Towing the Line:
Controlling Key Inputs to Disrupt Illegal Tobacco
MacDonald - Laurier Institute
Ottawa, 25 November 2014
Cellulose Acetate Tow

- Can’t make filtered cigarettes without it

- Supplied by only 6 companies: Celanese, Daicel Eastman, Mitsubishi, Rhoda Acetow and Sichuan Push Acetati Co. Ltd. (2 dominate: Eastman and Celanese)

- They oversupply, selling to illicit manufacturers in huge numbers

- In 2005, GAMA started “Know Your Customer Certificate” (KYC) Program, but not transparent or enforceable
ITTP: Size & Harms

- Harms to consumer health
- Harms to brand integrity
- $81 billion a year funds criminals and VEOs
- EU alone lost $12.5 billion in tax revenues in 2012
- Replacing ITTP with licit would result in an additional $31.3B in tax revenue worldwide

- Illicit averages 11.6% worldwide:
  - 16.8% in poor countries
  - 9.8% in high-income countries
CTP of ITTP

- In Sahel, same routes for drugs and tobacco
- Hezbollah: Operation Smokescreen & Operation Tobacco Road
- PKK: smuggles into Iraq in same route used by Husseins
- Real IRA fed by Belarussian smuggling gangs
- 2nd to heroin for Taliban
Key Source and Destination Markets for Illicit Cigarettes
Belarus

- Trade data for mid-2012 to mid-203 shows Belarus imported 30,715 metric tons of tow: nearly 10 x needed for domestic production

- Celanese’s supply alone exceed Belarus’ own production quotas by 5 billion cigarettes

- Eastman alone sold Belarus 9.18 x requirement to satisfy national production quota

- Even allowing for declared exports, there is enough for 209 billion illicit cigarettes
Belarus’s Unaccounted Tow

<table>
<thead>
<tr>
<th>Year</th>
<th>National Quota (in B of sticks)</th>
<th>Filtered (in B of sticks)</th>
<th>MT of tow required</th>
<th>MT of tow imported</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>33</td>
<td>31.68</td>
<td>3,960</td>
<td>30,715.861</td>
</tr>
</tbody>
</table>
Paraguay

• 189 billion cigarettes can be from the tow oversupply entered the Paraguay - Argentina FTZ: Mercosur + TBA

• Registered tobacco companies in Paraguay ballooned from 3 in 1993 to 33 in 2004: a 900% industry expansion in 11 years

• 2000-2010: production increased +2,592.3% while consumption shrank -6.9% for same period
## Scale of Paraguay’s Illicit Production

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Production (B of sticks)</th>
<th>Of Which, Filtered (in B of sticks)</th>
<th>MT of tow required</th>
<th>MT of tow likely imported</th>
<th>Likely illicit production (B of sticks)</th>
</tr>
</thead>
</table>
UAE

• UAE’s domestic consumption is all imported; its production is only for export

• 40 FTZs conceal reliable trade data of quantities and destinations

• UAE is importing 177 x the quantity of tow needed to produce its stated exports: enough to produce 98.7 billion illicit cigarettes
# UAE’s Excessive Tow Imports

<table>
<thead>
<tr>
<th>Year</th>
<th>Export Production (B of sticks)</th>
<th>Of Which, Filtered (B of sticks)</th>
<th>MT of tow required for export production</th>
<th>MT of tow imported</th>
<th>Possible Illicit Production (B of sticks)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>0.55</td>
<td>0.55</td>
<td>68.77</td>
<td>12,226.79</td>
<td>98.7</td>
</tr>
</tbody>
</table>
International Legal Framework

- UK’s NCA Programme 9: focused on “upstream” elements: employees of pharma companies

- INTERPOL Sec. Gen. Ron Noble on 5 March 2014: a “major enabler” of IT & “enormous source of funding” for TOCs

- WHO FCTC’s Illicit Trade Protocol (2012): supply chain security, including key inputs (but only 5 years later)

- UNTOC, UNCAC, RICO, OSCO, CTF, White House Strategy to Combat Transnational Crime

- FATF International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation
Proposed Solution

- Writing into OECD policy: better supply chain control of key inputs (based on OECD’ Conflict Minerals Guidance & Guidelines for Multinational Enterprises — 42 signatory countries)
- A clearinghouse with a credible authority
- INTERPOL enforcement of infractions
Clearinghouse Functions

- Regulate: institute a risk-based due diligence system to prevent adverse impact
- Punish & Reward: brands can promote their CSR; non-compliant are named-and-shamed
- Educate: consumers & LEA
- Coordinate: diverse international actors & authorities
Clearinghouse Operations

- Define legal market of each tobacco & filter manufacturer in every market
  - Sales / tax data of previous year (+ x% margin)
  - Supported by KPMG, PWC, WCO, etc.
- Tow manufacturers clear each order / shipment through clearinghouse
  - No shipment beyond legal market demand
  - Stock keeping / inventory allowed, but must be recorded and audited by clearinghouse
Regulatory Solutions

- Certification of buyers, sellers, exporters, agents and manufacturers involved in the sale of tow (start with high-impact hot spots, where > 40% of IT is)

- Clearinghouse by competent authority to ensure that tow shipments are in line with legal market demand for each tobacco manufacturer

- Effective tracking-and-tracing: in-bale RFID chip