WHO-EM/TFI/019/E

Tobacco industry activities in the Eastern Mediterranean Region

Illicit tobacco trade

World Health Organization
Regional Office for the Eastern Mediterranean

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Illicit tobacco trade
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In the Middle East, the two main targets for international tobacco companies are the Islamic Republic of Iran and Iraq.

According to a tobacco trade journal, "Iran is the largest consumer in the Middle East and this includes significant cigarette consumption. An estimated 45 billion units are sold each year and consumption is growing at an annual rate of 1 percent."

British American Tobacco (BAT) documents describe Iraq in the following way:

"Subsequent to the lifting of trade sanctions, every effort will be made to tap this large and predominantly Virginia market (30 + bns total market, which is undersupplied by at least 5 bns per year) with our international brands–firstly Benson & Hedges, subject to maximum assurance that stock will not be redirected."

An internal BAT document described the region as follows:

"The Middle East Cluster consists of 12 countries with a total population of 145 million at rates in excess of 3% per annum. Five countries viz Iran, Iraq, Kingdom of Saudi Arabia (KSA), Syria and Yemen account for 90% of the population…The total cigarette market is estimated at 108 billion cigarettes. This could be under estimated by 15–20 billion, mainly in Iran and Iraq where information (as in Yemen) is poor. 49% of the volume is in Iran (26%), Iraq (15%) and Yemen (8%), which have been neglected by us in the past, and where we are our share is either insignificant (Iran and Iraq) or zero (Yemen)."

The BAT document also recognized that:

"Iran, Iraq, Syria and Lebanon have a government monopoly on cigarette manufacturing and in Syria and Lebanon on imports as well…Lebanon permits free imports. Syria allows limited quantities whilst there is a complete ban in Iran. Despite this, or because of this, 62% of Iran's market is Transit."

In 1994, the tobacco company RJ Reynolds (RJR) would estimate the illegal or tax-free market share in the Islamic Republic of Iran at 68%, and the RJR market share (mainly with Winston and Magna) at 50%.

In 1991, Reuters reported that, "An official of the state tobacco company said last year Iranians smoked 30 billion cigarettes a year divided equally between domestic production, government imports and illegal imports mostly smuggled in across the Gulf. Despite occasional crackdowns, smuggled Winstons are sold on every corner."

Note: The references for all quotations in this summary publication can be found in *The cigarette "transit" road to the Islamic Republic of Iran and Iraq: Illicit tobacco trade in the Middle East*, Cairo, Regional Office for the Eastern Mediterranean, 2003, on which it is based.

In its 1994 business plan, RJR openly discussed the respective merits of both smuggling and legal direct import as tactics to conquer the Iranian market.

In fact, the choice between using legal or illegal imports to penetrate a specific market is often discussed in internal tobacco industry documents.

The main problem for international tobacco companies was how to deal with trade restrictions: illegal imports were one option, but more collaboration with the state monopolies was another.

While the companies might start illegally in the short-term, the ultimate aim was to do legal business in the long-term.

Smuggling is often not caused by high taxes, but by competition between tobacco companies to increase their market share, with the ultimate goal being obtaining official import or production capabilities. The strategy became a success story in the Islamic Republic of Iran in 2002 when the state tobacco authority signed an import and production deal with four cigarette companies in a bid to cut down smuggling.

The deal was strongly welcomed by the trade journal *Tobacco Reporter*: "Under the contracts, each company is allowed to legally import its products into Iran's strictly controlled tobacco market. BAT and [Japan Tobacco] have also granted permission to produce their products in Iran. Local production is the golden key for multinationals."

The way the scheme works is as follows:

- Penetrate the market through illegal imports.
- Weaken the state monopoly by reducing the market share of domestic brands and legal sales.
- Stop fuelling the illegal market and take over the market in a legal way.
- Convince authorities to privatize or open the market.
- Authorize the legal import and/or production of foreign brands.

Did you know?

Duty not paid (DNP)–an industry term for contraband–volumes are 12% of total market sales in Africa and the Middle East.

Cigarette smuggling occurs in all parts of the world, even in regions where taxes are low. One internal BAT document estimated that 324 billion, or nearly 6% of world cigarette sales of 5400 billion, were duty not paid (DNP)?

It has been estimated that a third of internationally exported cigarettes are lost to smuggling. Total revenue lost to governments due to cigarette smuggling is estimated at US$ 25 000–30 000 million annually.

DNP volumes are largest in Eastern Europe (around 13%) and Africa and the Middle East (around 12%).

The most common way to buy tax-free cigarettes is to buy cigarettes under the "in transit" regime. During international transit, when taxes are temporarily suspended, many containers disappear and never arrive at their final destination.

Significant sums of money are involved in large-scale smuggling. For example, containers of 10 million cigarettes can be bought without taxes "in transit" for US$ 200 000, but have a current fiscal value (import taxes, excise duties and value added tax) that is three to ten times higher.

Smugglers play hide-and-seek with customs authorities by exporting and importing the containers in different locations around the world over a short period of time, with the objective of making the final owner untraceable, and the intermediate owners as obscure as possible.

Containers with cigarettes are offloaded and reloaded onto other containers, and buried underneath other products, such as paper towels, shoes and furniture.

Foiling the tobacco industry's bogus reasoning:

Smuggling in Iraq is not caused by high taxes, but by competition between tobacco companies to increase the market share of their international cigarette brands. The way to combat smuggling is not to reduce taxes, but rather to control the supply of illegal cigarettes.

According to tobacco trade journals, "Cyprus is an important distribution point for American cigarettes going to the Islamic Republic of Iran through traders in Oman. At the same time, some cigarettes are sold to traders in Turkey who take them into Iraq." Furthermore, "Beirut's imported cigarettes are distributed to traders and merchants in various countries in the Middle East and North Africa…[including] Iran and Iraq…Trucks now carry cargo through Syria into Iraq as well."

In a 2002 lawsuit filed by the European Union (EU) against several international tobacco companies, a detailed schemata of these kinds of smuggling routes emerged:

1. Japan Tobacco, located in Puerto Rico and acting under license of RJR, shipped containers of Winston brand cigarettes from the United States to Valencia, Spain by cargo ship.
2. In Spain, the containers were offloaded and later reloaded onto a second vessel using the Spanish port facilities. From Spain, the containers were shipped to Cyprus.
3. In Cyprus, the containers were unpacked and the Winston brand cigarettes were reloaded into new containers, bearing different markings.
4. Subsequently, the containers containing the Winston brand cigarettes were exported from Cyprus, with Russia as the declared country of final destination.

5. The five forty-foot containers with the Winston brand cigarettes (packed with 5340 master cases) were shipped to Lebanon and then to Turkey.
6. Those five containers were then shipped overland through Turkey to the Habur border crossing and into Iraq.

The cigarette companies often blame organized crime for the massive amount of cigarette smuggling worldwide, but much of the organized criminal smuggling that accounts for the vast majority of cigarette smuggling worldwide has occurred with the knowledge of the major cigarette companies themselves, and would not occur without their compliance.

Despite its professed opposition to criminal activity, the tobacco industry benefits from smuggling in several ways. Smuggling stimulates consumption both directly (through the street sale of cheap cigarettes) and indirectly (through pressure to lower or keep down taxes). Studies of the impact of smuggling show that when smuggled cigarettes account for a high percentage of the total sold, the average price for all cigarettes, taxed and untaxed, will fall, increasing sales of cigarettes overall. The threat of smuggling has been used to avoid trade barriers or force open new markets.

The recent EU allegations on smuggling into Iraq attracted wide media coverage as they concerned billions of cigarettes exported by an American company to a country under embargo and considered by the United States government to be a public enemy.

The EU allegations are in line with the well known methods of the cigarette smuggling scheme:

- Export of billions of cigarettes from major tobacco manufacturers.
- Complex transport routes in order to complicate investigations.
- Offloading and reloading containers and removing marks and numbers from products to prevent their being traced.
- Frequently switched bank accounts to cover up actions.
- Operations led from Switzerland, a country protected by bank secrecy and business privacy laws.
- Offshore companies located in Liechtenstein.
- Use of tax-free harbours, such as Mersin in Turkey.

The tobacco industry has been accused of exporting cigarettes to entities or destinations where the legitimate demand for their cigarettes cannot possibly account for the orders made, and the massive quantities delivered.

The EU lawsuit cites the example of Japan Tobacco getting the approval of Kani, the Kurdish tobacco monopoly, to sell 401 000 master cases of Winston, Magna and Winchester–amounting to more than five billion cigarettes. The amount was far more than the 3.7 million Kurds could possibly smoke. “You’d have to find babies in their cradles smoking,” one official told *The Wall Street Journal*. Asked by the paper where the cigarettes might be ending up, Guy Cote, Japan Tobacco’s spokesman in Geneva, says, “I don’t have a clue.”

Tobacco companies should be obliged to determine the final destination of their products at the time of manufacture, and to supply their products only where there is legitimate demand in the intended final market. It is important to place the responsibility on the tobacco manufacturers; the evidence of their role in smuggling is so compelling that the onus should be placed firmly on them to account for the cigarettes they produce. It should be their responsibility to prove that their cigarettes have reached the intended legitimate end markets.

Manufacturers should know in advance to which country they export their cigarettes. Most countries have specific health warnings and/or tax stamps or markings. These can only be printed or attached at the place of manufacturing. Manufacturers exporting their products should provide information on the country for which the cigarettes are finally destined, provide evidence that there is a market for the products in that specific country, have prominent markings on the products which show the destination country, provide the list of all intermediate traders, and have covert markings which should contain this intermediate trader information.

The reversal of the burden of proof is important. It is hard to imagine any other consumer product being allowed to evade tax on such a scale–one third of global exports finding their way to the contraband market.

Among the clauses in Article 15 of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC)–adopted by the World Health Assembly on 21 May 2003–are the following measures to be adopted by Parties to the Convention:

"(a) require that unit packets and packages of tobacco products for retail and wholesale use that are sold on its domestic market carry the statement: 'Sales only allowed in (insert name of the country, subnational, regional or federal unit)' or carry any other effective marking indicating the final destination or which would assist authorities in determining whether the product is legally for sale on the domestic market; and
(b) consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade."

What are the tobacco industry documents?

The 1998 settlement of tobacco litigation in the American State of Minnesota resulted in over 40 million pages of internal tobacco industry documents becoming available.

The major cigarette companies included are Philip Morris (PM), RJ Reynolds (RJR) and British American Tobacco (BAT).

While there are omissions from the collections, and access to the documents of some companies is problematic, these collections do form a unique opportunity to look at the internal workings of a tobacco company.

For the most part the documents end in 1995, and the bulk of the collection dates from the mid-1970s through the mid-1990s. The materials presented in this report are drawn exclusively from these document collections.

For more information, please consult *The tobacco industry documents: What they are, what they tell us, and how to search them* (available at http://www.emro.who.int/tfi/TobaccoIndustry-English.pdf).