferior or dangerous counterfeit goods.”^{xx}

Together with the ATO, the ABF is the only Commonwealth authority with a clear responsibility for enforcement against illicit tobacco. At the State level, some states have specific penalties for offences relating to illicit tobacco, yet there is limited or negligible enforcement, outside of the New South Wales Police Force which has targeted illicit tobacco related activity since August 2014. News reports indicate the challenges faced by state law enforcement authorities:

“In March, 2013 Cabramatta police charged a man, who owned a tobacconist in John Street, Cabramatta, with five counts of possessing goods with a false trademark.

“We seized over \$750,000 worth of counterfeit tobacco and the man received a \$2500 fine,” Cabramatta crime manager Detective Inspector Darren Newman said.

“It's obviously a much bigger problem. It's something we focus on and we need to get more information from the public about rogue traders.”^{xxi}

Local government also shares responsibility for enforcing State government legislation related to various tobacco control measures, but lack of resources, powers and the danger involved mean that actual enforcement is limited. For example, the Municipal Association of Victoria prepares an annual report providing:

“an overview of the tobacco education and enforcement activities which were undertaken by Victoria's 79 councils from 1 July 2014 to June 2015 with the funding provided through the three-year service agreements that have been in operation since 1 July 2012 with funding provided by the Victorian Department of Health and Human Services (DHHS).”^{xxii}

The report details Tobacco Retailer Compliance in 2014-2015, noting 473 substantial breaches of Victorian regulatory requirements were identified, however there were no fines issues or prosecutions commenced. The report notes:

“Tobacco retailers have generally been compliant with the tobacco laws, with lack of correct signage being the most common breach of tobacco laws by retailers. A number of councils reported the difficulties associated with the sale of illegal tobacco products.”

Lack of information and education

Relatively low public awareness amongst the general population of the nature of the illicit trade in tobacco products is a concern. With little education about how the illicit trade operates, where illegal cigarettes come from, how they are made, and the extent to which the proceeds fund organised criminal activity, it's not surprising that adult smokers are increasingly purchasing from the black market where they can obtain cigarettes at low cost with little risk of being caught or charged.

The history and characteristics of Illicit trade in Australia

Terms of Reference:

a. the nature, prevalence and culture of illicit tobacco use in Australia, including in indigenous, regional and non-English speaking communities

Historical perspective

Australia has a long and intimate history with illicit tobacco. Attached to this submission is a collection of articles from the National Library Archive, covering news reports of illicit tobacco from the early 1800s through to the 1940s.

One of the articles clearly demonstrates that the illicit tobacco was an issue from the first instance of tobacco regulation in the earliest days of the Australian colonies following the issuing of a proclamation imposing the first levy on spirits and tobacco in the Colony of New South Wales on 4 February 1825 (full article at Appendix 1: Addressing Critique of the KPMG Report):

“This low price has been, and is now by most people attributed to there being a large quantity-brought into the Country, when a duty of sixpence only was levied; and it has been vainly imagined that, when that quantity was consumed, the utility of a duty of four shillings would begin to be experienced. We might be of this opinion also, could we be persuaded that no tobacco had been introduced into the Colony since the publication of the Proclamation, dated the third of March 1823. We might be of this opinion were it not notorious that thousands of Rolls had been smuggled into the Colony since that period, in so open and undisguised a manner as to be detected by cart loads at a time in the public streets, in the face of day.”^{xiii}

Following Federation of the Colonies in 1901, during consideration of the *Excise Bill 1901*, Henry Willis, the Federal Member for Robertson clearly concerned at the illicit trade, in what is now known as chop chop, advised the Parliament on 20 September 1901:

“I am of opinion that this clause as it stands will prevent the illicit manufacture of tobacco by storekeepers and others throughout the country.”

The articles from the National Library Archive reveal the naivety of this hope, detailing a large number of reported cases of people arrested for illicit tobacco related offences.

In 1946, the Queensland Premier requested that the Federal Government launch a Royal Commission into allegations of racketeering and black marketing, after the Queensland Government Health Minister, The Hon Thomas Foley MP, was charged with having illicit tobacco within his control after an Excise Inspector from the Trade and Customs Department found 533 pounds of illicit tobacco at his home. While ultimately found not guilty, the Minister’s brother-in-law was found guilty of related offences.

On 27 October 1948, the Prime Minister, The Hon Ben Chifley MP advised the House of Representatives in relation to an unrelated matter:

“On the 19th October, the honourable member for Wilmot (Mr. Duthie) asked me a question concerning allegations that there is a “racket” in illicit tobacco throughout the Commonwealth and that the Commonwealth Government is being defrauded of thousands of pounds of revenue each month.

The Minister for Trade and Customs has advised that he has no doubt that, despite the vigilance of departmental officers and the police, some cases of trafficking in illicit tobacco go undetected. Trained inquiry officers are, however, constantly on the alert in all States throughout the Commonwealth to combat this traffic and their efforts have met with considerable success. As recently as the 20th October, a case in Victoria of possession of illicit

tobacco was brought before the court and the person concerned was fined £500 on two counts. In that case, a motor car, cutting machines, electric motor and a large quantity of leaf tobacco and cut tobacco were in addition seized as forfeited to the Commonwealth.

Arising out of the investigations in that case, two other prosecutions are pending. Apart from these Victorian cases, eleven cases of manufacture or possession of illicit tobacco have been successfully prosecuted in the courts over the past twelve months. The Department of Trade and Customs at the present time has under consideration a course of action which it is expected will make the disposal of illicit tobacco more difficult and thus greatly reduce the number of cases which go undetected and unpunished.”^{xxiv}

It is interesting to note:

1. In addition to forfeiting property and the chop chop tobacco, the fine for possessing illicit tobacco was equivalent to around \$30,000 in today’s monetary terms^{xxv}. This is far more than the actual financial penalty imposed in more recent cases reported in the media;
2. The Government’s acknowledgement that despite the vigilance of departmental officers and the police, cases of trafficking in illicit tobacco went undetected; and
3. The Prime Minister’s absolute confidence that the Department of Trade and Customs was pursuing a course of action expected to make illicit tobacco more difficult and reduce the number of cases that go undetected.

Culture of illicit tobacco in Australia

In June 2002, the Australian National Audit Office (ANAO) conducted a review of the ATO Administration of Tobacco Excise. The report notes:

“1.21 The illicit tobacco trade began in Australia when people sought to avoid business franchise fees imposed by some States and Territories on tobacco products.¹ Since then, the factors noted in paragraph 1.20 have changed the extent and nature of the illicit tobacco trade significantly and include:

- *increased smuggling of tobacco product into Australian domestic markets;*
- *increased smuggling of counterfeit tobacco product into Australian domestic markets;*
- *increased diversion of Australian-produced underbond stock for export into domestic markets (eg. diversion of duty-free tobacco product); and*
- *the increased production and sale of Australian-produced tobacco, upon which excise has not been paid.”^{xxvi}*

The ANAO went on to describe the illicit trade at the time of the review, which focused on chop chop:

“Manufacture and distribution of chop-chop

1.31 Prior to 1997, the manufacture and distribution of chop-chop was not systematic. However, since that time, there is evidence to indicate that the manufacture and distribution of chop-chop is becoming more systematic. This is supported by an increase in the seizures of chop-chop (refer to Table 4.1 in Chapter 4) and sophisticated equipment used to produce chop-chop and manufacture cigarettes on a large scale, by the ATO. The ANAO also confirmed that Commonwealth law enforcement authorities have evidence to link organised crime groups to the trade in chop-chop.

¹ The footnote in the report states *“Illicit trade (at the time of business franchise fees) concerned mainly the unauthorised transportation of tobacco product between States. For example, tobacco product was transported illegally between New South Wales and Queensland, as Queensland’s business franchise fees were lower than those in New South Wales.”*

1.32 *The ATO has noted that the distribution networks used by those manufacturing chop-chop are well organised. They often use trucking firms and long haul coaches to transport large quantities of their illicit product.*

Sale of chop-chop

1.33 *The sale of chop-chop occurs through a number of different sources. These include licensed tobacconists, markets, hairdressers, newsagents and milk bars. Often, retailers of chop-chop trade it openly and several investigations by the ATO has shown that until recently it has not been difficult for consumers to purchase chop-chop in particular States. However, recently the ATO's investigators report that it is becoming more difficult to buy chop-chop and retailers are becoming more wary. While chop-chop was available to consumers at a price in the region of \$45 to \$60 per kilogram through 2000–01, recent ATO intelligence indicates that in 2002, the general market price has risen to between \$80 and \$100 per kilogram. In comparison, 50 grams of legal roll-your-own tobacco costs around \$16 (i.e. \$320 per kilogram)."*

Following the ANAO review in 2002, the Australian tobacco industry underwent major changes, as the local growing industry was bought out and progressively closed down, with the ATO ceasing to issue new tobacco growing licences in 2006. As the supply chain of legal tobacco grown in Australia dried up, the opportunity to intermingle illicit crops and loose tobacco with the legal market deteriorated. Anecdotally, illicit tobacco trends shifted to greater proportions of imported loose leaf tobacco and manufactured cigarettes.

In December 2004, the Commonwealth Department of Health and Ageing commissioned a report on *The Medical Consequences of Smoking "Chop-Chop" Tobacco*, which noted:

"One in five smokers in Australia has acknowledged awareness of "chop-chop". Of them, 60% volunteer having smoked it. In Australia, "chop-chop" is usually bought in bulk, often in 250 gram lots and sold on in plastic bags. It is then hand or machine rolled into cigarettes. "Chop chop" cannot be purchased directly but is usually offered, mostly at tobacconists, to regular smoking customers when it is considered safe to do so, as fines for the sale of this are considerable. Recent purchases of "chop-chop" at a tobacconist were costed at \$90 Aus dollars for 500 grams which is approximately ½ the price of equivalent manufactured branded cigarettes.

Sophisticated rolling machines have long been available for loose tobacco and paper and filters have also achieved a degree of sophistication (see Figures 6 and 7) and are often provided by tobacconists free of charge as inducements to buying loose tobacco.

Tobacconists are not the only outlets that have been known to sell "chop-chop". Grocers, pubs, petrol stations and private individuals have been known to traffic in "chop-chop" tobacco."^{xxvii}

The author of that report, Sydney University Professor Renee Bittoun, revealed that little had changed following the official end of domestic growing, quoted in the Sydney Morning Herald on 30 April 2010 in an article entitled *"Where there's smokes"*:

Sydney University professor Renee Bittoun runs Australia's only dedicated smoking cessation clinics in two of Sydney's hospitals. She believes illegal tobacco, both locally grown and imported, is widespread and could account for a quarter of all tobacco being smoked in Australia.

Bittoun fears that the government's increase in excise will further increase illegal tobacco's market share, doing even more damage to the lungs of those who inhale its smoke.

"It is not hard to grow and, given it looks like big spinach, might not normally attract much attention. I have been told the Tax Office loses \$400 million a year in excise due to illegal crops.

Given the size of government excise, chop chop is very cheap and it is often sold under the counter by weight by unscrupulous tobacconists, grocers and even service stations."

She says that although the regulated industry is gone, farmers can easily plant tobacco in an isolated back paddock. "They are paid cash in hand and its distribution is controlled by Mafia-like organised crime organisations.

"My information is that whenever there is a bust and a container of chop chop is seized, legal cigarette sales increase.

While illegal tobacco continues to be grown in Australia - a backyard full of it was discovered in Sydney's famous Bondi only a year ago - most of it comes from overseas.

According to customs officials at wharfs and airports, criminals are importing huge quantities of tobacco products into Australia and officials say they now expect the trade to increase following the hefty tax rise for cigarettes announced by the federal government...

Professor Bittoun says it is difficult to determine how much chop chop is being smoked because people are loath to admit doing something illegal. But a study done in her clinics in 2002 found that 43 per cent of her patients smoked it, with 83 per cent saying they did so because it was cheaper and 58 per cent because they believed it to be healthier.

Overseas evidence confirms the widespread use of illegal tobacco. In 2005, visiting professor Gilbert Geis of the University of California undertook a study of the use of chop chop for the Australian National University. While he refers to the difficulty of establishing real facts on smoking because people play down the amount they smoke, he cites British researchers aware of such underestimation who resorted to examining empty cigarette packets left by fans at a football match. They found 50 per cent were counterfeit, suggesting the cigarettes contained inside were composed of illegal tobacco.

But some health researchers believe the use of chop chop in Australia is not as great as others believe. Rob Moodie, chairman of the Preventative Health Taskforce, which recommended the increased excise and plain packet labelling, says it accounts for about 12 per cent of tobacco use in Australia.^{xxviii}

In 2006, the Australian National Audit Office conducted a Follow-up Audit after its 2002 work.^{xxix} On this occasion, their assessment was far more serious:

"Continued diversion of significant quantities of tobacco into the illegal market

11. The ATO's Compliance Program for 2005–06 identifies illegal tobacco operations as a key priority in the area of evasion and serious fraud. The ANAO concurs with the ATO that the risk of illegal tobacco operations is currently severe. A finding of this audit is that there are reasonable grounds to conclude that each year substantial quantities of tobacco continue to be diverted into the illegal market from Australia's tobacco plantations. Data limitations mean it is not possible to state accurately the precise amount of tobacco that is diverted each year...

Criminality in the illegal tobacco market

13. ATO research suggests that the profit takers, or organisers, in the illegal tobacco market are criminals actively involved in other forms of criminality such as drugs, money laundering, identity fraud, and car rebirthing as well as tobacco smuggling. ATO research shows that this type of highly organised involvement in the illegal tobacco market has intensified over the past three years. This is evidenced by, amongst other things, a degree of 'vertical integration' by, for example, criminal groups having an associate obtain a licence to grow tobacco.

14. The consequences of this criminal behaviour are serious. They include an adverse impact on the integrity of the taxation system as well as on the rule of law generally. The linchpin in

the illegal tobacco market is the collection of groups that purchase illegal tobacco from farmers, process it into a form suitable for sale and distribute the manufactured product to retailers who sell it illegally.”

More recently, it has been reported that Middle Eastern crime gangs are behind a massive boom in the illicit tobacco market in Australia.^{xxx} The Chief Executive of the former Australian Customs and Border Protection Service, Roman Quaedvlieg APM, said:

“Certainly onshore, the people who are involved in the Australian end of the importation are ethnically based crime gangs and predominantly Middle Eastern...”

He also noted the smuggling methodology was changing:

“We are seeing the same scattergun phenomenon which we see in the importation of drugs with illicit tobacco. We are seeing scattergun imports across air cargo, international mail and travelling passengers. The air stream has become an efficient and fast supply chain.”

Risks associated with illicit tobacco

Beyond the obvious risks of illicit tobacco covered elsewhere, some specific risks have been identified which should be considered.

Contaminated products

The Australian National Preventive Health Agency has raised serious concerns about the contamination of illicit tobacco products, especially unbranded tobacco:

“...the use of loose tobacco, or ‘chop chop’, has been associated with illness over and above that cause by commercially produced cigarettes due to bulking agents used such as twigs, raw cotton and grass clippings. Fungal (mould), mycotoxins, bacteria and actinomycetes have also been detected in chop chop. These contaminants have been linked to a number of adverse health effects in humans, including carcinoma of the lung.”^{xxxix}

A report commissioned by the Department of Health concludes:

“The smoking and handling of “chop-chop” tobacco has the potential to induce illness and possible fatality in those who use it. These illnesses may range from allergic reactions, chronic bronchitis, asthma, aspergillosis, alveolitis, pneumonitis, lung cancer to Legionnaire’s disease.”

“Illicit tobacco trafficking is growing and smokers do not readily volunteer that they use this illegal product despite no smoker having been prosecuted for smoking “chop-chop” in this country. It is likely that smokers have had severe medical repercussions from using this type of tobacco but are not aware of the implications nor make the link with the type of tobacco smoked. Health workers are also not versant with the usage nor the possible medical implications of patients smoking “chop-chop” and thus the probable effect of smoking “chop-chop” is not reported. At risk of the possible health consequences of “chop-chop” are those who smoke it as well as authorities and workers who may handle it.”^{xxxix}

Minors have access to illegal tobacco

There is considerable concern that those prepared to sell illicit tobacco will have no hesitation in selling to minors. In July 2010, the European Anti-Fraud Office (OLAF) stated:

“Illegal trade in tobacco undermines public health initiatives to curb tobacco consumption by making cheap cigarettes available in an unregulated environment where they may be sold to vulnerable groups such as minors.”^{xxxix}

The Sydney Morning Herald published a story on 20 August 2014 titled "*Illegal cigarettes 'easy' to obtain in Sydney, say teens*".^{xxxiv}

"Teenagers in NSW are purchasing illegal, original-branded cigarette packets, claiming the original packaging makes them "cooler".

Fifteen-year-old student Rosie said the original packaging detracted from the effectiveness of plain packaging.

"It just makes people more excited about original packaging," she said, "It helps that they are cheaper."

Illegal cigarettes sell for as little as \$8 a packet. A packet of legal cigarettes rarely costs less than \$16.

Ashley, also 15, from Blacktown, agreed.

"The only thing plain packaging does is make original packaging cooler," she said.

Several groups of school students said original-packaged cigarettes were easily obtained at tobacconists in Haymarket and in the western suburbs.

"At our age, everyone does it," said 15-year-old non-smoker Jasmin from Dulwich Hill."

The latest figures from the NDSHS indicate a slight increase in the number of teenagers smoking daily from 2010 to 2013, reversing a declining trend over the last decade.

Measuring the size of the problem

Terms of Reference:

c. the loss of revenue to the Commonwealth arising from the consumption of illicit tobacco products

The negative health policy, revenue and societal consequences of illicit trade are broadly agreed by all relevant stakeholders and interested parties, however the extent of the problem is perhaps the most controversial issue of all. Despite this and successive recommendations to various Government agencies to develop strategies and reliable measures of illicit tobacco consumption,^{xxxv,xxxvi,xxxvii} there is no recent official data source for measuring illicit trade and its impact on Commonwealth revenue.

The last government estimate of illicit trade was published by the ATO in 2006. **Table 1** (with PML analysis) shows their estimate of the illicit chop chop market (loose tobacco only, excluding illicit cigarettes).

Table 1: Illicit Chop Chop Market Based on Australian Tax Office data^{xxxviii}

| Loose Tobacco (kg) | 2004–05 | % of Legal Market |
|--|-----------|-------------------|
| Legally grown tobacco | 3 598 880 | |
| Estimate of diverted tobacco | 347 000 | 9.64% |
| Total seized illegal tobacco (cut and leaf) | 22 444 | 0.62% |

These figures from the ATO suggest that the chop chop market was almost 10%, which together with illicit cigarettes suggests that the total illicit market might be as large or larger than the illicit trade estimated by the KPMG Report a decade later (discussed below). While noting the range of uncertainties inherent in these estimates, the ATO also estimated that it seized less than 1% of the total market.

It should be noted that the ATO are in the process of developing a new tobacco excise and duty gap analysis^{xxxix} and ABF are also looking into the measurement issue, in the absence of an official source, the tobacco industry has commissioned consultants to do so.

KPMG Report Illicit Tobacco in Australia

The methodology and findings of reports by KPMG UK titled *Illicit Tobacco in Australia* (KPMG Report),^{xl} are the most comprehensive and rigorously considered available.

The most recent KPMG Report finds that smuggled or illicit tobacco consumption in Australia now represents 14.3% of total tobacco consumption. This means that one in every seven cigarettes smoked in Australia is illegal and untaxed, costing the Australian taxpayer an estimated \$1.42 billion in foregone excise taxes. Other key findings of the KPMG illicit trade report include (a copy of the latest KPMG Report is attached to this submission):

- Total volume of tobacco consumed in Australia in the twelve months to June 2015 was approximately 17.5kg.
- The price gap between genuine legal cigarettes and illicit tobacco continues to widen. A packet of illicit cigarettes is over \$10 cheaper than legal products, while ‘chop chop’ can be over \$17 cheaper.
- Consumption of ‘chop chop’ is at all-time record levels, up 51% over the 12 months to June 2015, now making up 65% of all illicit tobacco consumption.
- Asian countries, including China and South Korea, are the primary source of illicit cigarettes, where prices can be more than 600% cheaper than those in Australia.

As a data and consumer driven methodology is used, the KPMG Report does not provide information on the source of chop chop, which would not likely be known to consumers.

These findings are also broadly consistent with the Asia 16 Illicit Tobacco Indicator 2014, which uses a different methodology based in part on Treasury data detailing tobacco clearances.^{xii}

Alternative Measures and Critiques of the KPMG Report

The controversy around measurement of illicit trade noted above is particularly strong with respect to the KPMG Report although there is no legitimate reason for this. All reports fully detail the methodology used and the current report contains Appendix 8 'Notes to the Report', which discloses strengths and weaknesses of the methodology, many of which are inherent in measuring any dark or illicit market. It should be noted that in most respects, the assumptions underpinning the report are conservative, giving rise to the possibility that the KPMG Report understates illicit trade, rather than overstates it.

The KPMG Report also provides, in Appendix 9 'Alternative illicit tobacco estimates', a comparison of its consumer survey input to the only other major survey conducted by the Australian Institute of Health and Welfare.

Quit Victoria prepares an oft quoted 'critique' of each KPMG Report released, which is published on the website of the Cancer Council Victoria, though it dwindles annually in terms of its length and number of criticisms. These critiques have now ceased, though coverage continued from 2010 through until the 2014 Full Year report.^{xiii} Appendix 2: Addressing Critique of the KPMG Report deals with these critiques more comprehensively.

Quit Victoria Estimates

In May 2012, following a critique of the KPMG Report, Quit Victoria and the Cancer Council Victoria produced their own estimate of the size of illicit trade:

"The Quit Victoria analysis of the National Drug Strategy Household Survey data from 2010 calculated that the total market for unbranded tobacco was between 1.6 to 2.6% depending on what assumptions one makes about the amounts of tobacco smoked by users of unbranded tobacco relative to users of other tobacco products.

So, perhaps a more realistic estimate of the total use of illicit tobacco products in Australia (unbranded tobacco and cigarettes as well as branded tobacco products (counterfeit and/or contraband) would be more like 2 to 3% of the total market. This equates to about 350 million cigarettes with revenue forgone of about \$165 million."^{xiii}

This compares to the KPMG Report estimate of illicit trade of 11.5% for the same period.

The Quit Victoria and Cancer Council Victoria estimate is referred to widely and frequently by government and the non-government sector who follow this issue, almost religiously by the Department of Health, who have based major policy decisions and advice to the rest of government upon it (refer to Appendix 2: Addressing Critique of the KPMG Report).

The Quit Victoria estimate is nothing short of ridiculous. Their approach relies on a number of fundamental assumptions that are completely unsubstantiated:

1. There is little in the way of methodology to understand the calculations used, nor any of the methodical review, notes to the report and disclosures which are in the KPMG Report and demanded of KPMG by the Quit Victoria critique itself.

2. The basis of the estimate appears to be taken from old National Drug Strategy Household Survey (NDSHS)^{xiv} survey data from 2010, which is not designed to assess the quantum of illicit trade. Quit Victoria have then extrapolated from the NDSHS data, using assumptions on average daily use (as NDSHS does not include data about illicit amounts consumed because this is mysteriously not asked for).

They then 'gross up' the number for manufactured cigarettes (which again the NDSHS doesn't cover) from seizure data taken from the 2010-2011 Customs Annual Report.

It is important to note that this estimate references a point in time when manufactured cigarettes were still a small component of the overall illicit trade problem (under 25%, the second lowest proportion in recent years), following which manufactured cigarettes became a much larger as component (as revealed by Customs subsequent Annual Reports – manufactured cigarettes rose to over 50% of the total quantities seized in 2012-2014).

3. Tying future estimates of the size of illicit trade to the point in time figure exposes the Quit Victoria estimates to significant fluctuations on the basis of Customs sea cargo seizures alone and ignores all other components of the illicit trade.
4. The Quit Victoria estimate implies that Customs, through sea cargo seizures alone, is capturing almost all of the unbranded tobacco coming into Australia, which is nonsensical.

NDSHS Estimates

Looking beyond the KPMG Report, the most recent NDSHS in 2013 surveyed smokers about unbranded tobacco and non-plain packaged tobacco, both reasonable proxies for illicit tobacco. It found:

- 34% of smokers are aware of unbranded tobacco and 3.6% of people admit they "currently smoke unbranded";
- 18.5% of smokers have "seen tobacco products without plain packaging in the last 3 months", 1 in 10 purchased and 1 in 20 purchased more than 15 packets.

Though there may be some crossover between those consuming unbranded tobacco and those consuming tobacco products without plain packaging, the NDSHS data would suggest that around 8.6% of smokers (3.6% unbranded + 5% without plain packaging) are prepared to admit current and regular illicit tobacco consumption.

Given the smokers admitting to less regular use than those included above and the significant underreporting inherent in any such survey, a higher estimate than 8.6% would be more reasonable. While this does not reveal a level of illicit consumption, it sorely stretches the credibility of the Quit Victoria analysis which has been relied on by the Department of Health so completely and uncritically, reliance which has harmed the integrity of Australia's public policy process in dealing with this issue.

Moving beyond 'the number'

Outside of Australia, while there is discussion about the relative accuracy of illicit tobacco estimates commissioned by health authorities, the tobacco industry, law enforcement or other parties, the focus has shifted beyond whichever inherent inaccuracies exist in a particular estimate or report, to recognising that illicit tobacco is a serious problem that must be addressed and that each of these reports may provide something useful that can be learned from trends over time, the shift in smuggling patterns, source countries, prices and other matters that are actually useful in providing intelligence to combat illicit trade.

Over the next twelve months, KPMG (for the tobacco industry), the ATO and the ABF will each be preparing regular estimates of the size of the illicit tobacco market. These should continue to be refined by shared learning between each party, while the Department of Health should produce its own useful estimate or move 'beyond the number' to become a genuinely engaged party seeking to address the illicit tobacco challenge.

Law Enforcement, Policy & Regulation

Terms of Reference:

- b. the role of Commonwealth law enforcement agencies in responding to the importation, use, manufacture, distribution and domestic growth of illicit tobacco*
- d. the involvement of organised crime, including international organised crime, in the importation, distribution and use of illicit tobacco in Australia;*
- e. the effectiveness of relevant Commonwealth legislation*

Commonwealth Law Enforcement Agencies

PML has developed increasingly positive working relationships with the ABF, ATO, Australian Crime Commission and the Australian Federal Police in combatting illicit tobacco.

Many other aspects of the role of Commonwealth law enforcement agencies have been covered in some length in the *Background to the illicit tobacco trade* on page 5 of this submission. That said, the role of the Department of Health, Joint Taskforces and the need for a revenue enforcement focus should be noted.

Department of Health

The Department of Health has primary responsibility for tobacco policy within the system of government in Australia pursuant to the Administrative Arrangements Orders that exist from time to time, including matters of illicit tobacco.^{xlv} The Department of Health led international efforts to secure the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP)^{xlvi} under the WHO FCTC and has provided funding for its development and implementation around the world.

The Administrative Arrangements Orders include specific reference to the *Tobacco Plain Packaging Act 2011*. Based on the definition of illicit tobacco in the WHO FCTC referred to above, The Act provides for the largest penalties for illicit tobacco in Australia (fines in excess of \$1.7 million for manufacturers and \$360,000 for retailers for products sold in non-compliant packaging). The Act provides for strict liability offences, civil penalties and the Department of Health received millions of dollars of funding dedicated to compliance activity in the 2012-13 Commonwealth Budget.^{xlvii}

The Department of Health’s achievements in combatting illicit trade through the use of their very significant powers under The Act are summarised in **Table 2** below.

Table 2: Department of Health Reports Pursuant to s.108 of The Act^{xlviii}

| Annual Report Year | Alleged Contraventions | Criminal Prosecutions | Civil Penalty Orders | Infringement Notices | Warnings Letters |
|--------------------|------------------------|-----------------------|----------------------|----------------------|------------------|
| 2012-13 | 59 | 0 | 0 | 3 | 8 |
| 2013-14 | 59 | 0 | 0 | 0 | 19 |
| 2014-15 | 226 | 0 | 0 | 0 | 0 |

The Department of Health engaged the National Measurement Institute (NMI) to undertake compliance and enforcement activities across Australia, and to report potential contraventions to the Enforcement Committee. However, the rules which apply to the NMI in their work are insufficient to enable them to do their work effectively, with their powers to inspect and investigate being inferior and less effective in their work for the Department of Health, compared to their other work, such as those relating to trade measurement issues. The current administrative arrangements established by the Department of Health to deal with illicit trade matters have caused this mechanism to fail.

Joint Taskforces

The ABF has a clear front line role in guarding against the smuggling of illicit tobacco into Australia. It could and should work with other agencies on this task as required.

Given the existing setup of resources, areas of focus and powers of the other main Commonwealth law enforcement agencies, it is important that they work together to combat illicit trade where possible, including State law enforcement where appropriate.

The three multi-agency task forces targeting organised crime on the waterfront are an excellent example of how agencies can work together effectively. As noted above, Task Force Polaris (New South Wales), Task Force Trident (Melbourne) and Task Force Jericho (Brisbane) have yielded excellent results over the last few years on combatting illicit tobacco and could serve as a model for future work 'beyond the border', perhaps focused on illicit tobacco, especially where supporting revenue focused efforts, discussed below.

Revenue Enforcement Focus

Outside the ABF and ATO, the traditional role of Commonwealth law enforcement authorities has not been centrally driven by the need to protect the Commonwealth revenue. Further, the traditional law enforcement approach to deliver the best results is to focus on the broader criminal network in an effort to dismantle it.

While these also hold true with respect to illicit tobacco, there is a broader revenue enforcement focus required. In economic terms, the wide availability of illicit tobacco in the retail environment, especially in places such as Western Sydney, means that the elasticity of demand for legal tobacco products is impacted. A level of retail focused enforcement designed to impact this component of the market is therefore essential, in order to deliver the Commonwealth Government's revenue objectives.

State Law Enforcement

State-level law enforcement of illicit tobacco appears to be minimal outside of New South Wales, where the Commander of the NSW Police Force Property Crime Squad, Detective Superintendent Murray Chapman, has developed a comprehensive strategy to ensure constant focus on illicit tobacco, especially in the retail environment, while managing the resources impact between different local area commands.

This strategy has been quite effective in reducing the supply of illicit tobacco and with the publicity generated by NSW Police Force media ensuring the anti-illicit trade message is broadcast widely. As the largest if not exclusive recipient of the benefits of state-level enforcement, the Commonwealth should consider how to encourage all State law enforcement authorities to actively enforce against the illicit tobacco trade.

Organised Crime

The involvement of organised crime in the illicit tobacco market has been described quite extensively in the sections above discussing the *Background to the illicit tobacco trade* and the fact that *Organised crime makes huge profits for little risk*. In addition, specific reference should be made to the following international papers which are attached to this submission, detailing the involvement of serious and organised crime and other groups which pose a threat to national security:

1. World Customs Organization: [2014 Illicit Trade Report](#);
2. OECD Task Force on Charting Illicit Trade (TF-CIT): [Illicit Trade: Converging Criminal Networks](#);
3. United States Department of State: [The Global Illicit Trade in Tobacco: A Threat to National Security](#);
4. Financial Action Task Force (FATF): [Illicit Tobacco Trade](#)

Effectiveness of Commonwealth Legislation

Since Federation, the Commonwealth Government has sought to work with the Parliament to bring about an excise tax regime that will fit the purpose of the day, however this has typically been done in a piecemeal fashion, plugging holes as the illicit tobacco smugglers and traders adapt.

Fundamentally, the involvement of organised crime in the illicit tobacco trade emphasises the sophistication of the criminals involved and the need to take this into account when providing an appropriate legislative, enforcement and penalty framework.

Key legislative changes are required as follows:

| Legislation | Recommendation |
|---|--|
| Customs Act 1901 | |
| s233BABAD | <ul style="list-style-type: none"> • The new offence in s233BABAD specifically targeting the smuggling of tobacco and conveying or possessing smuggled tobacco products has dramatically improved the options available, particularly to the ABF. • However, the requirement for the prosecution to prove intent to defraud sub(1)(c) and knowledge in sub(2)(c) make these offences much more difficult to prove beyond reasonable doubt. • Consideration should be given to new offences which step down in degree of seriousness, from much more severe penalties for knowledge and intent to defraud, through to less severe penalties for recklessness, negligence or other roles in the offence, such as transportation, possession etc. • Alternatively, there could be a rebuttable presumption where certain quantities are deemed to be higher level of offence. |
| Penalties & Sentencing | <ul style="list-style-type: none"> • Often, where a custodial sentence is imposed, it is accompanied by a short non-parole period, such as the sentence reverting to a suspended sentence once the non-parole period has been served. Such penalties provide no disincentive. • Courts are not imposing criminal and financial penalties. Such penalties provide no disincentive. • Consideration should be given to minimum mandatory sentences, minimum presumptive sentences or legislating non-parole periods. |
| Beyond the border: wholesale, distribution, storage and retail | <ul style="list-style-type: none"> • At present, there is little to no legal coverage for offences along the supply chain beyond the border, who knowingly or otherwise are in effect a step in the illicit supply chain. Those involved in the illicit supply chain should also face offences and penalties that reflect their role in the broader criminal enterprise. • Offences should also cascade in terms of seriousness based on the level of involvement in the supply chain with the more severe penalties associated with knowledge and intent to defraud, through to less severe penalties for recklessness and negligence. |

| <i>Excise Act 1901</i> | |
|--|--|
| Penalties & Sentencing | <ul style="list-style-type: none"> Penalties for these offences are inadequate. Should replicate the options available and recommended here for the Customs Act 1901, instead of there being an artificial distinction for what is effectively the same offence. |
| <i>Tobacco Plain Packaging Act 2011</i> | |
| Enable use of security features | <ul style="list-style-type: none"> The Act and Regulations, as currently written effectively ban many modern security features from being used on retail cigarette packaging. The Act and Regulations should be amended urgently to enable core security features, such as unique identifier / security codes to ensure they are able to be used to protect the supply chain and to assist law enforcement. |
| Enforcement | <ul style="list-style-type: none"> In its current form, the Act and Regulation have never resulted in a prosecution or even a fine being issued. If the Department of Health is unable or unwilling to use its powers to address illicit trade, then they should be made available to a more conscientious agency. |
| Possession | <ul style="list-style-type: none"> At present, possession of branded products is not unlawful and it must be proven that the products are offered for retail sale. A possession offence and a deeming provision for a set quantity should be introduced to the law. |
| Miscellaneous | |
| Enablers | <ul style="list-style-type: none"> Those that enable crimes but who might not be directly be involved should face prosecution and penalties, as would be the case with other crime types, including property owners or others who assist and enable the underlying offences. |
| Address issue of origin of tobacco | <ul style="list-style-type: none"> At present, when faced with a chop chop store and no knowledge of the domestic or foreign source of the tobacco, neither the ATO nor ABF is comfortable with their legal position in pursuing the matter. This should be resolved, so that either organisation or another Commonwealth law enforcement authority can pursue the matter. |
| Enable investigative techniques and technology | <ul style="list-style-type: none"> Across all the Customs and Excise legislation discussed above, there needs to be clear authority for the ABF and ATO to use surveillance devices, tracking devices, telephone intercepts and other modern investigative techniques and associated technology to facilitate appropriate investigations. |
| Strict liability offence - minimum retail price | <ul style="list-style-type: none"> A deal too good to be true applies to the retail sale of tobacco. A price that is too low is one of the most obvious and effective signs that a product is being sold without the excise having been paid and more broadly that the product is illicit. A strict liability offence should be created for the sale and purchase of tobacco products at retail below a minimum retail price, which should be set at or around the total taxation price of excise plus GST, making it clear to retailers and consumers that any product sold below that price is illicit. This would also make it simpler for law enforcement to investigate, fine and/or prosecute illicit trade offences. Such an offence should be able to be brought by Commonwealth, State and local government officials. |

Recommendations

There are a number of recommendations below with respect to how to address illicit trade through addressing aspects driving both the supply and demand. At a high level, attached to this submission is [The Illicit Trade in Tobacco Products and How to Tackle It - Second Edition](#). At a more detailed level, Interpol has prepared a detail analysis of the legal environment, including their [Legal handbook, Illicit Trade Protocol in the Countering Illicit Trade in Tobacco Products: A guide for Policy-Makers](#).

General Recommendations

A number of areas are fundamental to establishing an effective base for addressing the illicit trade in tobacco products.

Agree on the scale of the problem: measure and monitor

The first step in tackling illicit trade is to develop an understanding of the scope of the problem, its origin, and what is driving supply and demand. Reliable research methodologies exist to accomplish this, however, they have not been applied consistently or globally and remain controversial in Australia despite adoption by responsible law enforcement authorities in Europe and elsewhere around the world. By taking a more comprehensive approach to collecting data about the illegal tobacco market we will improve understanding of trends, product types, volumes, sources, and destinations.

As noted in the section on Measuring the size of the problem above, this research is required to understand size of the problem and while measurement itself is important, it is more important to track trends over time. This means that the work of measuring and monitoring is ongoing. Criminal gangs involved in smuggling are quick to respond to enforcement efforts. They change production centres, smuggling routes, and distribution networks in next to no time. For this reason thorough, comprehensive, and regular monitoring to identify and anticipate changing trends and patterns is essential.

Participate in development of the most robust approach to measure illicit trade, including improving the tobacco industry methodology and sharing learnings and available data for ABF and ATO efforts to develop a measure system for illicit trade.

Measuring the total volume of illicit trade would be ideal, but would not be the only objective, for example:

- Obtaining information on trends, types of illicit trade, source countries, Australian usage demographics etc.
- The Empty Pack Survey identifies types of illicit products, source (country of intended sale), sales channel (duty free or domestic) and location of disposal (as a proxy for location of consumption).

Public & Private sector cooperation

Policy can also be complemented by cooperation agreements between law enforcement, the legal tobacco industry, and others who have a role to play in tackling this problem.

Coordination, resources and time

Stamping out the illicit trade requires coordinated and committed action by the public and private sectors on a continuous basis. Local and international cooperation involving governments, enforcement agencies, manufacturers, retailers and consumers is critical.

We cooperate closely with government and law enforcement agencies and provide support to authorities' efforts to find, track down, confiscate, and destroy illicit tobacco products.

Information sharing is an important aspect of this cooperation. For example, we share intelligence gathered through the several research projects and investigative operations we conduct across the globe every year with the authorities.

On 9 July 2004, PMI entered into a twelve year cooperation agreement with the European Union and 10 Member States to fight the illicit tobacco trade. Additional Member States have since signed and today, all 28 EU Member States are parties to the agreement. The agreement outlines a long-range and comprehensive framework for national governments, the European Commission, and PMI to work together against illicit trade. PMI has gone on to sign many such agreements with national governments and individual law enforcement around the world.

Intelligence

The tobacco industry has developed significant resources to address the illicit trade, constantly investing to develop a better understanding of the market, its drivers and enablers, current volumes and trends, and the way the criminals behind it work.

The intelligence we gather locally in Australia and around the globe through numerous annual initiatives is available to be shared with law enforcement and other authorities to support efforts to fight illicit trade. Feedback also helps the industry to enhance our controls and strategies to further secure our supply chain.

Addressing Supply

Tough penalties and strong enforcement

Implementing laws to criminalise the illicit trade in tobacco products is not effective without adequate enforcement and strict application of meaningful penalties. If not punished adequately, illicit tobacco trade will continue as a low risk, high profit crime.

At present, given the huge profits derived from the illicit tobacco trade, the penalties are much less significant than for those convicted, for example, of smuggling drugs or weapons. This encourages criminals to shift to the illicit tobacco trade. There are several ways governments can make illegal tobacco trade less attractive to criminals, including:

- Deterrent legislation, including asset forfeiture laws and laws that provide for deterrent prison sentences for convicted illicit tobacco traders;
- Well-resourced law enforcement teams, with a mandate to take action against illicit tobacco as a key government priority staffed with trained officers who are knowledgeable about the issue and with the right tools, such as surveillance and tracking equipment, container scanners, mobile scanners for trucks and sniffer dogs;
- Funding intelligence efforts to enable law enforcement to investigate the criminal networks and forging partnerships with the legitimate industry to share intelligence among manufacturers, retailers and the public;
- Implementing a zero-tolerance for anyone in possession of counterfeit tobacco products;
- Routinely destroying seized products and manufacturing machinery where it is found; and
- Entering into agreements with the legal industry to share resources and information.

Fundamentally, legislation of offences should be crafted in such a way that it is possible to achieve a conviction, rather than creating offences which are impossible to prove in a court of law.

Effective Policy to regulate the supply chain

Regulation of the legal tobacco market should assist in identifying when products are being manufactured, sold, or distributed outside of the legitimate supply chain. In large part, the ITP addresses many of these issues and if implemented in an effective and efficient way in Australia, could address many issues with respect to the supply chain.

The following regulatory measures covered by the ITP should be part of the tobacco policy framework to combat illicit trade and apply equally to all participants regardless of the size of their business:

- **“Know your customer”**: Legal tobacco manufacturers, wholesalers, distributors and transporters should be required to conduct due diligence with respect to their customers. This due diligence should include:
 - Verification of a customer’s legal right to trade in or purchase tobacco products;
 - An assessment of whether or not the volumes being purchased are consistent with the customer’s demand or sales;
 - A process for reporting suspicious transactions; and
 - A policy enabling business relationships to be reviewed and terminated when laws have been broken.
- **Tracking and tracing**: Tracking is the ability to monitor finished goods as they make their way through the supply chain from the point of manufacture. Tracing is the ability to recreate the movement of goods up to a certain point in the supply chain to help determine if the product was diverted into illegal channels at some point in the process. Tracking and tracing help to combat the diversion of genuine products. Please refer to the section on Technology below.
- **Record keeping**: The legal tobacco supply chain should be required to maintain complete and accurate records of all relevant transactions for five years and to make records available to relevant law enforcement authorities.
- **Licensing**: Combined with strong enforcement and deterrent penalties, a licensing or equivalent approval system that ensures only legitimate and law-abiding businesses can engage in the manufacture, import and export of tobacco products, manufacturing equipment and key components of cigarette manufacturing, especially cigarette paper and filters. While few of these ‘upstream’ elements of the tobacco industry exist in Australia, the supply of cigarette tubes, papers and filters are essential to the functioning of the illicit chop chop market and should be licenced at the important level and monitored at the retail level.
- **Enforcement in Free Trade Zones**: These tax-free locations were originally developed to enhance global trade and the free flow of goods. Recently however, they have become a preferred place of doing business for smugglers and illicit whites manufacturers. Therefore, the measures highlighted above should be implemented and enforced in these zones. Many seizures by the ABF have been linked to tobacco products produced in or transported through Free Trade Zones. The BASCAP report, *Controlling the Zone: Balancing facilitation and control to combat illicit trade in the world's Free Trade Zones*,^{xlix} provides useful recommendations in relation to this issue.
- **Control of key components**: Cigarettes are made of three main components: tobacco, paper, and filter. Without any of these components cigarettes, legal or illegal, can’t be produced. Implementing strict controls over the production and supply of each of these key components can therefore be one way to make the production of illegal cigarettes more difficult for criminals.

Intermediaries involved in the supply chain should also be regulated to eliminate global supply chain vulnerabilities. Applicable beyond the tobacco industry, BASCAP has also considered this in their report *Roles and Responsibilities of Intermediaries: Fighting counterfeiting and piracy in the supply chain*.¹

Technology

Technology plays a central role in the effective control of legal supply chains and in the fight against illicit trade. We implement cutting edge technological solutions in areas such as product authentication and tracking and tracing that have become the industry standard. In the past, in line with what

governments were expecting from manufacturers at the time, we focused our efforts on controlling the sales of our products to our direct customers.

Over the many years that followed, governments' views and expectations from manufacturers changed, requiring that we oversee the flow of our products even when they are out of our direct control. We have kept pace and continued to expand our controls further down the supply chain. Over time, we developed a deeper understanding of the unique nature of the illicit tobacco trade and implemented a broad range of measures and technologies that are recognized today as effective solutions to further prevent the diversion of our products from the legal supply chain.

There are many technologies that claim to prevent illicit trade but in reality none will stop copies being made or cigarettes being smuggled. However, some technologies can give governments, retailers, and consumers the ability to rapidly determine whether or not duty has been collected on a product, as well as if the product is genuine or fake.

Specifically these technologies can improve the security of the supply chain in three primary ways:

1. **Tracking and tracing** can help address smuggling of tobacco products across borders.
 - **Tracking** is the ability to monitor finished goods as they make their way down the supply chain from the point of manufacture.
 - **Tracing** is the ability to recreate the movement of packaged tobacco products back up the supply chain to a certain point.
 - A track-and-trace regime can contribute to preventing the diversion of tobacco products into illegal channels.
2. **Authentication** can help address counterfeiting.
 - **Authentication** is the ability to determine genuine products from counterfeit.
 - One of the most secure authentication solutions used today by various industries is to print a unique code on each and every pack. This code can then be scanned (e.g. with a smart phone) by consumers, retailers and law enforcement officials to determine whether or not that pack is genuine.
3. **Digital Tax Verification** can help to address tax evasion.
 - **Tax verification** involves verifying that the declared volume of tobacco products manufactured matches the amount of excise tax due and paid.
 - Digital fiscal marking of tobacco product packaging is used in many countries around the world as a tool to verify the payment or collect tobacco taxes. Codes that are directly printed on, or attached to the pack, are very common ways of doing this. The markers are used by auditors to ensure the number of codes or stamps used by the manufacturer match the number of tobacco products sold, in stock, or rejected during the production process.

All of these technologies can contribute significantly to tackling illicit trade and should be considered as part of a comprehensive strategy.

Addressing Demand

Awareness and Education

There is a lack of awareness about the reality of the illicit cigarette trade that can only be resolved through educating the public. As such, raising public awareness about illicit trade and its consequences is key to tackling the demand for illegal cigarettes. PML promotes awareness campaigns in several countries that are designed to inform the public and raise governments' attention to the negative consequences of illicit trade. We also educate retailers about the serious implications of selling illegal cigarettes and offer advice on how to avoid becoming involved in the illicit trade.

One of the most effective ways of reducing illicit trade is to help consumers identify the difference between legal and illegal products and the risks involved in purchasing illegal cigarettes. Unfortunately, low public awareness and understanding of the issue means that many smokers buy cheap, illegal cigarettes with little knowledge of where the product comes from, what it contains or the extent to which their money is contributing to fund organised criminal activity.

Public information campaigns are essential

Informing consumers about the societal and financial impact of the illegal cigarette trade, as well as publicising seizures made by enforcement authorities and prosecutions must be a core component of any plan to tackle the illegal tobacco trade. A 2009 report conducted by BASCAP observed:

“Only when consumers appreciate the full repercussions of their counterfeit purchase can they be expected to stop the practice.”

Numerous parties, including government agencies, tobacco manufacturers, media outlets, cross-industry groups and associations and legal retailers, can and should play an important role in developing education campaigns. Broad use of local and national media to raise public awareness of these campaigns is also critical and is an approach effectively adopted by the European Anti-Fraud Office (OLAF).

Appendix 1: Illicit Trade in Australia in 1825: The Australian

The following article was written following the proclamation imposing the first levy on spirits and tobacco in the Colony of New South Wales on 4 February 1825 and provides one of the earliest analyses of the challenges associated with regulation and excise driving up illicit trade. Dr Robert Wardell and William Charles Wentworth, publishers of the *Australian*, wrote of the challenges facing policy makers and excise collectors:

“It may very fairly be argued that, under the laxity of the system which has hitherto existed in the Collecting of Duties, and during a total absence of a custom-house establishment, one shilling a pound on tobacco is more protective to 'the cultivator, than four shillings. The question indeed almost reduces itself to this — whether a nominal duty of four shillings, or a real duty of one shilling, is the more efficacious.

A high duty hanging in terrorem over the importer, but easily evaded, or a low duty, about which it is worth no pedlar's while to incur a risk; and to avoid which would not repay the trouble, expense, and anxiety necessarily attendant upon smuggling. In regulating this duty then there ought to be considered under actual circumstances not so much what duty is necessary to afford, a positive and complete remuneration to the cultivator; as what duty can be imposed with a prospect of levying it and of ifs approximating as nearly as possible to that remuneration, without holding out inducement to illicit dealings.

It is easy enough to impose, but not so easy to levy a duty in a Country affording unbounded scope to smuggling. To impose a duty of four shillings a pound, without concomitant arrangements for ensuring the payment of it, would be holding out false allurements to the cultivator, and offering a bribe for the commission of frauds. Ruin to the experimentalist who had devoted his capital to a useful, and as he thought profitable purpose, would be the inevitable consequence, while the morals of the common people enticed by the hope of acquiring great gains rapidly, would be effectually undermined and destroyed.

It is impossible conscientiously to punish with severity a crime, to prevent which, no pains or precautions are adopted. Punishment in such cases might more justly be visited on those who thoughtlessly expose the weakness of human nature to trials which experience tells us it cannot at all-times resist. It is also impossible to prevent smuggling, without the aid of severe penalties, without the terror of a severe accountability on detection. Tobacco for a length of time has seldom exceeded in price three shillings and sixpence, and from that to four shillings currency, notwithstanding [sic] the supposed existence of a duty of four shillings sterling.

This low price has been, and is now by most people attributed to there being a large quantity-brought into the Country, when a duty of sixpence only was levied; and it has been vainly imagined that, when that quantity was consumed, the utility of a duty of four shillings would begin to be experienced. We might be of this opinion also, could we be persuaded that no tobacco had been introduced into the Colony since the publication of the Proclamation, dated the third of March 1823.

We might be of this opinion were it not notorious that thousands of Rolls had been smuggled into the Colony since that period, in so open and undisguised a manner as to be detected by cart loads at a time in the public streets, in the face of day. We might in short be of this opinion, could we believe that by increasing [sic] the profits of smuggling, and the inclination, to smuggle would be diminished. And that these profits must be increased [sic], is evident from this fact; — that when the stock on hand in the Colony, on which has been paid sixpence duty, is exhausted, the smugglers would have the trade to themselves— they would have a monopoly. There could only be smuggled and unsmuggled [sic] tobacco in the market — that which had paid no duty at all, and that which had paid four shillings duty; and it is quite certain

that there would be none of the latter, except an inconsiderable portion which might pass through the bonded stores as a blind for dealing in it.

Surely if illicit traffic were sufficiently lucrative to enable persons to compete with the price of tobacco which had only paid sixpence, it would be at least equally lucrative, equally tempting, when they had only to compete with tobacco, paying four shillings. It would surely enable them further to go to great expense in order to bring it circuitously from the Coast over the Country—through the Bush, or in a variety of ways to elude the vigilance of guards and preventive servicemen, or even to bribe these with a share of the spoil, should a horde of them be appointed to protect the revenue. But let us suppose that a preventive service could check, or even effectually put a stop to smuggling, and we by no means think that they could not, were they honest and active; where is the use of tempting the integrity of men, by imposing a heavy duty, (while no measures are taken to enforce it) which would invariably be eluded in preference to a smaller one, which would always be paid.

Let us have high duties by all means, let us protect the cultivator, and make tobacco a staple article of commerce, if possible. But this is not to be effected by the jumble and jargon of a confused and unintelligible Proclamation, with all its corrections and emendations. It is not indeed, to be done by any Proclamation alone. And what hopes have we at present in prospect, that anything else but this “blank cartridge” will or can be made available?

The Revenue of the Colony has already been drained to the dregs, and is threatened to be kept in a state of constant exhaustion by such sinecure appointments as. Clerk to the Council, and a variety of other things equally absurd, equally abominable. It has been already too much drawn upon, for one purpose or other; too many buildings have been commenced, and only commenced; too many systems of internal regulations have been projected and only projected, to give us any promise of security being provided against smuggling, or to afford us any room to anticipate, the erection of custom houses, and the organization of a regular preventive service. Until these be made the accompaniments of a Proclamation, and an Act of Parliament, the settlers may rest assured, that they are infinitely better off with a duty of one shilling, than with one of four shillings.

To render foreign tobacco contraband altogether, might narrow the mischief done to the grower in admitting it without a heavy impost; as such a regulation would necessarily confine the hazardous trading in it to a few persons of desperate means. The mere having in possession, after a short lapse of time, would afford such strong presumption of illegal trading, that no one of character would like to subject himself to suspicion, much less to danger. Even this provision might prove abortive, if the imported tobacco could be so disguised as to assume the appearance of Colonial grown. But this is a matter of no consequence at present; for the measure is entirely without the boundaries of the Governor’s Authority, — the Act of Parliament being altogether silent on the subject of prohibition, whatever it may have done with respect to the imposing of duties. The cultivators of tobacco however have a right to all the protection that this and the British Government can afford— they have applied their capital on the faith of, and with a dependence on both, and under the expectation of receiving all the encouragement which politic and useful legislation can confer. After all the pains and industry employed in ascertaining what maybe most beneficial the Governments may fail; still, however, the settlers are entitled to those exertions, be the result what it may — be their effect prejudicial to, or fully protective of, the interests taken in hand.

The reasonableness and policy of fixing the Duty on Tobacco at one shilling a pound may well be called in question, when it is known from whom information as a basis for legislation, was sought and acquired— from the Merchants! The only persons, besides the consumers, whose interest and advantage it is on all occasions to obtain a minimum of duty on all goods without exception. Duties at all times shackle trade and impede the circulation of money. And it is only from absolute necessity or for some countervailing advantages, such as the encouragement of

the growth of the article at home, as in the present case, that any duties at all are or should be imposed and levied. By these being imposed, the profits of the Merchants are considerably diminished, while the risks they incur from the insolvency of their customers are both greater and more serious. To take them as a guide, was an act of weakness, equalled only by the absurd manner in which the information was collected. An instance did certainly occur wherein Growers of Tobacco, because they happened to unite within themselves the two Characters of Cultivators and Merchants, were appealed to for an opinion. There is one thing, however, connected with this affair, which is satisfactory and pleasing, namely, the proof afforded us of a desire on the part of the Legislator to take opinions, and to pass a Law beneficial to the Country.

A more weighty trust cannot well devolve upon a single individual, than levying rates and duties— so necessary is it to be acquainted with all the intricate interests involved in measures of that description. When a Governor therefore finds himself unequal to the task, it is a happy illustration of correct feeling that he looks for information elsewhere, and does not depend only upon his own conceptions and his own conclusions.

But in collecting opinions that one set of men only should have been appealed to is what we deprecate, not that only one shilling at the present moment should have been imposed. The Proclamation may have prescribed the most advantageous duty, but this, if so, is mere chance, as the Merchants might have recommended any other rate. While they had the means in their power, it is somewhat surprising that they did not consider sixpence or even one farthing a sufficiently protecting Duty, and so contrive to have that sum imposed; for we are bound to suppose that, as their advice was asked and followed — it was requested with the intention of adopting it, and that therefore whatever that advice might have been, it would have equally been followed.”^{li}

Appendix 2: Addressing Critique of the KPMG Report

Based on the executive summary of the Quit Victoria and Cancer Council of Victoria (CCV) document, the critique is based upon three core arguments. These are bulleted below and then explored in greater depth within the table:

1. The average amount of chop-chop per person smoked appears excessive when compared to national averages;
2. Survey results are likely to overestimate the average tobacco smoked due to increased likelihood of smokers and illicit users participating in the survey; and
3. Cigarette packs collected as part of the EPS are likely to overstate the incidence of contraband / imported cigarettes.

In addressing these, the following should be borne in mind throughout:

- KPMG figures are repeatedly compared to NDSHS AIHW figures and assumed inaccurate because of the lower AIHW figures. There are a number of flaws in this comparison:
 - Within the AIHW report it highlights “results relating to illicit drugs (the survey is focused on illicit drug use) are likely to underestimate actual prevalence” with no adjustments made to those figures;
 - AIHW includes smokers aged 14+ which is likely to result in lower average smoking propensity than KPMG’s sampling of those aged 18+ survey due to the lower proportion of smokers aged 14-17 compared to adults aged 18+;
 - The AIHW data is gathered through use of a postal drop survey and is completed by the entire household. Intuitively this method is more likely to understate illicit consumption given the discomfort of disclosing the extent of illicit use to family members;
 - All consumer survey data analysed by KPMG is cross-referenced with additional third party sources, where possible, and these broadly support the figures put forward. This includes the use of the rolling papers analysis, detailed in the KPMG Report itself; and
 - The AIHW report uses data collected by RMR, the same sub-contractor as KPMG.
- The disclosures accompanying the KPMG report are far greater than any other published, peer reviewed report on the subject of which we are aware, that is focused on illicit tobacco consumption in Australia.
- The CCV critique only highlight areas of potential over-estimation of illicit tobacco consumption and does not appreciate those areas where more prudent figures have been made that could under-estimate illicit tobacco consumption, e.g. in the calculation of non-domestic (legal) purchases, KPMG assumes all smoking individuals would bring in their maximum quota. The unbalanced critique could lead to a view that KPMG are over-estimating the amount of illicit tobacco consumption whereby KPMG take all means possible to be balanced.

The table below specifically addresses the main points in the CCV critique of the KPMG Report.

| Critique | Response |
|---|---|
| 1. The average amount of chop-chop / person smoked appears excessive when compared to national averages | |
| <ul style="list-style-type: none"> Based on rolling paper assumptions each chop-chop user smokes 14.5-18.0 chop-chop cigarettes / day. This exceeds national average of 13.8 | <p>The lower end of the estimate is only c. 5% above the national average – not a significant departure from Australia’s largest national survey.</p> <p>There may well be a positive correlation between chop-chop use and daily use. Given the relatively cheaper price of chop-chop one could assume users would smoke more OR those who smoke a lot smoke chop-chop given it’s lower price and the potential financial stress CCV eludes to later in the critique.</p> <p>There is no evidence to determine which of the above conclusions is right, nor have we seen such evidence from CCV.</p> |
| <ul style="list-style-type: none"> Peer-reviewed papers suggest chop-chop users only smoke it occasionally indicating even higher, and more unrealistic, illicit tobacco use | <p>Without a better understanding of the definition “<i>occasionally</i>” and the frequency to which it applies it is impossible to understand the quantum of this difference.</p> <p>The peer-reviewed papers referenced in the CCV critique used differing survey methods (telephone, mail etc.), likely with different questions. This makes effective comparisons across the datasets ineffective.</p> <p>The peer-reviewed papers reference papers written by the authors of the CCV critique themselves.</p> |
| <ul style="list-style-type: none"> Concern that the length of the report and ‘skipping’ of questions may have caused KPMG to confuse their analysis due to varying denominators of summary data produced by RMR | <p>KPMG is aware of the analysis that it performs and any potential limitations. This is then reviewed internally for assurance.</p> <p>Data is analysed on a respondent by respondent basis to provide a consistent view of the average figure for the population.</p> <p>The average completion time for the survey is c. 7 minutes, significantly under the 20 minutes best practice length indicated by RMR.</p> |
| 2. Survey results are likely to overestimate the average tobacco smoked due to increased likelihood of smokers and illicit users participating in the survey | |
| <ul style="list-style-type: none"> Only 2,017 participants of RMR’s 92,527 members responded to survey. This smaller population may represent a greater proportion of smokers / illicit smokers than the total consumer panel | <p>This could be debated from either side – the smaller sample size may potentially over-estimate smoking prevalence, but likewise, could equally underestimate it.</p> <p>RMR follows the National market research guidelines and weights responses to provide results most similar to the overall population.</p> <p>The relative difference in confidence of the data sets is not as large as the difference in sample size. Again this argument appears speculative in nature and there is no evidence to prove this.</p> |
| <ul style="list-style-type: none"> Heavier smokers are more likely to be under financial stress and therefore incentivised to complete the survey for monetary reward. This skews the survey results in favour of more regular smokers | <p>Note that the monetary reward of the survey is a voucher equivalent to AUS\$1. The number of surveys an individual needs to complete to significantly improve their financial situation is too numerous to be a factor.</p> <p>Again this argument appears speculative in nature and to our knowledge there is no evidence to prove this and the RMR survey follows national market research guidelines.</p> |
| <ul style="list-style-type: none"> The percentage of regular participants from one report to the next is not reported | <p>It is unclear how this would specifically increase the likelihood of participants using illicit tobacco in any one survey.</p> |

| | |
|---|---|
| | <p>The fact the survey is done every half year and is compared to previous editions average out fluctuations in individual reports. Data points are confirmed using other sources where possible to negate significant one off variances of a sample.</p> |
| <ul style="list-style-type: none"> • Illicit tobacco smokers find the long survey more interesting given its personal relevance. They are therefore more likely to complete the survey than the 17% of respondents that didn't, thus increasing the proportion of responses that are given by smokers | <p>As previously mentioned in the CCV critique there are a number of 'skips' which remove questions dependent on previous answers. These 'skips' are predominantly initiated in response to a nil answer which would imply non-illicit smokers have fewer questions to answer and are therefore more likely to complete the questionnaire thoroughly.</p> <p>This argument appears speculative in nature and there is no evidence to prove this one way or the other.</p> |
| <ul style="list-style-type: none"> • The rationale for variances in response to 'currently smoking unbranded tobacco' (KPMG: 8.7%, NDSHS: 3.3%) have not been clearly put forward | <p>There is a low response rate to the NDSHS in this section and therefore does not provide strong evidence that the KPMG figures are in fact wrong.</p> <p>As noted above, there are several reasons why the NDSHS data indicates a lower incidence of illicit smokers.</p> |
| <p>3. Cigarette packs collected as part of the EPS are likely to overstate the incidence of contraband / imported cigarettes</p> | |
| <ul style="list-style-type: none"> • Discarded packs collected in the EPS are more likely to be disposed of by younger people, international students or visitors to Australia. All groups are more likely to be smoking illicit tobacco and therefore increase the proportion of illegal tobacco in the EPS • CCV comments that "the report does not state whether exactly the same method of sampling neighbourhoods is used" and this may positively skew the results for the year in question | <p>The EPS also extracts cigarette packs from easy access bins, refuting the critique clearly.</p> <p>There is no evidence to believe the allegations of younger people, international students etc. discard a greater proportion of their cigarettes than the average Australian smoker.</p> <p>The EPS analysis excludes areas of high tourist activity and sports stadia. Pack collections are weighted by population – thus focusing on residential areas.</p> <p>The same routes, areas, cities, neighbourhoods are sampled each time to ensure consistency. Also, the analysis undertaken to calculate Non-Domestic Legal quantities covers the CCV concern around over-estimating consumption by international visitors.</p> |
| <ul style="list-style-type: none"> • The NDSHS publishes significantly lower non-compliant pack figures than KPMG indicating the KPMG figure may be overstated | <p>The EPS is the only method that collects physical evidence and to that end is more reliable and less subject to human error than the NDSHS.</p> <p>The NDSHS also fails to quantify the amount of cigarettes purchased by the most prolific users but instead caps the top figures at 15 – this skews the data towards lower average amounts purchased.</p> <p>As mentioned above, the AIHW explicitly stated that it may under-report the illicit figures and does not adjust them. Such comparisons to the KPMG figures and consequent conclusion that KPMG figures are excessive are therefore speculative in nature.</p> |

Endnotes

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- ⁱⁱ <http://justthefacts.pmi.com/pmis-commitment-doing-our-part-to-put-an-end-to-illicit-trade-3>
- ⁱⁱⁱ WNTD 2015: <http://www.who.int/campaigns/no-tobacco-day/2015/event/en/>
- ^{iv} Ten tonnes of tobacco seized in Melbourne, Minister for Immigration and Border Protection, 15 October 2015:
<http://www.minister.border.gov.au/peterdutton/2015/Pages/tobacco-seized.aspx>
- ^v Record illicit tobacco seizure leads to new strike team, Minister for Immigration and Border Protection, 15 October 2015:
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- ^{vi} Australian Customs and Border Protection Service evidence to the Legal and Constitutional Affairs Legislation Committee on 23 February 2015:
<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22committees%2Festimate%2F726d2567-78be-48ef-a9df-f7302dbb884c%2F0006%22>
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http://www.aph.gov.au/~media/Committees/legcon_ctte/estimates/sup_1516/DIBP/OpeningStatement_Quaedvlieg.pdf
- ^{viii} Organised Crime in Australia 2015, Australian Crime Commission, page 68:
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- ^{ix} *Illicit tobacco in Australia*, 2015 Half Year Report, KPMG: <https://home.kpmg.com/uk/en/home/insights/2015/11/illicit-tobacco-in-australia.html>
- ^x Adapted from *Illicit tobacco in Australia*, 2015 Half Year Report, KPMG:
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- ^{xi} *Thirteen charged, illegal tobacco importation syndicate shut down – Polaris Joint Waterfront Taskforce*, Joint media release with NSW Police, AFP and ACC, 30 September 2015: <http://newsroom.border.gov.au/releases/thirteen-charged-illegal-tobacco-importation-syndicate-shut-down-polaris-joint-waterfront-taskforce>
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<http://newsroom.border.gov.au/releases/attempt-to-smuggle-tobacco-goes-up-in-smoke>
- ^{xiv} *Two prosecutions highlight seriousness of tobacco smuggling*, Australian Border Force, 14 August 2015:
<http://newsroom.border.gov.au/releases/two-prosecutions-highlight-seriousness-of-tobacco-smuggling>
- ^{xv} *Seven businesses raided as part of investigation into counterfeit tobacco trade – SCC Property Crime Squad*, New South Wales Police Force, 8 August 2014.
- ^{xvi} National Tobacco Strategy 2012-2018, page 19, Intergovernmental Committee on Drugs.
- ^{xvii} *Australia's Future Tax System: Final Report*, Part 2: Detailed analysis, Chapter E: Enhancing social and market outcomes, E6: Tobacco taxation: <http://taxreview.treasury.gov.au>
- ^{xviii} *Taxation reform and tobacco excise: best practice for a sustainable future*, Joint submission to the Australian Government review of Australia's tax system, Cancer Council Australia and The National Heart Foundation of Australia:
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- ^{xxi} Over 10 retailers in Fairfield and Cabramatta are selling illicit tobacco, Fairfield Champion, Bianca Perez, 13 May 2015:
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