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# REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

## Progress report on the implementation of the Commission Communication "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013)"

## SECTION A: INTRODUCTION

Cigarette smuggling has been a major concern in Europe for some time. The illicit tobacco trade makes cigarettes available at prices lower than those set to discourage smoking. At the same time, illicit products typically do not comply with product regulation, such as labelling. The illicit tobacco trade also causes considerable losses to public revenue: if all cigarettes sold on the black market were sold legally, the budget of the EU and its Member States would receive above EUR 10 billion annually. Last but not least, cigarette smuggling is a source of revenue for organised criminal groups from Europe and beyond, and there are indications that in some instances it is also linked to financing terrorism[1]. Fighting the illicit tobacco trade is therefore also key to protecting the security of the EU[2].

In 2013, the Commission presented a comprehensive Strategy[3] to step up the fight against the illicit tobacco trade. Based on a detailed analysis of the phenomenon of smuggling in the EU and the factors driving it, the Strategy proposed ways to counter the illicit tobacco trade, building on an earlier Action Plan to fight the smuggling of cigarettes and alcohol along the EU's eastern border[4]. The 2013 Strategy was accompanied by a new Action Plan[5] with 50 items to be implemented by the Commission and/or Member States. Strategy and Action Plan were endorsed by the Council through conclusions on 10 December 2013[6]. The European Parliament has recently underlined the need to intensify the fight against the illicit tobacco trade, in particular with regard to cheap whites[7].

This report fulfils a 2013 commitment by the Commission to monitor implementation of the Strategy and the Action Plan[8], with special regard to the specific factors driving the problem. Section **B** of the report offers an overview of the main initiatives taken since the presentation of the 2013 Strategy. Section **C** briefly describes the current situation with the illicit market. Section **D** discusses lessons learned since then and makes some suggestions for further reflection.

## SECTION B: MAIN INITIATIVES IMPLEMENTED SINCE 2013

The 2013 Strategy called for targeted internal and external measures to step up the fight against cross-border smuggling of cigarettes and other tobacco products. The overarching aim of these measures was to secure the legal supply chain, strengthen enforcement and address the incentives underpinning the illicit trade. Ultimately, the Strategy recognised that the territorial limits of national law imply that, in addition to measures taken at national level, only coordinated action at European and international level can adequately address this global phenomenon. With this in mind, several important measures have been taken since 2013:

### 1. Changes to the legislative and policy framework

**a)** At the global level, since the outset the Commission has been in the forefront of the work on the *Protocol to Eliminate Illicit Trade in Tobacco Products* to the *WHO Framework*

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1 See also the UN Security Council Resolution no. 2199 of 12 February 2015.

2 The European Agenda for Security, COM2015) 185 final of 28 April 2015, pp. 4 and 6.

3 COM(2013) 324 final of 6 June 2013.

4 SEC(2011) 791 final of 24 June 2011.

5 SWD(2013) 193 final of 6 June 2013.

6 https://ec.europa.eu/anti-fraud/sites/antifraud/files/docs/body/council_conclusions_en.pdf

7 European Parliament resolution of 9 March 2016 (2016/2555(RSP)).

8 For ease of reference, this report links specific paragraphs to action items in the 2013 Action Plan.

*Convention of Tobacco Control* ('**FCTC Protocol**') (Actions 2.1, 2.2). The Protocol aims to secure the supply chain of genuine cigarettes in particular by tracking and tracing tobacco products by parties to the Protocol, within five years of its entry into force. The Protocol also foresees the licensing of certain activities; due diligence rules for producers, as well as rules for internet sales, duty free sales and free zones. The Protocol also supports international cooperation between enforcement authorities.

Today the Protocol embodies the main response of the international community to the cross-border illicit tobacco trade. Showing its commitment to the Protocol, the EU was among the first Parties to ratify[9] it in June 2016. The Protocol must be ratified by 40 parties before it can enter into force. As of 31 December 2016, 25 parties had ratified, including six EU Member States[10].

The Commission is actively promoting the Protocol within the EU and worldwide, making use of its diplomatic influence in its international relations, including the institutional framework's with Neighbourhood countries (Action 3.2.12) and East Asia (Action 3.2.1). In this context the Commission supported the FCTC Secretariat in organising a Regional Workshop in Myanmar in December 2014. At the 7th Conference of the Parties to the WHO Framework Convention in November 2016, the EU initiated global discussions on implementing the Protocol in the future (Action 3.2.13). The Commission has also provided other financial support to the process since the outset[11].

**b)** In parallel, the EU has updated and strengthened its **tobacco control legislation.** The revised **Tobacco Products Directive**[12] (TPD) was adopted in 2014. In relation to the illicit trade in tobacco, the TPD aims to secure the supply chain on the basis of an EU-wide tracking and tracing system and tamper-proof security features at unit pack level. By implementing the relevant obligations of the TPD concerning tracking and tracing the Member States will also comply with the corresponding provisions of the FCTC Protocol. Cigarettes produced in, or for, the EU Single Market will be tracked and traced under the TPD as of May 2019. The Commission is currently preparing the legislation required to establish the EU's future tracking and tracing system (Actions 2.3, 2.4).

**c)** The EU has also strengthened its investigative tools to detect customs and excise fraud through the reform of **Council Regulation (EC) No 515/97 on mutual administrative assistance in customs matters**[13]. The new Regulation enables investigators to compare physical container movements with import and transit data as well as export data for excisable goods, notably cigarettes. It also facilitates the use of evidence from other EU jurisdictions in national administrative and judicial proceedings. Once fully implemented, the new **Union Customs Code (UCC)**[14] will create an IT environment that contributes to more effective, risk-based customs controls, including in the area of cigarette smuggling.

In a similar vein, in 2014, the Commission adopted an EU Strategy and Action Plan for customs **risk management**[15] to protect the security and safety of the EU and its citizens, the interests of legitimate traders and the EU's financial interests, while at the same time enabling

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9 Council Decisions (EU) 2016/1750 and 2016/1749 of 17 June 2016, OJ L 268 of 1.10.2016, p. 1.

10 Ratification by the EU does not count towards the requirement of 40 ratifications.

11 E.g. most recently from the EU Health Programme (EUR 400 000).

12 Directive 2014/40/EU of 3 April 2014, OJ L 127, 29.4.2014, p. 1.

13 Regulation (EU) 2015/1525 of 9 September 2015, OJ L 243, 18.9.2015, p. 1.

14 Regulation (EU) No 952/2013 of 9 October 2013, OJ L 269, 10.10.2013, p. 1.

15 COM(2014) 527 final of 21 August 2014.

the smooth flow of trade. In July 2016 the Commission adopted a progress report on the implementation of the actions[16].

**d)** In addition, the Commission is currently carrying out an impact assessment on the possible revision of the fiscal framework, namely Directive 2011/64/EU[17] on the structure and rates of **excise duty applied to manufactured tobacco**. An external evaluation report[18] has helped to identify options to reduce administrative burdens and costs for both Member States and economic operators, to reduce distortion within the internal market[19] and also to decrease the incentives driving the illicit tobacco trade. The Commission is currently studying the impact of these options, and in this context is also looking at the definitions and tax treatment of tobacco products across the EU (Action 1.1). Furthermore, it is reflecting on whether to include **raw tobacco** in the scope of excisable goods under Directive 2011/64/EU, which is not the case now. It is therefore currently not possible to use the key tools in the fight against fraud (i.e., administrative cooperation, exchange of information and the Excise Movement and Control System, or EMCS) with respect to raw tobacco.

In this context the Commission has considered harmonising anti-forestalling measures in the EU (Action 1.3). However, this was deemed neither feasible nor desirable by Member States. With respect to the **travellers' allowance** (based on Directive 2007/74/EC[20] on the exemption from VAT and excise duty of goods imported by travellers), the Commission concluded that this issue could be addressed in non-legislative measures[21] (Action 1.2).

**e)** Directive (EU) 2015/849 on preventing the use of the financial system for money laundering or terrorist financing (the '**4th Anti-Money Laundering Directive**')[22] marked a significant step towards improving effectiveness of the EU's efforts to combat the laundering of money from criminal activities and to counter the financing of terrorist activities. It sets high standards to prevent money laundering, such as the requirement for Member States to put in place national registers of beneficial owners of companies and designated trusts. This will help to better track the financial flows related, say, to the illicit tobacco trade and prevent criminals from laundering proceeds generated through such activities.

In addition, the Commission has adopted a comprehensive **Action Plan to step up the fight against terrorist financing**[23]. One of the plan's aims is to introduce measures to criminalise money laundering by establishing a common definition of money laundering offences and sanctions across the EU[24].

**f)** Moreover, the Commission has also taken the initiative of approximating **sanctions** for customs-related offences, including cigarette smuggling. To this effect, it has put forward a legislative proposal[25], which the Council and the European Parliament are currently

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16 COM(2016) 476 final of 19 July 2016.

17 Directive 2011/64/EU of 21 June 2011, OJ L 176, 5.7.2011, p. 24.

18 Study on the measuring and reducing of administrative costs for economic operators and tax authorities and obtaining in parallel a higher level of compliance and security in imposing excise duties on tobacco products http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/studies_reports/ramboll-tobacco-study.pdf

19 COM (2015) 621 of 21 December 2015.

20 Directive EC/2007/74/ of 20 December 2007, OJ L 346, 29.12.2007, p. 6

21 COM(2013) 849 final of 3 December 2013.

22 Directive (EU) 2015/849 of 20 May 2015, OJ L 141, 5.6.2015, p. 73.

23 COM(2016) 50 final of 2 February 2016.

24 COM(2016) 826 final.

25 COM(2013) 884 final.

negotiating. In addition, after political agreement between the co-legislators on a **new Directive on the fight against fraud detrimental to the Union's financial interests by means of criminal law**[26], the Council adopted its position at first reading in April 2017.

In parallel, the Commission has sponsored a study on the effectiveness of sanctions applied in Member States on offences relating to the illicit trade in tobacco (Action 3.3.1). The study confirms that existing penalties for cigarette smuggling and the way relevant legislation is applied in practice in courts differ substantially among Member States.

## 2. Strengthening enforcement authorities and inter-agency cooperation

A major element of the 2013 Strategy was to strengthen law enforcement at EU and Member State level and to enhance cooperation between the relevant actors.

**a)** The **European Anti-Fraud Office (OLAF)** is the only EU's investigative body for the protection of the EU budget, on the expenditure and revenue side alike. The Office's role includes detecting and investigating cases of customs fraud, and coordinating transnational anti-smuggling operations. Revised Regulation No 883/2013[27] governing OLAF's work builds on the experience gained since its creation in 1999 (Action 3.1.19). It codifies past practice and reinforces the effectiveness of OLAF's investigative activities. The Regulation also provides for better cooperation and exchange of information between OLAF and its partners. Since 2012 OLAF's policy-making and investigative functions have been clearly separated. A dedicated policy team focusing on the fight against the illicit tobacco trade has been created. OLAF's work in this area is supported by liaison officers in Ukraine, China and the United Arab Emirates (Action 3.2.10), all of which are important source and transit countries.

**b)** Regulation 794/2016[28] has strengthened the legal framework for **Europol** activities; enforcement powers remain with Member States. The fight against the illicit trade in tobacco is a priority for both OLAF and Europol, and both institutions are now stepping up their bilateral cooperation. This includes reciprocal access to data and technical networks so that the institutions can complement each other and leverage their respective strengths (Action 3.1.20). Discussions are also under way to strengthen **Eurojust**[29] (Action 3.1.21).

**c)** More broadly, efforts have recently been made to strengthen **inter-agency cooperation** in this area. As illustrated below (see point 3), officials from OLAF, Europol, Frontex, the World Customs Organisation and Interpol regularly carry out joint operations (Actions 3.1.17, 3.1.18). Additionally, in 2013 the EU set up a new European Border Surveillance System[30], EUROSUR, to improve Member States' situational awareness and reaction capability in combating cross-border crime and tackling irregular migration (Action 3.1.22).

**d)** The Commission supports Member States with **technical assistance** to strengthen operational and intelligence capacities. The Hercule III programme[31] has a budget of EUR 104.9 million for the period 2014-2020 to help the relevant authorities in the Member States to fight fraud, corruption and other illegal activities. Hercule III supports actions such as the purchase of x-ray scanners (which help to e.g. detect cigarettes hidden in trucks) and

[26] COM(2012) 363 final of 11 July 2012.
[27] Regulation (EU, Euratom) No 883/2013 of 11 September 2013, OJ L 248, 18.9.2013, p. 1.
[28] Regulation (EU) No 794/2016 of 11 May 2016, OJ L 135, 24.5.2016, p. 53.
[29] COM(2013) 535 final.
[30] Regulation (EU) No 1052/2013 of 22 October 2013, OJ L 295, 6.11.2013, p. 11.
[31] Regulation (EU) No 250/2014 of 26 February 2014, OJ L 84, 20.3.2014, p 6.

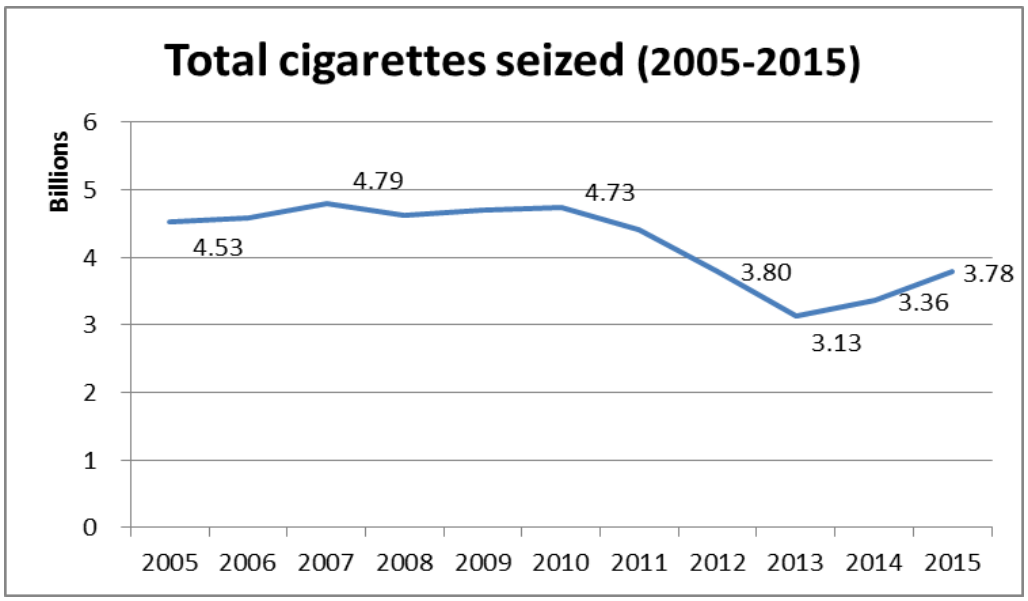
other technical equipment by customs authorities, as well as training activities to share best practices. In addition, the AFIS IT platform (Commission Anti-Fraud Information System) supports other Member State initiatives in this area, such as Joint Customs Operations (see point 3b below). During the lifetime of the former Task Force Greece, the Commission also provided Greek Customs with institutional expertise on anti-fraud matters (Action 3.1.23).

## 3. Stepping up law enforcement: operational activities, risk management and intelligence gathering

Successful policy actions to rein in the illicit tobacco trade must be complemented by **robust and coordinated law enforcement activities**.

**a)** Enforcement agencies in the EU have stepped up their fight against the illicit tobacco trade: **seizures** of illicit tobacco products (predominantly cigarettes), which had been in decline since 2011, are increasing once again. According to figures from the Member States, seizure volumes increased from 3.1 billion in 2013 to 3.8 billion in 2015 (see Graph 1). These numbers are, first and foremost, the result of daily work by the national authorities. Over the last two years, **OLAF operations** contributed to the seizure of more than one billion cigarettes.

***Graph 1: Development of total cigarettes seizures in the EU, 2005-2015***




**b) Joint customs operations** (JCOs) are operational, coordinated and targeted measures, implemented by customs authorities for a limited time, to combat cross-border trafficking in goods. In addition to the operational results, JCOs greatly contribute to stepping up cross-border cooperation and building trust between law enforcement agencies in the Member States. Since 2013, OLAF has organised or contributed to a number of JCOs focusing either entirely or in part on the illicit tobacco trade. Several of these operations (see Table 1) concentrated on the EU's eastern border, since around half of all seizures of cigarettes in the EU take place in the Member States in that region (Actions 3.1.3, 3.1.7).

***Table 1: Major Joint Customs Operations organised across the EU since 2013***

| Year | JCO Name | Led by | Cigarettes seized |
|---|---|---|---|
| 2013 | Romoluk | RO, OLAF | 23 million |

| | | | |
|---|---|---|---|
| 2013 | Warehouse | LT, OLAF | 45 million |
| 2014 | Replica | OLAF | 130 million |
| 2015 | Baltica | PL, OLAF | 13 million |
| 2015 | Romoluk II | RO, OLAF | 3.74 million |
| 2016 | Magnum | EE, OLAF | 11 million |

Furthermore, the Commission coordinated the 'DISMANTLE' Priority Control Action in 2013 and 2014[32] under the common risk management framework with all EU Member States. It lasted over 12 months, led to the seizure of 816 million cigarettes and, based on its findings, a number of specific recommendations for better risk-targeting of smuggled excise goods were presented (Action 3.1.2). In 2015 and 2016 OLAF also supported the 'HANSA' Joint Action Day, implemented by Member States with the support of Europol as part of the excise fraud priority in the EU policy cycle on serious and organised crime.[33]

**c)** Alongside these operational activities in Europe, **global actions** take place. Initiated and coordinated by the World Customs Organisation (in 2014 and, with the support of OLAF and Europol, again in 2016), around 100 customs administrations took part in the GRYPHON I and II operations. They resulted in the seizure of 1.39 billion cigarettes, 287 000 cigars, and several hundred tons of other tobacco products around the globe. Several machines and components used to manufacture cigarettes were also seized, as along with 12 million excise duty stamps. Several illegal tobacco factories were dismantled, and over 150 persons involved were arrested in those two operations.

**d)** Customs authorities have also intensified their efforts to better analyse trends in the illicit tobacco market. Experts met in May 2014 to discuss ways of strengthening **data gathering on seizures** (Action 3.1.12). These efforts, combined with new[34] and improved tools, have provided a clearer picture of seizures across the continent (Actions 3.1.11, 3.1.10).

**e)** When customs authorities seize cigarettes, it is often difficult to link individual seizures in one place to other cigarettes from the same illicit batch seized in another place. Here, **customs laboratories** can provide analytical support to investigators. To this effect, in 2015 the Commission's Joint Research Centre set up a laboratory for the independent analysis of any type of seized cigarettes. The laboratory is also designed to carry out verification taks in the context of the implementation of the anti-fraud agreements with three major tobacco manufacturers (Actions 3.1.8, 3.1.9).

## 4. Enhanced bilateral cooperation with major source and transit countries

To improve cross-border coordination and cooperation in the fight against the illicit tobacco trade, the Commission has also worked bilaterally with key source and transit countries:

**a)** When fighting customs fraud, customs authorities cooperate across borders based on rules on **mutual administrative assistance** in international treaties. Since 2013 mutual

[32] Commission Press Release available here: http://europa.eu/rapid/press-release_IP-14-679_en.htm

[33] The 'EU policy cycle' is a methodology adopted by the EU in 2010 to address the most important criminal threats affecting the EU. Operational Action Plans are drafted annually to coordinate cross-border law enforcement activities on priorities determined by the Member States. Excise fraud is one such priority for the 2014-2017 cycle.

[34] Such as the Tobacco Seizure Management Application (ToSMA) for the processing of seizures under the anti-fraud agreements with the major manufacturers; see SWD(2016) 44 of 24 February 2016, p. 24.

administrative assistance provisions with an additional 14 countries have come into force. Today, treaties including such rules are in place with more than 70 countries.

**b)** Since 2015 experts from Member States and the Commission/OLAF have stepped up their **bilateral dialogues**[35] **on customs issues** in particular with Russia, Belarus and Ukraine. These meetings at technical level seek to improve day-to-day cross-border cooperation, focusing in particular on the illicit tobacco trade (Actions 3.2.4, 3.2.5).

**c)** A key driver for cross-border trade in general and illicit trade in particular, is the big differences in the price differentials between EU Member States and neighbouring countries such as Belarus, Ukraine and Russia. To reduce this fiscal incentive for smuggling, in the association agreements reached with the EU recently, Moldova, Ukraine and Georgia **undertake to raise and adjust** their level of **tobacco excise rates and structures** (Action 3.2.3).

**d)** The EU has an established policy of negotiating **anti-fraud clauses** when granting tariff preferences to third countries. Today, such clauses are in place with many partner countries to promote cooperation in customs investigations that also relate to cases of illicit tobacco trading. Since 2013, anti-fraud clauses have been negotiated with Canada, Georgia, Moldova, Singapore and Vietnam, and negotiations with other countries are ongoing (Action 3.2.11).

**e)** OLAF also uses **administrative cooperation arrangements** (ACAs) with competent authorities in third countries to facilitate practical investigative cooperation. In recent years, OLAF has stepped up the negotiation of ACAs in the customs area. Today, OLAF has ACAs with customs authorities from Australia, Bangladesh, Belarus, China, Moldova, Morocco, Taiwan and Ukraine (Actions 3.2.6, 3.2.7).

### 5. Addressing the demand side of the illicit tobacco market

The 2013 Strategy also saw the need to develop a better understanding of the **demand side**. To this effect, the Commission funded[36] a Eurobarometer[37] survey on people's perception of the illicit tobacco trade. The key findings of this first survey in this area showed that: people's main concern with black-market cigarettes is the loss of revenue for the state; that they buy them because they are cheap; and that the penetration of black-market cigarettes is significantly higher in Central and Eastern Europe. Only 14 % of people believe it is an important source of revenue for organised crime groups (Action 1.4).

## SECTION C: AN UPDATE ON THE ILLICIT TOBACCO MARKET IN THE EU

Despite the implementation of the 2013 Strategy at European and national levels in recent years, **the extent of the illicit tobacco trade in the EU remains overall high and troubling**.

Quantifying a clandestine activity is inherently difficult. With this in mind, **illicit tobacco consumption** in the EU has been estimated by various sources[38] to have remained **broadly stable** – in the range of 55 billion to 65 billion sticks – despite an overall decline in tobacco

[35] Such as under the EU-Ukraine free trade agreement, the Strategic Framework for EU-Russia customs cooperation; the EU-Russia Working Group on Custom Border Issues; or the Action Plan for the EU-Belarus customs dialogue.

[36] The survey was carried out among 27 672 respondents in all Member States in autumn 2015.

[37] https://ec.europa.eu/anti-fraud/public-perception-illicit-tobacco-trade_en.

[38] SWD(2016) 44 of 24 February 2016, pp. 10-11

consumption in the EU[39]. Seizures of illicit tobacco products in the EU have risen by a fifth over the last two years (see point 3a above) which indicates a stable or possibly even growing share of illicit cigarettes. In some Member States the share of the illicit market may well exceed one quarter of the entire tobacco market.

The **average size of individual seizures** has come down over recent years. Smuggling illicit tobacco products in very large quantities, in particular in containers, is less frequent today. Conversely, multiple border-crossings with smaller quantities are gaining in frequency; some of these are organised operations by criminal gangs. These small-scale activities pose different challenges to law enforcement authorities than containerised traffic.

As observed in February 2016[40], the **composition of the illicit tobacco market has significantly changed over the years.** Contraband from the major international producers is much less prominent in large seizures in the EU today than in the past. On the other hand, **cheap whites** and **counterfeits** (including the counterfeiting of cheap whites) dominate in large-scale seizures[41], and in particular in seizures related to containerised transport. In this context, the European Parliament has called on the Commission to take actions setting out new measures to tackle the problem of cheap whites[42].

The increasing consumption of shisha in the EU is reflected in Member States' substantial seizures of smuggled **water pipe tobacco**.

Furthermore, there also seems to be an upsurge in **illicit tobacco manufacturing inside the EU**, which is a hypothesis supported by large-scale seizures of raw tobacco and the discovery of numerous illicit tobacco factories[43]. In increasing illicit production inside the EU, smugglers may be reacting to more stringent monitoring of the EU's external borders.

The countries identified as **key source and transit countries** in the 2013 Strategy remain a source of concern, although the involvement of individual countries seems to be shifting. There now seems to be more diverse sourcing in East Asia, whereas smuggling from China may have declined. Moreover, the weakening of governance structures in countries such as Libya facilitates smuggling in the Mediterranean. Smuggling of Belarusian cheap whites, and transit and illicit production activities in the free zones in the UAE, remain of particular concern.

Criminals and smugglers continue to abuse certain **customs and excise procedures allowing for the movement of goods under duty suspension**. One of the scenarios used, which is lucrative to criminals, is that cigarettes are produced inside the EU and declared for export but are actually not exported or are smuggled back in the EU after export. Similarly, imports can be moved inside the customs union under the transit procedure using multiple fictitious movements in order to conceal the real destination of the cigarettes. Instead, these cigarettes are distributed illegally on the EU illicit market without payment of VAT and excise.

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[39] According to figures compiled by the Commission based on data from Member States, releases for consumption of cigarettes declined from 728 billion (2005) to 486 billion (2014). See http://ec.europa.eu/taxation_customs/resources/documents/taxation/excise_duties/tobacco_products/tobacco_products_releases-consumption.pdf.

[40] SWD(2016) 44 of 24 February 2016

[41] According to Member States' seizure data from 2013, eight of the ten most seized cigarette 'brands' were 'cheap whites'. Of the more than 1 billion cigarettes seized with support from OLAF over the last two years, more than 90% were cheap white 'brands'.

[42] European Parliament Resolution of 9 March 2016 (2016/2555(RSP)).

[43] According to the Polish authorities more than40 factories were discovered in Poland alone in 2016, with an estimated combined capacity to produce several billion cigarettes per year.

## SECTION D: KEY EXPERIENCES AND FURTHER REFLECTION

### 1. Building further on the 2013 Strategy

The **main pillars of the 2013 Strategy and virtually all items of the Action Plan have been implemented**. With the phenomenon persisting and some key measures still awaiting application, work should continue in the current direction with some adjustments:

a) Together, the TPD and the FCTC Protocol will be instrumental to **secure the supply chain** for legally produced cigarettes destined for the EU market, along with cigarettes produced in the EU for export. However, the full effect of both instruments will only be felt in a few years' time.

   Promoting the FCTC Protocol vis-à-vis third countries (as well as Member States) to secure global supply chains and moving forward its internal implementation in the EU will be a key part of the Commission's activities in the fight against illicit trade in tobacco in the coming years. In the end, the illicit trade in tobacco products will be tackled most effectively if the FCTC Protocol is implemented by a framework of coordinated action at international, European and national level.

b) Enforcement authorities such as OLAF have been strengthened and inter-agency coordination is increasing. This **improved enforcement framework** contributed to significantly higher seizures across the EU since 2013. To counter illicit tobacco producers moving their production from outside to inside the EU, a strengthened enforcement at EU level should be discussed, including the powers of OLAF.

c) In this respect, the EU and its Member States have also made progress in **integrating analytical, reporting and IT capacities**. Customs authorities are already upgrading their analytical expertise and capacity to fully exploiting the available data sources[44]. This process could be supported by further pooling the analytical capacities available at European level, for instance by providing access to the relevant IT systems and data bases. Investigators should also be encouraged to fully capitalise on the potential of the tobacco laboratory available at the Commission's Joint Research Centre.

d) **Engagement with key source and transit countries** is gaining traction, although diplomatic initiatives will inevitably take time before they translate into more effective enforcement. There has been good progress in engaging with third countries at institutional and operational level, and bilateral contacts with key countries should be strengthened further. These contacts could also be used to promote the FCTC Protocol and the EU is in a good position to utilise its diplomatic influence to this effect. In this context, an increase in the number of OLAF liaison officers beyond the current three should also be considered, subject to available resources.

e) The enforcement community focuses on the **demand side** for illicit products less consistently as compared to, for example, health authorities. However, some Member States, such as Estonia, have undertaken interesting initiatives in this area, running public awareness campaigns highlighting the links between illicit cigarettes and

[44] Such as the Container Status Messages and the Import, Export and Transit directories set up under Council Regulation (EC) No 515/97.

organised crime. The potential of measures focusing on demand could be exploited more routinely.

## 2. Further reflections

Despite the actions taken so far, the size of illicit trade remains by and large stable. In particular, the phenomenon of cheap whites and counterfeits, while not entirely new, has become increasingly troublesome over the last years. Therefore, now seems to be the right moment for considering additional measures to effectively complement the 2013 Strategy in the future. The following issues are proposed for further reflection:

a) Incentives for smugglers should be reduced. Currently, the main incentive for the illicit tobacco trade is the possibility to exploit **price differentials** between EU Member States and neighbouring countries, but also between markets in EU Member States[45]. One standard 40ft container holding some 20 million cigarettes smuggled into the EU can yield up to EUR 2 million in illegal revenue depending on the tax burden. The level of taxation is a major factor in the price of tobacco products, which in turn influences consumers' smoking habits, following the rules of price elasticity. A certain degree of upward convergence between the tax levels applied in the Member States would help to reduce fraud and smuggling. Neighbouring countries such as Belarus with an excessively low tax rate on tobacco products should be urged to approximate their excise duty rates with the minimum rates in the EU, not least in the shared interests of health policy and raising public revenue.

b) The effect of reduced incentives could be enhanced if in parallel **smugglers' production and distribution costs** were driven up and if sanctions had a sufficiently dissuasive effect. Such initiatives could include:

   i. **Curtailing access to input materials**, which is essential for illicit tobacco manufacturers. Curtailing their access to key input materials would disrupt their business. The European Parliament has called on the Commission to take actions to ensure the effective control of input materials[46]. Apart from manufacturing equipment, three main product groups could be considered in this respect:

      - The control of the movement of **raw tobacco,** currently not subject to excise duty, is under review (see point B1d above). The market for raw tobacco is, however fragmented, with many producers operating both inside and outside the EU.

      - The **paper** used in cigarettes has special features. Monitoring and controlling paper is complicated by the fact that there are numerous paper producers all over the world,

      - In contrast, the number of producers of the **acetate tow** used in cigarette filters is limited, which would increase the prospect of effectively controlling supply. In view of global sourcing possibilities in this industry (not to mention for cigarette producers in third countries), it would, however, be difficult to

[45] The average price for 20 cigarettes in Finland is EUR 5,01. It is only EUR 0,95 in Russia, and maybe half of that in Belarus. Also, a pack of 20 cigarettes has an average price of EUR 2.08 in Poland, compared to EUR 9.09 for the same pack in Ireland (see Frontex Eastern European Borders Annual Risk Analysis 2015, p. 24).

[46] European Parliament Resolution of 9 March 2016 (2016/2555(RSP)).

imagine that a control system limited to Europe could be effective. Therefore, cooperation from industry and their host countries would a priori be required.

ii. **Tightening of the logistics chain exploited by smugglers.** This involves closer monitoring of the customs processes frequently abused by smugglers (see Section C.). The fiscal regime applicable to imported cigarettes is a sequence of tax and customs rules; these are often implemented by different authorities. Cooperation between these national authorities may be further intensified such as by the interoperability of IT systems, for example.

iii. **Sanctions and guarantees**. There are questions as to whether the administrative and/or penal sanctions actually applied in Member States on smuggling offences are sufficiently dissuasive. This is all the more relevant in the context of the internal market, since the attractiveness of the illicit tobacco trade in one Member State can easily trigger significant smuggling activity in another.

Moreover, there are similar questions as to whether the guarantees required by Member States for certain sensitive activities linked to the duty-free handling of excise products (e.g., managing a bonded customs warehouse) are sufficiently calibrated to the illicit profits that criminal gangs can make.

c) The Commission has for years **supported Member States** in the fight against tobacco smuggling. In particular, the Member States on the EU's eastern border are on the front line against the smuggling of illicit tobacco into the EU via land borders. The question, therefore, is whether it would be in the general interest for those customs authorities to receive more targeted support. This question could be looked at as part of the review of the Hercule programme, also taking account of new obligations under the FCTC Protocol.

d) There is an ongoing discussion about whether the current legal instruments, such as the mutual administrative assistance agreements, give sufficient possibilities to systematically **exchange customs data** with neighbouring countries. The Council has therefore called for new instruments[47] to improve this situation, based on the new Article 12 of the Union Customs Code.

e) There are many legitimate **private and state** intermediate **actors** involved in the supply chain, such as shippers, carriers, ports, freight forwarders, customs agents, or warehousing companies. These are mindful of their good reputation and could become even more valuable allies in the fight against the illicit tobacco trade.

As the FCTC Protocol also recognises, production in and smuggling out of and through **free zones** pose particular challenges. Often it will only be possible to address current difficulties with the cooperation of local authorities. To this effect, customs cooperation agreements with relevant countries, including the UAE/Dubai, could be considered, where such agreements do not yet exist.

f) In addition, there is currently no **independent estimation** of the scale and development of the illicit tobacco market in the EU. Though statistics have improved, these are inevitably based on seizures, which cannot give a full and independent picture of the illicit market. Therefore, additional insights, based for example on consumption patterns, may be required to further support informed and targeted policy-making.

[47] Council Conclusions of 16 December 2016.

## SECTION E: CONCLUSIONS

Despite the measures taken since 2013, the challenge posed by the illicit tobacco trade remains as preoccupying today as it has been in the past. The EU and its Member States have no choice but to continue to address the threat from illicit tobacco and its changing patterns with determination, since this illicit activity is detrimental to public health, finances and security.

With its combination of strong legislative responses, robust law enforcement and enhanced cooperation at national, European and international levels, the 2013 Strategy remains relevant. It is too early to pass final judgment on its effectiveness, since its key components – such as tracking and tracing – are not yet applicable.

Looking at the growing threat from cheap whites in particular, the FCTC Protocol – once fully applied by a critical mass of countries, including key source and transit countries – will be a key tool in combating the global illicit tobacco trade. However, while tracking and tracing in particular will help to secure the legal supply chain, additional tools will be needed to address domestic or foreign clandestine cigarette production effectively.

Against this background, based on the present analysis and further dialogue with stakeholders, the Commission will complete its evaluation of the present strategy and decide on the appropriate follow-up in 2018.