

# A HAZY CRISIS: ILLICIT CIGARETTE SMUGGLING IN THE OSCE REGION

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## HEARING BEFORE THE COMMISSION ON SECURITY AND COOPERATION IN EUROPE ONE HUNDRED FIFTEENTH CONGRESS FIRST SESSION

JULY 19, 2017

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# **A HAZY CRISIS: ILLICIT CIGARETTE SMUGGLING IN THE OSCE REGION**

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## **A HAZY CRISIS: ILLICIT CIGARETTE SMUGGLING IN THE OSCE REGION**

**July 19, 2017**

COMMISSION ON SECURITY AND COOPERATION IN EUROPE  
WASHINGTON, DC

The hearing was held at 9:30 a.m. in room 106, Dirksen Senate Office Building, Washington, DC, Hon. Roger F. Wicker, Chairman, Commission on Security and Cooperation in Europe, presiding.

*Commissioners present:* Hon. Roger F. Wicker, Chairman, Commission on Security and Cooperation in Europe; and Hon. John Boozman, Commissioner, Commission on Security and Cooperation in Europe.

*Witnesses present:* Dr. Louise Shelley, Director, Terrorism, Transnational Crime, and Corruption Center, George Mason University; David Sweanor, Adjunct Professor of Law, University of Ottawa; and Marc Firestone, Senior Vice President and General Counsel, Phillip Morris International, Inc.

### **HON. ROGER WICKER, CHAIRMAN, COMMISSION ON SECURITY AND COOPERATION IN EUROPE**

Mr. WICKER. This hearing of the Helsinki Commission will come to order. Welcome, and good morning to everyone.

The Commission is mandated to monitor the compliance of participating states with the consensus-based commitments of the OSCE. Today's hearing of the Commission focuses on the multi-dimensional issue of illicit cigarette smuggling in the OSCE region.

Illicit cigarette smuggling is a significant transnational threat. I would say again it is a significant threat: ongoing illicit trade helps fund terrorist activities, it fosters corruption, and it undermines the rule of law.

European Commission and KPMG studies estimate that around \$11.64 billion is lost every year to this criminal activity in the European Union alone, where counterfeit cigarettes are particularly prevalent and account for nearly 30 percent of the articles detained by EU customs.

This issue involves two of the three dimensions of the Helsinki Final Act, the first being hard security and the second being economic issues.

Illicit cigarette smuggling's link to hard security is evident in a recent report issued by the Department of State in conjunction with the Departments of Treasury, Homeland Security, Health and Human Services, and Justice. The report emphasizes what I have

already said in this opening statement, and I quote: “Illicit tobacco provides a significant revenue stream to illicit actors,” unquote, and, quote, “fuels transnational crime, corruption and terrorism.” So, for these reasons, it’s important that we be here today. And the report declared that the global illicit trade in tobacco poses a threat to national security.

Building upon former commitments, the OSCE established a Charter on Preventing and Combating Terrorism in the aftermath of the September 11, 2001 attacks in New York and Washington. That charter targeted four strategic areas for specific action: policing, border control, trafficking, and money laundering. I hope today’s witnesses will consider how measures taken pursuant to that charter are being applied to the illicit trade in tobacco and tobacco products.

With regard to economic issues, illicit trafficking in cigarettes is a major source of corruption. International criminal organizations that engage in tobacco trafficking generate profits that are then available to corrupt public officials and subvert the rule of law. The Department of State estimates that the worldwide tax loss from illicit tobacco smuggling is between \$40 billion [dollars] and \$50 billion annually. This is money that is lost to taxpayers, further weakening state institutions while enriching and empowering criminal elements that are themselves a threat to those institutions. These are serious challenges in many emerging-market economies within the OSCE, and I hope we will hear more today from our witnesses about the scope of the threat and the measures that can be taken to combat it.

Underlying all of these problems is the fact that there is enormous money to be made in illicit tobacco trafficking. An OECD report issued last year concluded that cigarettes present high profit margins, and are among the most commonly traded products on the black market due to the relative ease of production and movement along with low detection rates and penalties. The OECD cited many reasons for the growth of the illicit trade in tobacco. Today we will engage in an in-depth examination of those reasons and identify potential responses.

To help us do that, we have three very distinguished witnesses.

Dr. Louise Shelley is a professor and the director of the Terrorism, Transnational Crime, and Corruption School of Public Policy at George Mason University. She is a leading expert on the relationships among terrorism, organized crime, and corruption, and she also specializes in illicit financial flows and money laundering. I assume you specialize in the study of—[laughter]—money laundering. Dr. Shelley serves on the Global Agenda Council on Illicit Trade of the World Economic Forum, and she was the first co-chair of its Council on Organized Crime. Dr. Shelley has frequently testified on Capitol Hill regarding issues that impact national security.

Professor David Sweanor is an adjunct professor of law at the University of Ottawa. Professor Sweanor has pioneered efforts to reduce cigarette smoking in Canada and around the world. As part of those efforts, he has worked with groups such as the World Health Organization [WHO], World Bank, and the Pan American Health Organization, the latter of which honored him with the Public Health Hero Lifetime Achievement Award. Professor

Sweanor has previously testified before the Canadian Parliament and the U.S. House, and the Senate, and is before the Helsinki Commission for the first time.

Mr. Marc Firestone is the senior vice president and general counsel for Phillip Morris International. In that capacity, he helps guide the company's global response to the illicit trade in tobacco.

We hope to accomplish three things at today's hearing. First, we hope to draw attention to the problem of illicit tobacco trafficking—how it helps fund terrorist activities, foster corruption, and undermine the rule of law—have I said that enough times?—and why the United States should provide leadership in this fight. Second, we hope to learn more about best practices in both the public and private sectors to minimize illicit tobacco trafficking, and deny the financial proceeds of such trafficking to terrorist and criminal groups. Third, we hope to increase an understanding of how illicit tobacco undermines public health policy.

So thank you to these distinguished members of today's expert panel for joining us today, and I look forward to our discussion. Perhaps we can begin with testimony by Dr. Shelley.

**DR. LOUISE SHELLEY, DIRECTOR, TERRORISM, TRANSNATIONAL CRIME, AND CORRUPTION CENTER, GEORGE MASON UNIVERSITY**

Dr. SHELLEY. Thank you for this great honor, and it's a great pleasure to speak again before the Helsinki Commission. One of my first congressional testimonies was on the issue of human trafficking before this Commission, and with Congressman Smith's support.

I've been following this issue of cigarette smuggling and illicit trade for a long time, and it has taken me to many different locales. More than a dozen years ago I was in Georgia, where our research had shown that there were linkages between the illicit cigarette trade and Iraq. And when I talked about this in a public meeting, it was one of the first times in my research career in which I was threatened. So it tells us that illicit cigarette trade is not a benign activity, and traffickers will even go after researchers.

More recently, I have visited the open markets in Paris where cigarettes are sold en masse, and France is the contraband capital of Europe for illicit cigarette trade. And it's hardly surprising that one of the Kouachi brothers, who murdered the journalists of Charlie Hebdo, received some of his income from the illicit cigarette trade.

Also, I have visited the markets of illicit cigarettes in Italy, which are very much under the control of organized crime. So we see very different variations in this problem, but many, many elements of it across the OSCE region.

I've also spoken to investigators in New York who work closely with their international counterparts, as there is an important crime-terror connection to illicit cigarette trafficking in the United States.

What is important, I think, to point out, beyond your opening and very clear remarks, is that there has been a problem of a culture of impunity. As I have in my longer written statement, the former president of Montenegro won the award from the Organized

Crime and Corruption Reporting Project as criminal of the year one year ago because of his very important role in the illicit cigarette trade. So it's not just criminals, it's not just terrorists, but it's high-level officials that are not just in policing or in the borders but at the heads of national governments, that are involved in this.

Beyond this, we need to look at the importance of hubs outside the OSCE region and what they're doing in facilitating the trade of the illicit cigarettes that move into Europe and also into North America. Free-trade zones like the Jebel Ali Free Zone in Dubai is absolutely central to this.

Furthermore, we need to be thinking about illicit cigarette trade as not a standalone crime. It converges with the drug trade, with wildlife smuggling, trade in counterfeit goods, and other crimes. Illustrative of this is a case that occurred in the Czech Republic in which the Czech police that were monitoring illicit cigarette trade tipped off members of the customs police in the Czech Republic to the fact that a shipment of rhino horn was about to be arriving in the Czech Republic from South Africa. What this tells us is that there is a convergence of different crimes, and also that the cigarette trade often serves as what I call venture capital for other forms of serious crime, so that the money that you get from this petty trade that you can start with leads you to even higher revenue streams that can have very corrosive impact.

Also, we need to be thinking about the role of companies in facilitating this trade. In my written statement, I cite a problem that British American Tobacco cited and Imperial Tobacco with Facebook in the U.K. where posts on Facebook were facilitating the delivery of cigarettes in that country, and the same thing has been found by PMI in France. And yet, there has been very limited response from the new media companies that are facilitators of this trade. And just as we've put pressure on the new media to be countering terrorist recruitment, we also need to be focusing on how they are facilitating illicit trade.

Part of the reason that this is going on is that there is an absence of a law enforcement response. And in my last book, which was called "Dirty Entanglements: Corruption, Crime and Terrorism," I had a whole chapter on the funding of terrorism through what I called underpoliced crime. And cigarette trade figured in that chapter because of the absence of resources and the absence of an adequate law enforcement response.

So the prevalence of illicit cigarette trade reveals the limits of our strategies to counter illicit trade. In my statement, I've provided some text from my forthcoming book that I'm just completing on illicit trade. And in it, I show how there is a merger of problems that we're facing, especially in Europe today and in our community of the OSCE, with the illicit cigarette trade.

And I start off with a case of going to the Museum of Immigration in Paris and listening to a broadcast on earphones to a migrant describing his problems in Europe. And he describes how he arrived illegally in Italy and can't find employment. He traverses Italy. He goes to France and, finally, winds up in Marseille, and says: "In Marseille, I'm now working—I'm working as a cigarette seller." But what it doesn't say is that he's working in the illicit cigarette markets, where 40 percent of the sales of cigarettes in

Marseille, a hub that also connects with terrorism, are illicit cigarettes. And so, as Europe fails to integrate its masses of illegal migrants, it is also fomenting the problem of illicit trade because illicit activities cluster where individuals who cannot work legitimately work in illicit markets.

So what do we need to do to address this problem? First of all, we need to allocate more law enforcement responses to this, and to do the kind of network analysis, analysis of hybrids, following the money that is not done enough in relationship to this crime. We need to address not just the low-level corruption, but the high-level corruption that facilitates this trade.

About 10 days ago, when I was talking about this in front of the security assembly of the Annual Security Review of the OSCE in Vienna, I talked about these problems of new trends which we're looking at. And subsequently, I went to a rollout of a publication called the "Crooked Kaleidoscope—Organized Crime in the Balkans," which made the same point as I do—and I've cited it in my report—that high-level corruption is behind this trade in the Balkans.

We need to require corporations in the new media space to focus more on their facilitating role, and that needs to be part of a larger effort to focus on public-private partnerships.

And we need to pay more attention to the facilitating role of free-trade zones in illicit trade.

And as a researcher, I suggest that we need to focus much more on understanding the illicit flows, the hubs of the trade, and the convergence of different forms of illicit trade, because insights from one kind of criminal activity can help in fighting another.

We need to work on the harmonization of tax policies on cigarettes because it is the discrepancies in pricing that provide so many of the financial incentives for participation.

And we need to provide serious analysis of the optimum tax rates on cigarettes that address state revenue concerns, but also do not contribute to smuggling. About 10 days ago, I was in France and listening to the radio, and it said they need to increase their taxes on cigarettes in France to reach 10 euros a pack. But there's no analysis of what this will do to illicit markets, though the radio commented that they imagine that this would increase the problem, where already France is number one in Europe.

So we need to do serious policy analysis that will help us address this issue. It is not just a small-scale problem. And as you mentioned in the introduction, it is very crucial to state revenues, state capacity, and to national security.

Thank you.

Mr. WICKER. Well, thank you very much.

And Mr. Sweanor, you are recognized next. Thank you.

**DAVID SWEANOR, ADJUNCT PROFESSOR OF LAW, UNIVERSITY OF OTTAWA**

Mr. SWEANOR. Thank you, Mr. Chairman. It's a pleasure to be here despite the weather in Washington in July.

I've worked as a lawyer on public health issues around tobacco and nicotine for over a third of a century, and a lot of that time has been spent dealing with issues of tobacco taxation and then

with the contraband trade—monitoring it, trying to understand it, litigating on it in order to try to deal with the problem. I think there are a few basic facts to start with.

To date, price is by far and away the most powerful tool that's been used globally in reducing cigarette smoking. I mean, it just completely dwarfs what we've accomplished with our other measures. So it is a very, very powerful tool. But beyond the elasticity of this—there's the cross elasticity, as economists would say—people will move between product categories based on differences in price, whether it be between different tobacco products or, in this case, between licit and illicit products. That's just a reality of the market, and it's odd that a lot of people will deny that—either claim that price is the single factor dictating whether there's going to be a contraband trade or that price doesn't have any impact, tax doesn't have any impact, often depending on somebody's ideological or vested interest.

But I think the way to see this is simply as a business. People get involved in the contraband trade in order to make money. And profitable smuggling really depends on pretty simple economics. It's a matter of what's the cost of acquisition of the goods, what's the cost of dealing with the goods, and what's the profit margin and the size of the market for selling those goods?

Cigarettes create a tremendous opportunity in many places, and few as much as what we see in Eastern Europe, where the cost of acquisition is very small. If you're manufacturing cigarettes, you can usually do it for one or two cents per cigarette. There's areas in Central Europe I've been able to buy packages of cigarettes for 20 cents, and told by my interpreter that I was being ripped off because I was a North American. They've very inexpensive to make.

The costs of—as we've just heard from Dr. Shelley—the costs of being involved in the business, the chance of apprehension, the penalty should one get caught can be extraordinarily low. And the ability to sell those products to a largely lucrative market is pretty much unparalleled, because for Eastern Europe it's a short trip into the European Union. And, as we've heard, the price of cigarettes can be very high.

So there's a particular problem there. And I think the solution, in large part, is dealing with the business viability. What can we do that creates a higher cost for acquisition? What can we do that increases the cost of dealing with the product? And what can we do that reduces the market for the illicit products? And that's a matter of things like how do we limit the availability of the manufacturing machinery, the supplies that are used in manufacturing cigarettes and the people who are engaged in that? And there's been various measures aimed at trying to do that sort of thing.

But also, dealing with the supply of cigarettes that are just sort of floating around the gray market. I mean, the—there has been a long history of a huge difference between the number of cigarettes legally exported and the number legally imported. And that's a key issue to go after. And I've been involved in that, with racketeering actions here in the States against multinational cigarette companies for products that were sort of disappearing and showing up in the European Union. And I think that was very successful,

because it largely ended that trade by changing the economics. It greatly reduced the supply of cigarettes that were available.

We can do more, though, on increasing the cost to the business through things like enforcement, increasing chance of apprehension, track and trace technology that makes it easier to figure out where products came from, trace it back to the manufacturer. The penalties that we end up levying, making it easier for people to enforce actions, including U.S. law, in order to put up the cost for criminals being involved in this sort of business.

And then finally, and in an area that I think is neglected and shouldn't be, is what do we do about the demand for illicit trade? I think that's worth expanding on, because it's—as I say, it's been oddly ignored that unlike most areas of illicit trade, the vast majority of people who are currently smoking cigarettes are telling us they wished they didn't smoke. They're not smoking because they want to. They're smoking through some combination of dependence, addiction, and self-medication.

But mainly, they're smoking because they're not given a viable alternative. And so they're buying—if the only alternative is legal cigarettes and illicit cigarettes, illicit cigarettes are way cheaper and widely available. But the challenge that we have, or the ability to address this I think is huge, and we're not paying attention to it. That what kills people from smoking is the smoke. It isn't the tobacco. It isn't the nicotine. It's the smoke. Cigarettes are an incredibly deadly delivery system.

If we met the needs by working with consumers to give them better access to alternative products, non-combustion products—the vaping products, the heat-not-burn products, the smokeless tobacco products, the pharmaceutical products—we could probably eliminate much of the demand for illicit trade by giving people a viable option that not only makes much better economic sense to them—because it can be cheaper, because so much of the price of cigarettes is tax—so it can be cheaper, but it also can save their lives rather than kill them.

That's a huge possibility. If we made those products available, if we allowed people to get accurate information about those products, we get to change the market. You know, just like we can eliminate the market for snake oil medicines by having licensed pharmaceutical products, we could change the market by having products that are far harder for people to counterfeit and consumers are far less likely to want to buy, because we're giving them a viable alternative to cigarettes.

So I think that that, going after the end consumer, working with consumers, would be incredibly important. And we have the ability to use policy tools. I co-authored an article in the *New England Journal of Medicine* a couple of years ago, and using differential taxes for products with differential risks—we could be using those types of measures around the world. There's no reason to tax the low-risk products. We can affect the differentials in marketing, product standards, product placement. Give the people who are buying illicit products a viable alternative to them.

But in looking at particular measures, I think that the use of existing laws, including here in the United States with the racketeering laws, RICO laws—which as I said I've been involved with

before—to battle the criminal gangs, make it easier for the states that are—that are losing such huge sums of money to criminal gangs to use U.S. courts as one of their avenues for going after the criminal gangs.

It's very hard for anybody to be involved in widescale money laundering without using U.S. banks. That brings them within the purview of U.S. law. Get rid of things like the Common Law Revenue Rule that was making it hard for any government to collect forgone taxes using the U.S. courts. Help them go after these criminal gangs. Make it possible to take the money away from these gangs, and they'll stop doing what they're doing because you've destroyed the business viability.

Again, non-combustion alternatives. Give people alternatives to the sorts of illicit products that they're buying now. Recognize that the whole tobacco-free world approach that's been taken by U.S. Government agencies has unintended consequences. And the unintended consequences include that if you don't give people alternatives to cigarettes as a product, the alternative they're going to find is illicit cigarettes. We have the ability to make real changes in those things. And I think it takes some vision. It takes some creativity. But the options are available and we can do meaningful things to deal in a serious way with a tremendous problem that's affecting health, it's affecting revenue, and it's promoting criminality.

Thank you.

Mr. WICKER. Thank you very much.

Mr. Firestone, you're recognized.

**MARC FIRESTONE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, PHILLIP MORRIS INTERNATIONAL, INC.**

Mr. FIRESTONE. Yes, sir. Thank you, Mr. Chairman. Thank you very much for holding today's hearing on the illicit tobacco trade. As you've said, and as Professor Sweanor and Professor Shelley have said, it is indeed a significant problem. And it's one that merits, undeniably, this Commission's expertise, attention, and authority.

In my role as general counsel at Philip Morris International, PMI, I'm ultimately accountable for the company's compliance programs and our anti-illicit trade efforts. And it's, indeed, an honor for me to appear before you today on this topic. PMI is the world's leading tobacco company. We employ 82,000 people around the world. We do not sell products in the United States, but we're among the largest buyers of American-grown leaf tobacco, and proud to support the livelihoods of farmers in this country.

The battle against illicit tobacco products concerns both the private and the public sectors. And we welcome this hearing as further evidence of the determination of the United States Government to confront a major social issue. Cigarette smuggling exists on a large scale around the world. For criminal organizations, there are huge profits. For governments, there are huge losses. As you've said, estimated at over \$40 billion per year. For PMI, we welcome competition, and we compete aggressively for market share, while playing by the rules.

But gangs that sell smuggled cigarettes have an illegal price advantage versus legitimate companies. They're not competing based on product quality or other benefits to consumers. Their success comes from rank cheating. Their conduct corrodes lawful markets, and robs treasuries around the world of billions in tax revenues.

Here's an example: Often criminals have their own brands of cigarettes—not counterfeit, but not legitimate either. And what they do is, in country A they make these brands solely to sell in the illicit channels in country B. And like termites, these illicit brands undermine country B's regulatory framework for tobacco products. Termite brands are a form of invasive species, and they make it easier for kids to buy cigarettes. They are out of compliance with health warning requirements. And they are on sale for illegally low prices.

But smuggling does more than destroy legitimate markets. It generates funding for other illicit enterprises, as Professor Shelley has said and written, from dangerous drugs to the true abomination of human trafficking. So this is not about tourists who occasionally take a few extra carton[s] of cigarettes through the nothing-to-declare line at an airport. This is not about casual transgressions. It is about a dangerous, high-profit machine whose activities spread far and wide.

Now, even as a legal and ethical business, PMI faces much controversy. And we certainly don't want to be anywhere close to the illicit trade. We've worked hard and invested a huge amount of money to put tight controls on our supply chain and run our business with keen vigilance to the risks of product diversion. We've continually increased our effectiveness through advice from leading experts, and through cooperation with governments, including, for example, those in Canada, the United Kingdom and Italy, as well as cooperation with the European Union and European Commission.

We are determined to be innovative. We are determined to remain at the forefront of industry in controlling a supply chain. But even the best possible commercial practices cannot change a few basic facts. PMI doesn't make or enforce anti-smuggling laws. We don't police borders. We can't tell other companies what to do. So in our view, there has to be an integrated, cooperative, comprehensive approach. There has to be control of all elements of the supply chain. And this definitely includes raw materials to make cigarettes.

For example, if criminals can't get the cellulose acetate that goes into all cigarette filters, and if they have no access to other raw materials, they can't make these termite brands. Now, the pharmaceutical industry has seen success in controlling drug precursors, such as pseudoephedrine. And I believe there are many lessons from that industry in the present context. We also need stronger legal deterrence, such as those that exist against trafficking in narcotics, wildlife, and blood diamonds.

Legislation on tobacco and the fight against illicit trade should include provisions for identifying the worst offenders, for freezing their assets, and for imposing far stiffer penalties than often exist under current law. Our views rest of empirical evidence. Experience in a number of countries has shown that aggressive, well-

funded enforcement, combined with the right laws and sincere cooperation from business can, indeed, dramatically reduce illicit trade. My written testimony includes more detail on our recommendations, but I hope these examples show what we have in mind.

Now, today's hearing focuses on the OSCE region. But we're actually talking about a worldwide problem. And progress requires cooperation among regions and nations. PMI supports transparent implementation of WHO's protocol to eliminate illicit trade in tobacco. We urge international organizations to welcome, rather than exclude, the views of all subject matter experts including manufacturers, retailers, farmers, law enforcement officials, and, of course, ministries of justice, finance and health. That's the core group to counter the criminality that troubles us all. And I believe the U.S. has a great opportunity to show—indeed to lead—the way.

Mr. Chairman, I, again, thank you for the privilege and honor to appear before this esteemed Commission. And on behalf of PMI, I pledge our full support to the Helsinki Commission and the United States Government as a whole in crushing the illicit trade in tobacco.

Thank you, sir.

Mr. WICKER. Thank you. And thank you all. Without objection, the written statements of all three witnesses will be added to the record of this hearing.

Dr. Shelley, I believe you stated that new media is facilitating this illicit activity, and that new media corporations should be held to account and more requirements placed on them. Could you elaborate on that suggestion?

Dr. SHELLEY. Certainly. One of the things that facilitates deliveries is that people post "meet at this point, a delivery is going to be here," on Facebook pages and other forms of communication. And I think it's very important that we not have criminal facilitation through media. This requires the construction of algorithms and other means that are being used now, as there has been a focus on countering statements of radicalization. There have been efforts by new media companies now to invest in this area, which they hadn't before.

When I talk about corporate involvement, is that they cannot have as laissez-faire approach towards things that are harmful to society, like messages that recruit for terrorism, messages that allow for illicit deliveries. And if there was more monitoring of this kind of activity, some of it might go into the dark web, but that is not as easy to access as a Facebook page.

Mr. WICKER. And who should do the monitoring?

Dr. SHELLEY. I believe that this is part of what we need in having what Mr. Firestone talked about as a private partnership, because it is incumbent on the new media companies to be responsible about what they're posting. We can't have law enforcement come and force them to take this off. There have been efforts made previously, I know, through corporate channels to approach Facebook to be more careful about this monitoring, in this climate before terrorist radicalization. And this was rebuffed. And I think that we need to understand that our social media can be a force for good, but it also needs to do much more policing of itself. Just

the way I talk about, in my book, how platforms are selling counterfeit goods without adequate surveillance.

Mr. WICKER. To be clear, are you advocating a government role in enforcement in this—in this area of the new media?

Dr. SHELLEY. I wouldn't call it government enforcement. I would call it public-private partnership, where the government sits down with the new media, just as it's done in the area of terrorism, in saying: We have this problem. And we need your help, your resources to help do this for the collective good. And that's—

Mr. WICKER. And what agency of the government should do this?

Dr. SHELLEY. I think it needs to be a combination. I think it would be in part the Bureau of Alcohol, Tobacco, Firearms and Explosives. It would be Homeland Security. It might even be also FBI. It would need to be an intergovernmental working group, such as produced that counterterrorism—or, I should say—that report on cigarette smuggling and its relationship to terrorism that you cited, Chairman Wicker, in your opening remarks. That was a coalition of government officials working to counter this threat. And I think they need to sit down with the private sector, this working group, and point out the problems that exist.

Mr. WICKER. Mr. Sweanor and Mr. Firestone, comments on this topic from either of you.

Mr. SWEANOR. I think if we look at what happened with the European Union challenging the cigarette companies over facilitating a trade, their actions are allowing product to become available to the smugglers, and closing that, I think it raises the same question that could be thrown at those who are facilitating the trade through information. What's their role in this?

I think of a discussion with them and the possibility—I'm not an expert in U.S. law—in U.S. racketeering law, but I think it does at least raise a question of, do they have some responsibility for those billions of dollars that are being lost in those countries? Might that be enough to give them a wake-up call to say, we maybe don't want to be facilitating this. We'd just as soon not end up in court with someone trying to recoup that money. But they need to accept some level of responsibility for this, as does everybody else along the supply chain.

And I would say, and as we all do, for having engaged in policies that prevent smokers from having viable alternatives to cigarettes. You know, they're moving to illicit trade because we're not giving them a better option.

Mr. WICKER. And I'm going to get to that in a moment.

Mr. Firestone?

Mr. SWEANOR. Yes, Senator, thank you. I think it's a very interesting and important point. And I think that for me, three points that come out of it. One is, it's an example of how many different threads there are to the illicit trade in tobacco. And I think that's maybe one reason that this area gets less focus than it merits, because if you look at each of these individual threads, maybe you say, well, it's a problem but it's not my top three priorities. But when you put them all together, it is. And I think that the availability of ads and so on for illicit products on social media is one of the threads.

Second, as Dr. Shelley and Professor Sweanor have emphasized, I think it's important to tell everyone on the legitimate side of the business that you can't have, in Professor Shelley's words, a laissez-faire attitude. No, maybe one company can't control everything, but all of the companies have to be doing their best to shut down these trades.

And third, and in respect to your question about agencies of the federal government, I would be optimistic that any agency that contacts any responsible public company—that company would be very responsive simply to know that the United States Government is aware of what's happening, and that the United States Government has a concern that that company or our company needs to address.

Mr. WICKER. Dr. Shelley, we're here at the corner of Constitution and 1st in Washington, D.C. How far do I have to go to buy some illicit cigarettes here in town?

Dr. SHELLEY. You can go to your computer.

Mr. WICKER. OK.

Dr. SHELLEY. And you can order them online and have them delivered to you in a shipment that will arrive either by the Postal Service or by UPS or FedEx, that segment their shipments.

Mr. WICKER. So, that's the cleanest, safest way for me to engage in this illegal activity.

Dr. SHELLEY. Yes.

Mr. WICKER. So what—I mean, I'm pretty technically challenged. What website do I go to? Come on.

Dr. SHELLEY. You—

Mr. WICKER. The cameras are rolling. [Laughter.]

Mr. SWEANOR. You're facilitating illegal activity here. [Laughter.]

Dr. SHELLEY. That I'm not going to do. But you could go to many providers that you—

Mr. WICKER. So, what would I need to click on?

Dr. SHELLEY. You could look at—

Mr. WICKER. So, what if I put in untaxed cigarettes?

Dr. SHELLEY. That, I don't think would be—well, you know, you could try that. I would also put in, you know, cigarettes at low price, bargain cigarettes. And if you found you were media-taxed, then I would go off to—or send one of your assistants off to some local bar, convenience store that'll sell you some cigarettes under the table.

Mr. WICKER. OK, now—so I go to a convenience store. How far away is this convenience store?

Dr. SHELLEY. I'd say we could find you one within a mile of here.

Mr. WICKER. OK. And how—

Dr. SHELLEY. Not a—you know, a small place. Not a large convenience store.

Mr. WICKER. OK, so the name-brand convenience stores that advertise, they're going to stay away from this? OK.

Dr. SHELLEY. Generally, yes.

Mr. WICKER. So I go into—and how—and so I want some cigarettes, how do they know I'm cool? How—[laughter]—if I walk in dressed like this, they're probably going to sell me the taxed—

Dr. SHELLEY. They'll probably sell you the taxed cigarettes. That's why I said send in one of your assistants who might be in

blue jeans, because the same enterprise often sells, as I write about, both licit and illicit products.

Mr. WICKER. OK, so how much is a carton of cigarettes going to cost me if I'm buying the right way, if I pay the tax and buy it over the counter?

Dr. SHELLEY. Well, it depends if you buy it in D.C. If you buy it in Maryland, there'll be another price. If you buy in Virginia there'll be another price. And that's part of the problem.

Mr. WICKER. OK. But typically—and so maybe, Mr. Firestone, I'm not leaving this line of questioning—but how much am I going to pay in Washington D.C. for a carton of whatever's?

Mr. SWEANOR. I can't say exactly because we don't sell products here, but I think if you assume that a pack may be \$4 and if there are 10 in a carton, maybe \$40, \$50 a carton, a legal product.

Mr. WICKER. So, Dr. Shelley, how much am I going to pay for illicit?

Dr. SHELLEY. Probably about half that.

Mr. WICKER. OK, and is—if I'm particular about my product and I don't want a termite brand, can I get a name brand by clicking on the right source and ordering it online?

Dr. SHELLEY. Sometimes you can get a name brand.

Mr. WICKER. OK.

Dr. SHELLEY. Sometimes you have packages that are produced with even—how do I say—with counterfeit packaging, with counterfeit stamps put on them. There's a whole supporting industry that goes with this to falsify products. And there's also a problem of diversion. We've had terrorist cases in the United States of funding for terrorism done by diverted cigarettes, where cigarettes have been taken from low-income states, low-taxation states like North Carolina, and shipped to New York or Michigan that have much higher tax rates. So then you would get a real cigarette that's been diverted from a market in another state.

Mr. WICKER. And I do this illegal thing, they ship it to my condo in Maryland—which I don't have a condo in Maryland—[laughter]—but what is my penalty and who's going to catch me?

Dr. SHELLEY. There's very little chance that you're going to be caught. The Postal Service is so busy monitoring shipments of opioids that are coming through the mail, that they hardly have any chance to be looking at other illicit products that are coming through.

Mr. WICKER. You're not really blaming the Postal Service, are you?

Dr. SHELLEY. No.

Mr. WICKER. What about UPS and FedEx, do the same thing?

Dr. SHELLEY. The problem is that we have such a new business model from illicit traders that they're segmenting their markets, that it's just putting an enormous pressure on our delivery services to monitor these fragmented shipments of illicit items. It's a real national concern. And they're stepping up to the plate. They're not avoiding this issue, but it's just a massive problem to try and find the needles in the haystack.

Mr. WICKER. And you mentioned harmonization of tax policies.

Dr. SHELLEY. Right.

Mr. WICKER. So tell us—what ought to be done there?

Dr. SHELLEY. I think that when you have such low taxes, such as you have in North Carolina—I'm not faulting North Carolina, I'm just saying we have those—and very high taxes in Michigan, there's an incentive to move cigarettes in bulk.

Mr. WICKER. But if we didn't tax cigarettes at all, this wouldn't really—we wouldn't have this problem of illicit trafficking of cigarettes?

Dr. SHELLEY. Right, but we need revenue. And cigarettes are a very good way to achieve revenue. So I don't think we want to de-tax cigarettes, both for a public health reason—as Mr. Sweanor will tell you more—and also for a revenue reason. But one of the things that we need to do is find what I call a balance between what provides revenue, what deters consumption, but what does not encourage movement to an illicit market.

Mr. WICKER. OK. And this is a global problem, which is why we're having an OSCE Helsinki Commission hearing on this.

Dr. SHELLEY. Yes.

Mr. WICKER. So what can be done at the OSCE level, at the EU level, at the international consultation and treaty level to address this harmonization of tax policies?

Dr. SHELLEY. I think—

Mr. WICKER. And you're advocating that, are you not?

Dr. SHELLEY. I'm advocating that we begin to have, you know, research and analysis—such as Mr. Sweanor is suggesting—and then that is applied in ways that help construct more rational and harmonized policy. One of the things that I talked about, at the OSCE there's an annual symposium for the ambassadors on the latest trends and tendencies and threats. And I was asked to speak on transnational threats, as opposed to many other issues that they've

discussed before. This year they decided that illicit trade, along with cybercrime, was a priority for them. And this was quite new to the OSCE, to think about these issues as central problems for them. But there was a lot of receptivity. And I think that's important. We didn't get into all of the nitty gritty, but I think that's important.

Mr. WICKER. Why is this a recent problem and phenomenon? Or have I misunderstood you on that?

Dr. SHELLEY. It's not a recent problem, but it's certainly—it's growing. And the fact that there are many more people in Europe who are not working in the legitimate economy either through the recession or through migration, are not integrated into the legitimate economy. It's been shown that this illicit trade had funded terrorism in Europe, which Europol was not looking at until about two, three years ago.

Mr. WICKER. Really?

Dr. SHELLEY. Two, three years ago, they were not looking at the crime-terror relationship. In fact, I had discussions with the head of Europol, who headed this working group at the World Economic Forum, when I released my last book that looked at these relationships. And he said: We don't perceive this is a great problem. But illicit cigarettes is one of the unifying points between the criminals and the terrorists, because it is such an under-policed area of activity. And now Europol has totally switched and is focusing multiple

times an hour in their databases of reviewing these linkages between crime and terrorism. And I understand, from my discussions in France earlier this month, that the new minister of interior is very much focused on doing more network analysis of looking at these relationships and that there is going to be a real shift in policy.

Mr. WICKER. Whose minister of interior?

Dr. SHELLEY. Macron's new minister of interior has begun to focus on these issues of crime and terrorism relationships because France, as we've seen, is the champion of the moment of this illicit trade in cigarettes.

Mr. WICKER. If we stamp it out in France, it'll probably move someplace else.

Dr. SHELLEY. It may move someplace else, but it's also related—as Mr. Sweanor has said—to larger economic issues.

Mr. WICKER. OK. Well—now, I'm going to let you take a breath—

Dr. SHELLEY. Thank you.

Mr. WICKER. —and ask if either panelist would like to weigh in on anything you've talked about so far. And then we're going to get to Mr. Sweanor's point about alternatives.

Mr. SWEANOR. Well, sir, I would just add to what Dr. Shelley is saying. I think one reason that this topic gets maybe less attention is, as the title of this hearing calls it, "A Hazy Crisis." And there is haziness to it.

Mr. WICKER. We like that. I thought that was pretty clever. [Laughter.]

Mr. SWEANOR. Well, I will compliment you, sir, as the chairman, on having come up with it. I don't—

Mr. WICKER. Oh, I have a good staff.

Mr. SWEANOR. Yeah, the good staff.

But to all the creators of that phrase, I think it really does capture one of the great challenges here; it is a hazy crisis in that there are so many thousands and thousands and thousands of people involved at different levels in the supply chain, in making the termite brands and transshipping them, et cetera, et cetera.

Another challenge—where there are solutions is the transnational nature of the problem, where by definition—well, it turns out most of the time we're dealing with transnational shipments, smuggling from country A to country B, and there are often questions about who has jurisdiction, even within the two countries, and how do those two countries integrate their enforcement efforts, how do they share information, et cetera, et cetera. So I would say that there are a lot of those process aspects that can make the enforcement more effective.

And then, third, I would add to the points you made in your hypothetical. If you had a condo in Maryland and were receiving cigarettes there illicitly, what would the penalties be? I think a problem to address is to raise consumer awareness because ultimately all of these products in the illicit trade, whether termite brands or counterfeit, are going to actual individuals, and there needs to be a much greater sense among those individuals that this is not something to do, and that when you do this maybe you do save \$20, \$30 on your carton but those \$20–\$30 in savings are funding this

enormous criminal activity around the world. And that's another aspect of demand reduction, along with Professor Sweanor's very interesting and important ideas about demand reduction by shifting people to better policies.

Mr. WICKER. OK, well, let's shift to that, then. Mr. Sweanor, tell us what you mean. I made a note here: it's the smoke that kills, not the nicotine. That just gets you addicted. The tobacco itself doesn't kill you. Although I guess it could give you throat cancer. But you suggest that there are viable tobacco alternatives to smoking and we ought to look at that. So would you enlarge on that for us, please?

Mr. SWEANOR. Sure. We've known scientifically for decades, as the late Professor Michael Russell used to say, that people smoke for the nicotine but they die from the tar. They die from the smoke. It would be like trying to get our caffeine by smoking tea leaves rather than brewing them; we would get the same diseases. It's the smoke that's causing the cancers, the heart disease, the lung disease, anything that gets smoke into our bodies. You know, cooking over an open fire without ventilation, you'll get the same diseases. Firefighters get diseases from inhaling smoke. We have examples such as in Sweden, where the primary form of tobacco use is a form of oral tobacco called snus, with minimal health risks. It's very hard to distinguish between snus users and non-tobacco users in terms of health outcomes, whereas cigarettes will kill over half of their long-term users.

Mr. WICKER. How do you consume snus?

Mr. SWEANOR. It's something that one just puts between their lip and their gum. It's very similar to moist—

Mr. WICKER. They feel very relaxing.

Mr. SWEANOR. Yeah. Things like Copenhagen or Skoal, products that are in the United States as well, which are also—

Mr. WICKER. So is snus a snuff?

Mr. SWEANOR. Yes. It's a moist snuff product made by—

Mr. WICKER. That's going to give me mouth cancer, isn't it?

Mr. SWEANOR. Apparently it doesn't. I mean, the best evidence is that it's not causing cancer. You can never prove something doesn't cause cancer, we just can't find evidence that it does.

Mr. WICKER. OK. Do they—

Mr. SWEANOR. And that's very different than cigarettes.

Mr. WICKER. Do they tax snus?

Mr. SWEANOR. They do, but they had the big switchover in the 1970s, when they had differential taxation so that a package of snus cost half as much as a pack of cigarettes and apparently lasted about twice as long, so your effective price is much lower. So very similar to what some countries did in moving from leaded to unleaded fuel.

Mr. WICKER. So there's not as much of an incentive to cheat because the taxes are lower.

Mr. SWEANOR. Yes, there's a viable alternative. We see the same thing with—

Mr. WICKER. A viable alternative. But theoretically, if we—if we aggressively taxed snus, then we'd end up with the same problem of being able to buy it untaxed online and fund terrorism.

Mr. SWEANOR. Well, there is—there is a difference here, in that if you're buying cigarettes, from a health standpoint—and I'm sure Mr. Firestone will agree with me—there's really no difference between the things that are manufactured by the major companies, the major brands, and those termite-type brands. There are reasons why if, for instance, I offered you an EpiPen that I've just brought back from the night market in Asia, that you would decide you didn't want to buy it because it's counterfeit. There's a reason you want something different. When a product's made to exacting standards and you know that it's much lower risk, there's a reason why you want the legitimate product rather than something faked. If your children are sick and I offer you a fake pharmaceutical product at a much lower price, you're probably going to tell me to take a hike.

So when we come up with far safer products, there's reasons to buy the legitimate products, and that's working with consumers. And with some of these products, they're actually cheaper than the illicit cigarettes, as we've seen with vaping products in my own country of Canada, of people who have moved from illicit cigarettes to vaping to save money. They didn't even know initially that, as the Royal College of Physicians in the U.K. has told us, these products are likely to be at least 95 percent less hazardous than cigarettes. It's just they're way cheaper. But if we gave people the information to say not only are these products likely to be at least 95 percent less hazardous than smoking, they're going to cost you less money than even the contraband cigarettes, we go from a problem now where contraband is a public health problem as well as a criminal problem as well as a revenue problem to something where we do something that gets rid of the criminality while solving our biggest cause of preventable death. We have a huge opportunity to seize here.

Mr. WICKER. Would people acknowledge that Sweden is a success story in combatting illicit cigarette smuggling?

Mr. SWEANOR. Yes, I haven't been to Sweden for a few years, but I used to go there quite frequently. I didn't see a problem there, in part because, as I say, this is a business, and it's a matter of where's your market, how big is the market, how much can you sell for. Well, we just recently had data out of Eurobarometer that said the daily smoking rate in Sweden is now down to 5 percent. There just aren't a whole lot of people smoking cigarettes. If you're going to try to sell cigarettes, far better that you go to a place like France or elsewhere where it's over 30 percent.

Mr. WICKER. Well, that is remarkable because I can tell you, you walk down the street of a major city in most European countries and it's graphic, the number of people that are walking up and down the sidewalks smoking.

Dr. Shelley, who's doing a good job in the international community on this issue? Who can we look to for success stories?

Dr. SHELLEY. I think Mr. Sweanor has given us a success story in Sweden in reducing consumption, which helps reduce illicit trade. The British and Her Majesty's Customs Service have allocated a lot of attention to trying to analyze the problem. They still have serious problems of illicit trade, but they do prioritize this.

And maybe Mr. Firestone can give us some other examples that he—

Mr. WICKER. Mr. Firestone, do you all make snus?

Mr. SWEANOR. It's a very, very small part of our business. We're focused on—[microphone feedback]

Mr. WICKER. Go ahead.

Mr. SWEANOR. Yes, sir.

Mr. WICKER. Good news; they've called a vote.

Mr. SWEANOR. Oh.

Mr. WICKER. So this hearing is almost over.

Mr. SWEANOR. All right. No, this is—[chuckles].

We are on a completely new strategy at PMI, which is what we're calling designing a smoke-free future, and that really focuses on some of the types of products that Professor Sweanor mentioned, including heat-not-burn tobacco. And we have applications pending before the FTA right now on that.

In terms of countries, I wholeheartedly agree with Professor Shelley that the United Kingdom has been, I think, very focused and very thoughtful on this topic. From our perspective, we've also seen that Greece has been receptive to trying to address the problem, as well as Poland. Even though Poland is a source of product that goes west into the higher-priced markets, we have had good experiences in cooperating with the Polish Government as well.

Mr. WICKER. Well, let me just say this has been a real education to this senator, and I appreciate the testimony and the give-and-take with the witnesses.

One thing that always bothers me in a hearing is, you've got this pesky chairman calling time on the questions. There was nobody to do that to me today, so we went on and on and we had a nice exchange.

There have been so many conflicts with our members. We had four who were going to try to attend and ask questions. And regrettably Senator Boozman had to leave after hearing the testimony, but I know he appreciated the testimony.

But the word goes out, whether there are members here to ask questions or not. And I think we've made a valuable point today. If you're out there and you think you're going to save \$20 [dollars] or \$30 [dollars] or \$50 on this illegal, illicit product, you're engaged in something a lot bigger and you're funding some of the worst actors that have ever walked the face of the Earth. And to that extent, bringing public attention and understanding to this has been very helpful.

We need to continue a dialogue on the role of government, the role of a legislative body and our oversight, our statutory pronouncements. And I look forward to hearing more from the three of you in the future—feel free to substitute additional testimony and supplement your answers—and also from the public.

And with that, and with the thanks of the Commission, this hearing is adjourned. [Sounds gavel.]

[Whereupon, at 10:38 a.m., the hearing ended.]

## **APPENDICES**

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## PREPARED STATEMENTS

PREPARED STATEMENT OF HON. ROGER F. WICKER, CHAIRMAN, COMMISSION ON  
SECURITY AND COOPERATION IN EUROPE

The hearing will come to order.

Welcome and good morning everyone. The Helsinki Commission is mandated to monitor the compliance of participating States with the consensus-based commitments of the Organization for Security and Cooperation in Europe, or OSCE. Today's hearing of the Commission focuses on the multidimensional issue of illicit cigarette smuggling in the OSCE region.

Illicit cigarette smuggling is a significant transnational threat. In short, ongoing illicit trade helps fund terrorist activities, foster corruption, and undermine the rule of law. European Commission and KPMG studies estimate that around \$11.64 billion is lost every year to this criminal activity in the European Union alone, where counterfeit cigarettes are particularly prevalent and account for nearly 30 percent of the articles detained by EU customs. This issue involves two of the three dimensions of the Helsinki Final Act: the first being hard security and the second being economic issues.

Illicit cigarette smuggling's link to hard security is evident in a recent report issued by the Department of State, in conjunction with the Departments of Treasury, Homeland Security, Health and Human Services, and Justice. The report states that "illicit tobacco provides a significant revenue stream to illicit actors" and "fuels transnational crime, corruption, and terrorism." For these reasons, the report declared that the global illicit trade in tobacco poses a "threat to national security."

Building upon former commitments, the OSCE established a Charter on Preventing and Combating Terrorism in the aftermath of the Sept. 11, 2001, attacks in New York and Washington. That Charter targeted four strategic areas for specific action: policing, border control, trafficking, and money laundering. I hope today's witnesses will consider how measures taken pursuant to that Charter are being applied to the illicit trade in tobacco and tobacco products.

With regard to economic issues, illicit trafficking in cigarettes is a major source of corruption. The international criminal organizations that engage in tobacco trafficking generate profits that are then available to corrupt public officials and subvert the rule of law. The Department of State estimates that the worldwide tax loss from illicit tobacco smuggling is between \$40 billion and \$50 billion dollars annually. This is money that is lost to taxpayers, further weakening state institutions while enriching and empowering criminal elements that are themselves a threat to those institutions.

These are serious challenges in many emerging market economies within the OSCE, and I hope we will hear more today from our witnesses about the scope of the threat and the measures that can be taken to combat it.

Underlying all of these problems is the fact that there is enormous money to be made in illicit tobacco trafficking. An Organization for Economic Cooperation and Development, or OECD, report issued last year concluded that "cigarettes present high profit margins and are among the most commonly traded products on the black market due to the relative ease of production and movement, along with low detection rates and penalties." The OECD cited many reasons for the growth in the illicit trade of tobacco. Today, we will engage in an in-depth examination of those reasons and identify potential responses.

To help us do that, we have with us three very distinguished witnesses.

Dr. Louise Shelley is a professor and the director of the Terrorism, Transnational Crime and Corruption School of Public Policy at George Mason University. She is a leading expert on the relationships among terrorism, organized crime, and corruption, and she also specializes in illicit financial flows and money laundering. Dr. Shelley served on the Global Agenda Council on Illicit Trade of the World Economic Forum and was the first co-chair of its Council on Organized Crime. Dr. Shelley has frequently testified on Capitol Hill regarding issues that impact national security.

Professor David Sweanor is an adjunct professor of law at the University of Ottawa. Professor Sweanor has pioneered efforts to reduce cigarette smoking in Canada and around the world. As part of those efforts, he has worked with groups such as the World Health Organization, the World Bank, and the Pan American Health Organization—the latter of which honored him with the "Public Health Hero Lifetime Achievement Award." Professor Sweanor has previously testified before the Canadian Parliament and the U.S. House and Senate.

Mr. Marc Firestone is the senior vice president and general counsel for Philip Morris International. In that capacity, he helps guide the company's global response to the illicit trade in tobacco.

I hope to accomplish three things at today's hearing: First, I hope to draw attention to the problem of illicit tobacco trafficking; how it helps fund terrorist activities, foster corruption, and undermine the rule of law; and why the United States should provide leadership in the fight against this illicit trade.

Second, I hope to learn more about best practices in both the public and private sectors that can minimize illicit tobacco trafficking and deny the financial proceeds of such trafficking to terrorist and criminal groups.

Third, I hope to increase an understanding of how illicit tobacco undermines public health policy.

I thank the distinguished members of today's expert panel for joining us today, and I look forward to our discussion.

PREPARED STATEMENT OF HON. CHRISTOPHER H. SMITH, CO-CHAIRMAN, COMMISSION  
ON SECURITY AND COOPERATION IN EUROPE

Good morning and welcome to everyone joining us this morning as we examine cigarette smuggling in the OSCE region.

The volume of tobacco and cigarette smuggling is staggering—the WHO estimates 1 in 10 cigarettes are part of the global illegal tobacco trade. A former FBI agent explained it this way: “Cigarettes are easy to smuggle, easy to buy, and they have a pretty good return on the investment. Drug dogs don’t alert on your car if it’s full of Camels. The other advantage is you don’t go to jail for 50 years.”

One of the principal reasons we are here today is that recent reports, including a 2015 State Department report, find that terrorists around the world smuggle cigarettes and tobacco to finance their crimes. The State Department found that this form of smuggling is encouraging a convergence between terrorist and organized crime networks, and that it facilitates other crimes, including human trafficking and the smuggling of illegal street drugs and weapons.

I’m looking forward to going into the evidence for this with our witnesses, and discussing what should be the policy response, both from us as legislators and from the executive branch.

Mr. Sweanor and Mr. Firestone, I particularly look forward to hearing from you about the health implications of cigarette smuggling—how price affects smoking rates, and whether there are known differences between the nicotine content of smuggled tobacco and cigarettes versus those produced by the major cigarette manufacturers.

Dr. Shelley, welcome back to the Commission—we recall your testimony in 1999 at hearings I chaired on “*Corruption in the Former Soviet Union*” and “*Sex Trade: Trafficking of Women and Children in Europe and the United States*”—and as the Parliamentary Assembly’s Special Representative on Human Trafficking Issues I look forward to discussing what kind of evidence there might be of connections between the criminal rings that traffic in human beings and those that smuggle tobacco, which is asserted in the State Department report.

PREPARED STATEMENT OF DR. LOUISE SHELLEY, DIRECTOR, TERRORISM,  
TRANSNATIONAL CRIME, AND CORRUPTION CENTER, GEORGE MASON UNIVERSITY

**Cigarette Smuggling has become such a major problem in the OSCE region for the following reasons:**

1) There is a long-term **Culture of Impunity**. This is particularly pronounced in the Balkans where there has been the involvement of **high-level officials** (see text and Appendix). But it also exists among the **migrant communities** that cannot find employment and and marginalized communities who become sellers of cigarettes.

2) **Corruption is a key facilitator of this trade** and involves officials at all levels—at borders, ports, customs, policing and even heads of state.

3) Important role of **non-state actors including both criminals, terrorists** and hybrids of the two. Transfer of this much money to these illicit networks is a **security challenge in the OSCE region**. Example of this is one of the Kouachi Brothers, a terrorist who killed the cartoonists of Charlie Hebdo, sold illegal cigarettes. Other cases within the US and Europe.

4) **Numerous facilitators** help move cigarettes including truck drivers, corrupt officials who let the containers and trucks with illicit cigarettes transit and smugglers.

5) **Importance of Hubs outside of OSCE Region**. Free Trade Zones play a key role in the illicit trade in cigarettes, The Jebel Ali free zone in Dubai is key in the import of illicit cigarettes into Europe.

6) **Illicit cigarette trade is not a stand-alone crime. It converges with the drug trade, wildlife smuggling, trade in counterfeit goods and other crimes**. The Czech police found an illegal shipment of rhino horn transiting Prague as they were tipped off by law enforcement following the cigarette trade of the Vietnamese diaspora community.

7) **Importance of new media**. Facebook, for example, has notices on delivery and pick-ups of illicit cigarette loads but does not do enough to police content even though the issue has been brought to their attention.

8) **Absence of law enforcement focus on cigarette smuggling in OSCE region, an “underpoliced crime”**—absence of network analysis, crime-terror analysis, they do not allocate enough law enforcement resources to combating what seems to many like petty trade. Criminals and terrorists go where there is low-risk of enforcement.

9) Sale of cigarettes provides the **venture capital for other forms of illicit trade**. For example, members of the Vietnamese diaspora community became key actors in the low-level cigarette trade in Germany and the Czech Republic. With this initial capital, they were able to become key conduits for the import of counterfeit goods from Asia and their distribution within Western Europe. That trade gave them the capital and the connections to escalate to the extremely profitable illicit rhino horn trade.

10) **The prevalence of illicit cigarette trade reveals the limits of our strategies to counter illicit trade**.

The following is an excerpt from my forthcoming book under contract with Princeton University Press on illicit trade. It illustrates many of the key points that I have made above.

At the Museum of Immigration in Paris, there are headsets where you can listen to immigrants recount their life stories. One especially moving audio that I heard was of an illegal North African migrant living in Southern France on the margins of society. His voyage out of Africa started on a precarious boat that crossed the Mediterranean several years before the mass transports of today. He arrived in impoverished Southern Italy and found no work. He worked his way farther north in Italy, still finding no employment. Then he crossed into France and made his way to Paris. There, he explained he found no better prospects to make a living. He moved south, this time, settling in Marseille. He ended his tale reporting he had found a way to survive. He was selling cigarettes.

What the immigrant does not mention is that most street cigarette vendors of Marseille are selling illegal ones. Hardly surprising, as France in 2016 merited the distinction—“European champion of illicit cigarette sales.” One form of illegality lies within another—irregular migrants, without the right to work, sell smuggled cigarettes. These illegal products arrive through smugglers—a third of France’s illegal cigarettes are smuggled from Algeria, and a quarter arrive from Spain where tax

rates are lower<sup>1</sup> and Barcelona is a key hub for the receipt of smuggled cigarettes.<sup>2</sup> Cigarettes arrive in France from Algeria, having avoided all taxation, allowing them to be sold in open-air markets at substantially lower prices than legitimate retail products.

Marseille is the French hotspot for illicit cigarette sales—approximately 40% of all sales are of illegal imports.<sup>3</sup> This port city has long been a center of illicit trade. Think of the French Connection, where drugs arrived from Turkey to be shipped to the United States via Canada.<sup>4</sup> But international law enforcement expended formidable resources to combat the lucrative heroin trade. In contrast, police allocate few resources against the petty cigarette traders even though these also harm human life. This inattention is not a result of corruption, as the sellers lack the funds and the contacts to corrupt French officials.<sup>5</sup> Therefore, the recorded migrant, as well as many others at the margins of the economy, exist in this trade as France is the contraband cigarette capital of Western Europe. In France, over 27% of its sales (820 million packs) in 2016 were bought in shops or locales not authorized to sell tobacco. Half of the cigarettes were contraband and counterfeit and many of the rest were illicit whites produced to be smuggled.<sup>6</sup> In France, cigarettes on the street sell for about 5 euros for diverted products and illicit whites or counterfeited products can be found at 4 euros. In the shops the prices are much higher—7 euros. The difference in price results in massive tax losses to the state, approximately, four billion euros of tax losses annually for the French economy.<sup>7</sup> Moreover, the state may subsequently also incur greater health costs, as unregulated cigarettes may also be worse for individual health, as they are often produced under unregulated conditions and often contain components that are more carcinogenic. The massive tax losses also undermine funds that could be spent on social and health services, and invested in infrastructure.

There are also more pernicious sellers in these illicit markets. One of the Kouachi who killed the cartoonists of Charlie Hebdo also made money by selling cigarettes.<sup>8</sup> But as we will see, the higher levels of the illicit cigarette chain may support terrorist funding in more significant ways.

An official US State Department report provided this slightly bizarre case. A major illicit cigarette smuggling operation was revealed when al Qaeda operatives successfully launched two rockets at a container transporting illegal cigarettes while it was passing through the Suez Canal in Egypt in transit to Ireland. The subsequent investigation of the facilitators behind this \$55 million illicit cigarette shipment revealed a wealthy Irishman who had made his fortune selling illegal ciga-

<sup>1</sup> Laurent Martinet, “La France, championne d’Europe des cigarettes de contrebande,” June 8, 2016. Accessed June 16, 2017, [http://lexpansion.lexpress.fr/actualite-economique/la-france-championne-deurope-des-cigarettes-de-contrebande\\_1800103.html](http://lexpansion.lexpress.fr/actualite-economique/la-france-championne-deurope-des-cigarettes-de-contrebande_1800103.html); Bill Wirtz, “Why Counterfeit Tobacco is Plaguing France,” April 17, 2017. Accessed June 16, 2017, <https://fee.org/articles/why-counterfeit-tobacco-is-plaguing-france/>.

<sup>2</sup> “Spanish Customs,” in Interpol, *Against Organized Crime : Interpol Trafficking and Counterfeiting Casebook* 2014, 36 (Lyon: Interpol, 2014).

<sup>3</sup> Anne Vidalie, “Contrebande: le boom des marques clandestines de cigarettes,” July 12, 2016. Accessed June 15, 2017, [http://www.lexpress.fr/actualite/societe/contrebande-le-boom-des-marques-clandestines-de-cigarettes\\_1811389.html](http://www.lexpress.fr/actualite/societe/contrebande-le-boom-des-marques-clandestines-de-cigarettes_1811389.html); Francesco Calderoni, et. al., *The Factbook on Illicit Trade in Tobacco Products-8 France*, June 1, 2016, Accessed June 15, 2017, <http://www.transcrime.it/publicazioni/the-factbook-on-the-illicit-trade-in-tobacco-products-8-france/>.

<sup>4</sup> Ryan Gingeras, *Heroin, Organized Crime and the Making of Modern Turkey* (Oxford: Oxford University Press, 2014), 122–123 and Jonathan V. Marshall, *The Lebanese Connection: Corruption, Civil War, and the International Drug Traffic*. Stanford Studies in Middle Eastern and Islamic Societies and Cultures Series. (Stanford: Stanford University Press, 2012), 33–48.

<sup>5</sup> Nacer Lalam, “France from Local Elites to National Leaders,” in *Corruption and Organized Crime in Europe: Illegal partnership* eds. Philip Gounev and Vincenzo Ruggiero, 109–110. Abingdon: Routledge, 2012.

<sup>6</sup> KPMG, Project Sun, *A Study of the Illicit Cigarette Market in the European Union, Norway and Switzerland, The Illicit KPMG 2016 Results*. 2017, Accessed July 13, 2017, <https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2017/07/project-sun-2017-report.pdf>.

<sup>7</sup> Martinet, “La France, championne d’Europe des cigarettes de contrebande,” and KPMG, “Project Sun-Results 2015.” Accessed June 16, 2017, <https://home.kpmg.com/uk/en/home/insights/2015/05/project-sun-a-study-of-the-illicit-cigarette-market.html>. Project Sun is a project of KPMG as part of the agreements concluded among Philip Morris International, the European Commission, OLAF and the Member States to tackle the illicit trade. Project Sun involves all the four major multinational tobacco manufacturers (Philip Morris International, British American Tobacco, Imperial Tobacco and Japan Tobacco International).

<sup>8</sup> Rajan Basra, Peter Neumann and Claudia Brunner, *Criminal Pasts, Terrorist Futures: European Jihadists and the New Crime-Terror Nexus* (London: ICSR, 2016), 44. Accessed June 16, 2017, <http://icsr.info/2016/10/new-icsr-report-criminal-pasts-terrorist-futures-european-jihadists-new-crime-terror-nexus/>; Katrin Bennhold and Eric Schmitt, “Gaps in France’s Surveillance Are Clear; Solutions Aren’t,” *New York Times*, February 17, 2015. Accessed June 16, 2017, <https://www.nytimes.com/2015/02/18/world/gaps-in-surveillance-are-clear-solutions-arent.html>.

rettes to UK and Irish markets. His clients included sellers known to have ties with the IRA.<sup>9</sup>

The public face of the illicit cigarette trade, seemingly a low level activity, masks a variety of actors that go up to the senior leadership of many countries. The leaders of illicit trade are often rich and powerful politicians who escape sanctions, whereas the street sellers are the ones targeted by law enforcement and suffer disproportionately.

Between the top and the bottom lie a significant group of diverse facilitators. Sales are also facilitated by social media that largely lies outside regulation. The sale of almost nine billion illegal cigarettes in France annually points to a large group of facilitators between the source and the street markets.<sup>10</sup> This movement of product is not done by “ants” who carry a few cartons of cigarettes at a time.

The Algerian-origin cigarettes are produced for a legal market in Algeria. For millions of cigarettes to arrive in France illegally, there need to be factory workers, shippers and vendors in Algeria capable of diverting this product en masse to France. There are also high level Algerian officials implicated in this trade. This quantity of product requires containers arriving from Algeria, revealing corruption in the French port. Individuals must load the trucks from the ships and many drivers, both knowingly and unknowingly, move large quantities of illicit cigarettes overland from Spain to France.

But the drivers’ defense that they are not aware of what they transport is contradicted by examining social media. Just as false news can be disseminated through Facebook because it does not have the appropriate filters to weed out such posts, neither does it control the posts placed on Facebook pages to facilitate illicit trade. Despite official complaints by those trying to arrest this illicit trade, posts on Facebook continue to advise truck drivers and distributors where to pick up these illicit shipments.<sup>11</sup> The problem in France is just the tip of the iceberg.<sup>12</sup> In the UK, Imperial Tobacco has targeted Facebook as a key facilitator of illicit trade in cigarettes.<sup>13</sup> The new media is a force multiplier for the growth of illicit trade from human trafficking to drugs and wildlife products.

France is not the only illicit cigarette hub in Europe that combines massive low-level street sales with significant imports.<sup>14</sup> Huge containers of illicit cigarettes travel along with the legitimate commodities destined for European ports, such as Naples, where the Camorra sell cigarettes in the markets they control.<sup>15</sup> Another hotspot of this trade is Germany and the Czech Republic where Vietnamese vendors<sup>16</sup> sell “illicit whites”, a product produced legally in the home country with the intent to be smuggled to countries with higher tax rates. In this region of Europe, the shipments emanate from illicit white producers in Asia and the Middle East. They illustrate a recurring principle, illicit trade is rarely of one commodity—prod-

<sup>9</sup> “The Global Illicit Trade in Tobacco: A Threat to National Security,” US Government, 2015, 21. Accessed June 15, 2017, <https://2009-2017.state.gov/documents/organization/250513.pdf>.

<sup>10</sup> KPMG, “Project Sun Results,” 10.

<sup>11</sup> Interview with PMI official in France in 2015.

<sup>12</sup> C. Ben Lakhdar, “Quantitative and Qualitative Estimates of Cross-Border Tobacco Shopping and Tobacco Smuggling in France,” *Tobacco Control* 17, no. 1 (February 1, 2008): 12–16.

<sup>13</sup> “Imperial Tobacco Targets Facebook Fraudsters,” *Scottish Local Retailer Magazine*, July 14, 2016. Accessed June 17, 2017, <http://www.slrimg.co.uk/imperial-tobacco-targets-facebook-fraudsters/>.

<sup>14</sup> Francesco Calderoni et al., “United Kingdom. The Factbook on the Illicit Trade in Tobacco Products 1,” *The Factbook on the Illicit Trade in Tobacco Products*—Università degli Studi di Trento, 2013. Accessed June 17, 2017, <http://www.transcrime.it/publicazioni/the-factbook-on-the-illicit-trade-in-tobacco-products-1/>, accessed March 6, 2017; Francesco Calderoni et al., “Italy. The Factbook on the Illicit Trade in Tobacco Products 2,” (Trento, Italy: Transcrime—Università degli Studi di Trento, 2013). Accessed June 17, 2017, <http://www.transcrime.it/publicazioni/the-factbook-on-the-illicit-trade-in-tobacco-products-2-italia/>; Transcrime, *European Outlook on the Illicit Trade in Tobacco Products* (Trento: Università degli studi di Trento, 2015), 53, Accessed June 17, 2017, <http://www.transcrime.it/publicazioni/european-outlook-on-the-illicit-trade-in-tobacco-products/>; Francesco Calderoni, “A New Method for Estimating the Illicit Cigarette Market at the Sub-national Level and Its Application to Italy,” *Global Crime* 15, no. 1–2 (2014): 51–76.

<sup>15</sup> Isaia Sales, “Droga e contrabbando, stesso affare di Camora,” *Il Mattino*, August 1, 2016.

<sup>16</sup> Klaus von Lampe, “The Trafficking in Untaxed Cigarettes in Germany: A Case Study of the Social Embeddedness of Illegal Markets,” In *Upperworld and Underworld in Cross-Border Crime*, edited by Petrus van Duyn, Klaus von Lampe, Nikos Passas, 141–161. Nijmegen: Wolf Legal Publishers, 2002; M. Nožina, “Crime Networks in Vietnamese Diasporas, The Czech Republic Case,” *Crime Law and Social Change* (2010) 53: 229–58; M. Nožina, “The Czech Republic: A Crossroads for Organised Crime.” In *Organised Crime in Europe. Concepts, Patterns and Control Policies in the European Union and Beyond*, edited by C. Fijnaut & L. Paoli, 435–66. Dordrecht: Springer, 2004; Miroslav Nožina and Filip Kraus, “Bosses, Soldiers and Rice Grains. Vietnamese Criminal Networks and Criminal Activities in the Czech Republic,” *Europe-Asia Studies*, Vol. 68, No. 3 (2016): 508–28

ucts, routes and networks converge. A seemingly low level and “victimless” crime like the cigarette trade can provide the structure to facilitate the trade in one of the most endangered species.<sup>17</sup>

Yet the cigarette trade can reach to the top of the political pyramid. The Organized Crime and Corruption Reporting Project, an amalgamation of some of the top investigative journalists in the world, decided to create an award that is a dark reflection of the “Time” magazine “Man of the Year.” This award, given annually to the political figure who has done the most to facilitate organized crime and corruption, was presented in 2015 to Milo Djukanovic who served either as President or Prime Minister of Montenegro from 1991 to 2016 as one of the nominators for the highly competitive award, “2015 Man of the Year in Organized Crime,” stated, “Djukanovic, the last European dictator, has captured our country for his own private interests and turned it into safe haven for criminals. While he, his family and friends enriched themselves, ordinary people suffer from poverty, injustice and lawlessness, while those who dare to talk about the corruption become his targets.”

Among the many cited crimes that merited this distinction was his major role in cigarette smuggling, for which he was particularly singled out in the award statement. The distinguished jury of OCCRP concluded that “Djukanovic and his close associates engaged in extensive cigarette smuggling with the Italian Sacra Corona Unita and Camorra crime families. He was indicted in Bari and freely admitted the trade, but said his country needed money. He invoked diplomatic immunity to get the charges dropped.”<sup>18</sup> Furthermore, according to OCCRP, “While he claims to have stopped the smuggling, OCCRP found an island off the coast financed by his family bank and owned by his good friend Stanko Subotic, a controversial businessman who was three times indicted but never convicted of cigarette smuggling related activities. The island was run by Djukanovic’s head of security and was being used to smuggle cigarettes with some of the same organized crime figures who were previously involved.”<sup>19</sup>

The forensic evidence for this award was strong—the Italian courts presented wiretap-derived evidence and hundreds of thousands of documents to show that the Montenegrin government was making \$700 million annually from this illicit trade in the 1990s and the Italian mafia groups behind this trade laundered \$1 billion dollars through Swiss banks based in Lugano. The Italian authorities showed that this massive illicit cigarette trade went straight to the top—Djukanovic was behind this enormous racket.<sup>20</sup>

The public face of the illicit cigarette trade, seemingly a low level activity, masks a variety of actors that go up to the senior leadership of many countries such as Bulgaria. The leaders of illicit trade are often rich and powerful politicians who escape sanctions, whereas the street sellers are the ones targeted by law enforcement and suffer disproportionately. What these snapshots of the illicit cigarette trade reveal is a diverse array of participants from the highly vulnerable illegal immigrant up to the heads of small countries who engage in this activity for their personal advantage and possibly for some benefit for their state. Also involved in this trade are factory workers eager to add to their incomes, organized crime groups making vast profits, terrorists in Europe, and the Middle East. These are not the only ones to profit from this trade, as there are truck and cargo transporters who move this bulky freight, and bankers laundering huge profits of this trade. To move this much product, to evade billions in taxes and generate millions in profits requires more than just organized crime. It requires the complicity of the powerful and the enablers of the legitimate world.

<sup>17</sup> Accessed June 17, 2017, <https://www.occrp.org/personoftheyear/2015/>.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Leo Sisti, “The Montenegro Connection: Love, Tobacco, and the Mafia,” July 9, 2009, Accessed June 17, 2017, [https://www.reportingproject.net/underground/index.php?option=com\\_content&view=article&id=7&Itemid=20](https://www.reportingproject.net/underground/index.php?option=com_content&view=article&id=7&Itemid=20); Calderoni, “A New Method for Estimating the Illicit Cigarette Market at the Subnational Level and Its Application to Italy.” Calderoni cites the Italian investigation on this topic: DIA, Esito Attività Di Indagine Svolta Sul Conto Di Djukanovic Milo + 4. N. 125/BA/2°SN. 125/BA/2° Sett. Inv. Giud. /H5. 148-1/ 1379 Di Prot.ett. Inv. Giud. /H5. 148-1/ 1379 Di Prot.,14, see online Accessed June 17, 2017, [https://www.reportingproject.net/unholyaliances/docs/Smuggling\\_2.pdf](https://www.reportingproject.net/unholyaliances/docs/Smuggling_2.pdf); Walter Kemp, *Criminal Kaleidoscope: Organized Crime in the Balkans*, (Geneva: Global Initiative Against Transnational Organized Crime 2017), 13–4, 19–22.

**Addressing the Illicit Cigarette Trade:**

- 1) **Allocate more law enforcement resources to the problem** to focus on convergence with other forms of illicit trade, the problem of hybrids (criminal/terrorists) engaged in this activity. Focus on network analysis of the participants, facilitators and corrupt officials who promote and facilitate the trade.
- 2) Europol is focusing more on the connections of crime and terrorism. **Encourage law enforcement in the OSCE region to focus on the cigarette trade as a security challenge.**
- 3) **Address the high-level corruption** that facilitates this trade and end the culture of impunity for this activity, on this see the recent report: Walter Kemp, *Criminal Kaleidoscope: Organized Crime in the Balkans*, (Geneva: Global Initiative Against Transnational Organized Crime 2017), 13-4, 19-22. <http://globalinitiative.net/ocbalkans/>.
- 4) **Require corporations in the new media space to focus more on their facilitating role in the illicit cigarette trade.** Just as Facebook and other new media companies are being forced to focus more on the abuse of their platforms for terrorist recruitment, they should be required to do more to address the illicit trade that funds criminal and terrorist networks.
- 5) More attention needs to be paid to **counter the facilitating role of Free Trade Zones in illicit trade.** Their existence also has an important impact on the customs and tax revenues of OSCE member states.
- 6) **We need research** to help us understand the illicit flows, the hubs of the trade and the convergence of different forms of illicit trade.
- 7) We need greater **harmonization of tax policies on cigarettes** as it is the discrepancy of pricing in many countries in the OSCE region that provides the financial incentive to participate in smuggling.
- 8) **There needs to be serious analysis of the optimum tax rates on cigarettes that address state revenue concerns but also do not contribute to smuggling.** France that is already the contraband capital of Europe was discussing in early July raising tax rates to 10 euros a pack without analyzing the impact this would have on illicit trade.

PREPARED STATEMENT OF DAVID SWEANOR, ADJUNCT PROFESSOR OF LAW,  
UNIVERSITY OF ONTARIO

**My background.** I led efforts to use tax-based cigarette price increases as a public health tool in Canada starting in the 1980s and worked to bring such policies to the US and elsewhere. Among other things, I was the primary author of the 1996 WHO World No-Tobacco Day materials on the the economics of tobacco and a co-author of a 2015 New England Journal of Medicine commentary on the importance of differential taxes for differential risks. For decades I have been actively involved in studying, monitoring, and litigating on, the global illicit cigarette trade.

**The price of tobacco products is a dominant driver in their use.** Cigarette taxation has been, by far, the most powerful tool used to date in reducing cigarette consumption. Higher prices result in reduced smoking. Differential taxation of different tobacco/nicotine products also significantly spurs movement between types of products. But differential prices between licit and illicit products also spurs contraband. The countries of eastern Europe are a particular concern as a source for illicit trade due in part to significant price differentials with the countries of the European Union.

**The illicit traffic in tobacco products (ITTP) is a public-health issue, a public-safety issue, and a drain on public revenue.** Cigarette tax increases can be a ‘triple win’, benefiting public health while raising revenue and being popular. By contrast, the illicit trade is a ‘triple loss’, adding to health burdens, augmenting criminality and reducing revenue.

**ITTP is substantial.** While accurate numbers are hard to establish, because of both the inherent difficulties in measuring illicit activities and the frequent lack of interest in quantifying the problem, ITTP currently appears to generate billions of dollars per year in illicit earnings, and an even larger volume of taxes not paid.

**Understanding the business model.** Profitable smuggling depends on a significant profit margin between cost of acquisition plus cost of doing business (including the likely penalties and probability of apprehension) and the selling price.

Cigarettes are inexpensive to manufacture (1–2 cents per stick) and the market for them is huge; measured in the hundreds of billions of dollars and over a billion customers worldwide. Due to high manufacturer margins and high taxes licit products sell at a huge multiple of manufacturing costs, creating the enormous profit potential for illicit products. Effective interventions need to focus on changing the business viability of this trade.

Within OSCE countries the business conditions for this illicit trade can be particularly favorable. Cigarettes can relatively easily enter the illicit category; the costs and overall risks of the trade are often manageable and there is a very large and high-price market easily accessible in the European Union.

**Changing the business viability.** Measures such as impediments to acquiring manufacturing machinery and supplies can raise the price of manufacturing illicit cigarettes. As will measures that constrain the supply of untaxed cigarettes, such as the agreements the European Union reached with international tobacco companies as a result of civil RICO actions launched in the United States.

Measures that increase the likelihood of apprehension, such as effective product track and trace technology, cooperation with businesses harmed by ITTP and greater resources for enforcement can combine with significant penalties to raise the cost of engaging in the business.

Finally, reducing the potential selling price of illicit cigarettes further constrains the viability of the contraband business.

**Working with consumers rather than against them.** Too many efforts to counter illicit trade see the consumers of these products simply as part of the problem. There is much to be gained by working with them.

Most smokers wish not to be smoking, but are held in the market by issues that include addiction, self-medication and a lack of knowledge and availability of viable alternatives. The lack of alternatives to cigarettes for dependent smokers creates the basis for the lucrative market for illicit products. This makes illicit cigarettes different than most consumer products with an illicit market in that the purchasers express a strong desire to stop using the product in question. That in turn gives a huge opportunity to those seeking to reduce the illicit demand.

The enormous harm to health from cigarettes is caused not from the nicotine nor the tobacco, but from the inhalation of the products of combustion. Thus, if we did far more to facilitate access to, and provide non-misleading information about, non-combustion alternatives to cigarettes we could give the consumers of illicit cigarettes

a far better alternative. Such products already exist in the form of smokeless tobacco, medicinal nicotine, vaping and heat-not-burn products, with tremendous scope for ever better alternatives. Given the ability to use policy measures to set relative taxation, marketing, product standards, etc. the licit products that are massively less dangerous could be facilitated to out-compete illicit cigarettes, driving them from the market. We are already witnessing this in many markets where vaping is displacing contraband cigarettes.

By combining these efforts to raise the cost of acquiring and dealing in the ITTP category, and facilitating market forces in replacing the consumer market for such goods, we can more effectively control the ITTP market. We can do it in a way that respects consumer rights, the rule of law and the power of market forces while stemming criminality and greatly improving health.

**Concrete steps include:**

- 1) Greater resources to monitor and control ITTP within the United States.
- 2) The use of existing laws, including RICO actions, to battle illicit trade. For European and Eurasian countries, action by the US to ensure that foreign governments can access RICO remedies for loss of revenue to international criminals, and stronger efforts to prevent money laundering through the US, would be major positive steps.
- 3) Greater resource allocation to battling ITTP globally. Such law enforcement can be expected to more than pay for itself while combatting crime and protecting health.
- 4) Differentiate taxation so that licit non-combustion alternatives to cigarettes are both a better health and better economic choice than illicit cigarettes. Currently US funded anti-tobacco groups are doing the opposite—campaigning globally for measures that discourage smokers from switching to less hazardous products, thus making illicit cigarettes a more likely option for the nicotine dependent.
- 5) Far greater access to reduced risk products that are a viable alternative to cigarettes. The FDA should be facilitating rather than constraining the entrance of such products onto the market, and sharing the resulting expertise globally.
- 6) National and international efforts to adequately inform smokers of the range of low risk alternatives to cigarettes and the differentials in risk compared to smoking cigarettes. The CDC could move from an abstinence-only ‘tobacco free world’ orientation to one focused on reducing both health risks and illegality.

PREPARED STATEMENT OF MARC FIRESTONE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, PHILIP MORRIS INTERNATIONAL, INC.

## INTRODUCTION

Mr. Chairman, Co-Chairman Smith, members of the Commission, thank you for holding today's hearing on the real and growing threat posed by the illicit trade in tobacco. I appreciate the opportunity to testify on this important issue. I am Marc Firestone, Senior Vice President and General Counsel at Philip Morris International.

Philip Morris International is the world's leading tobacco company, employing more than 80,000 people globally. We are one of the largest purchasers of American-grown tobacco leaf and support the livelihoods of American farmers in multiple states.

Outside of the United States we own the trademarks of six of the world's top international brands, including the iconic *Marlboro*. We operate in approximately 180 countries outside of the United States. Philip Morris USA, a subsidiary of Altria—our former parent company—owns the trademark rights to Marlboro, for example, and other brands in the U.S., and manufactures, distributes and sells products bearing these trademarks for the U.S. domestic tobacco market.

The illicit tobacco trade is deeply concerning to our company. But, we recognize that we have a shared challenge with governments, as the illicit trade in tobacco poses a threat to safety, security and the rule of law in Europe, the United States and around the globe.

I appear here today in the spirit of cooperation to describe what we consider industry best practices to fight illicit trade. We hope that this hearing will assist U.S. government leadership to prioritize this issue within the OSCE member nations, partners for cooperation, and global security community.

Within PMI's structure, I am ultimately responsible for our company's anti-illicit trade efforts, which are organized in a department we call Illicit Trade Strategies & Prevention (ITS&P). Our ITS&P group is a dedicated team of over 70 professionals around the world, including forensic specialists, logistics experts, researchers, intelligence analysts, businessmen and women, lawyers, government relations and communications specialists. This commitment of resources to fighting illicit trade is warranted, we believe, because of the magnitude and complexity of the problem.

According to the most recent estimate conducted by the World Health Organization in 2006, and echoed by the U.S. State Department in 2015, illicit trade represents 10-12% of global tobacco consumption, constitutes an illicit volume of approximately 600 billion sticks, and robs governments of USD 40-50 billion annually. This makes the value of the illicit tobacco trade greater than the value of illicit trade in oil, wildlife, timber, arts and cultural property, and diamonds combined.

The global auditing firm KPMG has published similar figures and identifies an illicit volume of more than 48 billion cigarettes in the E.U. alone. Aside from the risks to consumers from purchasing illicit and unregulated cigarettes, the effect on European tax revenues is substantial. KPMG estimates EUR 10.2 billion is lost in the E.U. every year to this criminal activity.

In addition to the macro-economic impact of the illicit tobacco trade, other negative implications are also significant and include:

- Threats to national security by providing a major source of illegal income for transnational organized criminal groups;
- Encouragement of corruption and threats to the rule of law in countries where illicit trade is rampant;
- Reduced effectiveness of public health policies;
- Threats to the sustainability of the legal supply chain; and
- Impact on the legitimate industry's business.

PMI has a clear business imperative to combat this problem and ensure our products are legally sold in the market for which they are intended. We lose significant revenues and market share because of illicit trade. For example, we earn as much as three times less revenue every time an adult smoker in a high-price market buys PMI-branded cigarettes smuggled from low-price markets instead of buying the cigarettes through legal sales channels. Illicit trade also damages the reputation and value of our iconic brands.

However, the threat posed to safety, security, and the rule of law in Europe, the United States and around the globe is where the interests of our company and the concerns of this Commission most pointedly intersect. The concern for this issue is shared by multiple agencies within the U.S. government, including the State De-

partment, which released a December 2015 interagency report entitled, “The Global Illicit Trade in Tobacco: A Threat to National Security.” In this report, the State Department described the problem as follows:

*“Like other forms of illicit trade, the illicit trade in tobacco products, commonly referred to as cigarette smuggling, is a growing threat to U.S. national interests. Internationally, it fuels transnational crime, corruption, and terrorism. As it converges with other criminal activities it undermines the rule of law and the licit market economy, and creates greater insecurity and instability in many of today’s security ‘hot spots’ around the world.”<sup>1</sup>*

#### **DIFFERENT FORMS OF ILLICIT TOBACCO**

In the past, anti-illicit trade efforts were focused on fighting counterfeits, intellectual property violations and trademark infringement. Criminals have shown their agility, however, and we now fight a more diverse range of illicit tobacco activities. Research shows that contraband and excise tax avoidance schemes make up the vast majority of illicit trade in the tobacco industry.

This is a critical distinction. Counterfeiting and related trademark and other intellectual property violations, have been directly addressed in U.S. and foreign legal codes. In most countries, the law is clear on this point, and provides for severe penalties. Trademark owners can pursue remedies to support a case for prosecution and punishment.

However, smuggling is a much more diffuse and difficult criminal activity to tackle—and this is where many criminals have found safe haven. Cross-border smuggling, by definition, introduces jurisdictional challenges. The capacity to operate beyond national borders is an important advantage for organized criminal groups, which can quickly change their modus operandi or trafficking routes. Cross-border smuggling is also a substantial challenge for national law enforcement, because it requires obtaining evidence from multiple jurisdictions and effective exchange of information between law enforcement worldwide. Unfortunately, practice shows that legal tools or mechanisms for such exchange are insufficient. As a result, even if law enforcement agencies seize illicit shipments, criminal investigations rarely dismantle cross-border networks, and criminal groups continue to operate with impunity. The problem is made worse by certain manufacturers, which knowingly produce for markets in which they lack legal distribution or behave recklessly in their approach to supply chain control.

#### **DRIVERS OF ILLICIT TRADE**

A major driver of the growth in illicit trade is the substantial profits to be made by criminal organizations from selling illegal cigarettes, but other factors also contribute to the problem.

##### **Price disparities encourage smuggling**

The price of legitimate cigarettes varies substantially across countries (and sometimes within states or provinces of the same country) because of often vastly different tax rates and consumer disposable income levels. These large disparities motivate smugglers to target high-price countries with product from lower-price countries. The increased free flow of people and goods across national borders in areas such as the European Union brings many benefits but significantly reduces the risk for criminal gangs by providing easier access and transportation links between countries.

##### **Excessive taxation and regulation**

Taxation and regulation play an important role for governments as part of a public health policy to reduce smoking rates. However, when taken to an extreme, a heavily taxed and over-regulated market makes the unregulated and untaxed black market attractive for criminals. Tax increases on cigarettes that go well beyond inflation rates give smokers the incentive to 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.

##### **Criminals make huge profits**

In China, counterfeiters produce approximately 190 billion counterfeit cigarettes annually. Just one 40-foot container of counterfeit cigarettes produced in China could generate up to USD 2.3 million in profit when sold in Europe. If all 190 billion Chinese counterfeit cigarettes were exported and sold in Europe, this criminal trade could be worth up to USD 44 billion a year.<sup>11</sup>

### **Inadequate penalties and overstretched enforcement authorities**

While the profits may be comparable, the penalties for smuggling cigarettes in some countries are far lower than for crimes such as smuggling drugs or firearms.

For example, in Germany, criminals caught and convicted of smuggling drugs regularly face a minimum prison term of two years, whereas convicted cigarette smugglers may get away with only a monetary fine. 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.

Poland, for example, has numerous border crossings with Russia, Ukraine and Belarus. High pedestrian and vehicle traffic at these borders combined with limited enforcement resources make it difficult to control the flow of goods. These borders are routinely used by smugglers to move cigarettes into Poland and from there the goods are transported to other EU countries without further border controls.

### **CONSEQUENCES OF ILLICIT TRADE**

Among its many destructive consequences, the illicit tobacco trade:

- Robs governments of tax revenues;
- Exposes consumers to unregulated products often manufactured in unsanitary conditions;
- Poses threats to security by providing a major source of illegal income for transnational organized criminal groups;
- Encourages corruption and threatens the rule of law in countries where illicit trade is rampant;
- Reduces the effectiveness of public health policies;
- Makes it easier for minors to access tobacco products; and
- Undermines the legitimate industry's business.

### **Threats to Security**

The increasing threat to security was recently illustrated by the European Commission:

*"The illicit tobacco trade has long been recognized as a main source of revenue for organized crime, and, in some cases, terrorist groups. The new European Agenda on Security adopted by the European Commission on 28 April 2015 recognizes the importance of fighting cigarette smuggling as a means of cutting off criminal groups from this revenue source."*<sup>iii</sup>

### **Illicit tobacco trade as a threat to the national security of the United States:**

The past two decades have provided a number of cases demonstrating the direct link between cigarette smuggling and serious organized criminal and terrorist activity in the United States. Illicit cigarette tax stamps helped to fund one of the convicted bombers in the first World Trade Center bombing in 1993, and U.S. government reports have found that illegal cigarette smuggling networks here in the U.S. are being used to fund terrorist networks in the Middle East like Hezbollah, Hamas, and al Qaeda. As an American company, we are particularly troubled by these cases and supportive of any efforts the U.S. government takes to shine a light on this problem.

### **Security threats in other parts of the world:**

At the 2009 International Law Enforcement Intellectual Property Crime Conference, Ronald K. Noble, INTERPOL Secretary General, stated:

*"Paramilitary groups and organized crime rely on counterfeiting—especially of cigarettes—to reap huge profits and even to fund terrorist activities."*

Experts have also said illegal cigarette trafficking is a source of funding for terrorist group Islamic State (ISIS). According to one of the witnesses appearing before this commission today, Dr. Louise Shelley:

*"Oil is not ISIS' only source of revenue ... Still more funding comes from the sale of counterfeit cigarettes, pharmaceuticals, cell phones, antiques and foreign passports." — Foreign Affairs Magazine, 2015*

Christian Eckert, France's Minister of Budget, also recognized the link between terrorism and illicit trade in an interview in 2014, where he stated the following:

*"What is clearly evolving is to involve Customs in the fight against terrorism. It is demonstrated and known that many jihadists are involved in petty crime (counterfeit, contraband of tobacco, drugs)."*

### **Damage to legitimate business**

A study conducted by Frontier Economics, a leading European economics consultancy, reported that 2.6 million jobs have been lost in the G20 countries due to counterfeiting and piracy of a wide range of consumer products, including brand name luxury goods and tobacco.<sup>vi</sup>

In the legal tobacco supply chain, manufacturers, suppliers, wholesalers, distributors, and retailers are all affected by illicit trade. Manufacturers suffer considerable financial losses, and long-term damage to their brands, which they have invested time and money to build. Wholesalers, distributors, and retailers lose because reduced demand for legal products leads to fewer sales. Small retailers not only lose cigarette sales, but also the sale of other items adult smokers usually buy when in their shops. To illustrate, in the two Canadian provinces of Ontario and Quebec, 2,300 convenience stores closed down in 2009, largely because they are unable to compete with the low prices of contraband cigarette offerings.<sup>v</sup>

Illicit trade in tobacco is a threat to our business and to the entire legal tobacco supply chain. We welcome competition from competitors that respect the law. The problem we are discussing at this hearing is unlawful competition, which is inherently a threat to the entire lawful market. Moreover, the loss of legitimate sales to the black market results in fewer jobs and less taxable income for governments.

### **Billions in lost tax revenue**

As previously stated, the World Health Organization (WHO) estimated in 2006 that global illicit trade costs governments USD 40–50 billion annually in lost tax revenues. These resources could have been used to fund other services such as public safety or education programs. The European Commission estimated that in 2015 the illicit trade in cigarettes resulted in tax loss of EUR 11.3 billion within the European Union.

### **Minors have access to illegal tobacco**

PMI's unequivocal position is that children should not smoke or use products containing nicotine. Criminals who deal in and profit from the illicit trade in tobacco simply cannot say the same. By the very nature of their criminal activities, they do not differentiate between consumers on any basis. Independent experts and government authorities agree that the illicit tobacco trade—by operating outside lawful and regulated channels—provides easy access to tobacco products to youth.

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.”*

Furthermore, a study by the Canadian Centre for Addiction and Mental Health reported that 43% of secondary school smokers in the province of Ontario smoked contraband cigarettes.<sup>vi</sup>

### **PMI'S COMMITMENT TO ENSURE CONTROL OF OUR SUPPLY CHAIN AND FIGHT ILLICIT TRADE GLOBALLY**

Over the last few decades, PMI has led the industry by investing considerable resources to maintain strict controls over our supply chain. PMI products are sold in more than 180 countries to more than 900,000 direct customers, of which approximately 2,000 sell more than 25 million cigarettes per year. Supply chain control is not easy, but our efforts to maintain strong and robust control measures of our supply chain help prevent criminals from defrauding governments, legitimate businesses and consumers.

In each country where we sell our products, our business presence, trade dynamics, size of the retail universe, geography of the country and legal constraints differ. Thus there can be no uniform distribution model. In some countries we operate through a direct sales and distribution model, meaning that a PMI representative delivers the product to a local retail shop. In others, we sell to customers via third-party distributors or through wholesalers. Where a longer distribution chain is warranted, there will be some increased risk involved. However, we have developed supply chain tools and processes to mitigate that risk, which we have detailed in the following pages.

Supply chain control aims to ensure that our products are sold legally in the market for which they are intended, which makes sound commercial sense for us. Fighting against the diversion of our products, and more generally against illicit trade in tobacco products, is a key component of our sustainability program and supports our commitment to the United Nations Global Compact—of which PMI is a member.

Fighting illicit trade links directly to fighting corruption, contributing to improving human rights, labor rights and environmental standards, principles that organizations involved in illicit trade surely ignore or violate.

Over the years, our supply chain controls have been improved through our cooperation with regulators and other governmental agencies with whom we have specific commitments and obligations. PMI's 2004 signing of the Anti-Contraband and Anti-Counterfeit Agreement and General Release ("EC Agreement") and our commitments to, and cooperation with OLAF and the Member States under that Agreement have helped us to develop a better understanding of the evolving nature of the illicit trade in tobacco products and the potential solutions to this complex problem. Further to this point, we:

- apply Know-Your-Customer and Know-Your-Payment requirements in all PMI markets;
- have made large investments in state of the art tracking-and-tracing technology and developed other tools to effectively reduce the diversion of tobacco products from our supply chain; and
- use the information gathered from seizure inspections to identify the points of diversion with the aim of preventing reoccurrence.

The supply chain control measures developed through the EC Agreement have become part of the way we do business. We view these controls as global best practices, are committed to continuing them, and encourage others to adopt similar policies.

We have learned more about how to increase the effectiveness of our supply chain controls through our compliance with country-specific regulations, like the UK's Tobacco Products Duty Act 1979, and our ongoing cooperation with national customs and similar officials, such as the UK's HM Revenue & Customs (HMRC). During the course of 2014, HMRC conducted a review of our supply chain controls and recommended that PMI initiate a more formal global body to oversee coordination in the area of anti-diversion. We took this recommendation seriously, and launched a process that led to the creation of the Anti-Diversion Governance Committee and a review of the entire supply chain control program.

The Governance Committee's key objective is to ensure that PMI has the best possible approach to preventing the illicit flows of our products. The Committee's members are drawn from PMI's senior management. The creation of a global governance body comprised of senior company officials is further recognition that addressing product diversion requires effective coordination across countries, regions and departments. The Governance Committee is supported by an Anti-Diversion Working Group that includes representatives from Finance, Compliance, Law, Communications and ITS&P departments, reflecting the many PMI departments involved in supply chain control.

Under the Governance Committee's direction, we further refined our anti-diversion strategy and moved to a risk-based approach for our supply chain controls. We believe that a risk-based approach will enhance our efforts and efficacy by focusing resources and controls where they are most needed.

We classify markets from high to low risk into four risk categories. In a "high risk" market, profit opportunities and enabling factors make diversion of our products likely if not already evident. A "low risk" market, on the other hand, is a market where lack of profit opportunities and other factors make diversion of our products unlikely. For example, for a market with a simple distribution network and a high retail price, such as the U.K., the market risk profile would indicate limited or no incentives to smuggle product out of the country, and therefore, the U.K. would be classified as a "low risk" market. We continuously re-examine and adapt our supply chain control tools to fit the risk profile of the market.

#### **TOOLS AND PROCESSES TO SECURE THE SUPPLY CHAIN**

Each Philip Morris International employee, department, affiliate and region is aligned on our anti-diversion efforts. For us, alignment means common knowledge and a shared understanding of the interrelationships between the issues affecting different markets, as well as a shared commitment to the goal of preventing the diversion of our products.

The following is a list and brief description of the tools and processes we believe are critical for a tobacco company to control its supply chain:

- Order Controls
- Enhanced Volume Monitoring for higher risk markets
- Reporting Suspected Compliance Violations

- Training for Our Employees
- Tracking and Tracing
- Seizure Follow-Up

#### **Order controls**

We have a control system in place to monitor customer orders. In markets with significant risk of diversion, this control often involves benchmarking, in each customer order, brands at most risk for smuggling against the total order. In other words, when we receive an order from a customer, the ratio of high-risk brands is compared to the total ordered volume. If the ratio is higher than a benchmark based on average market demand, we take appropriate action, which may include reducing or declining the delivery of the high-risk brand volume.

#### **Enhanced volume monitoring**

Where markets are identified as having a higher risk of product diversion, in addition to the standard requirements of PMI's Know-Your-Customer program, we introduce enhanced volume monitoring processes. On a monthly basis, as part of our Know-Your-Customer program, each PMI affiliate is required to analyze sales to Significant Volume Customers in an effort to identify any unusual activity or trends. When there is a higher risk of product diversion we work to extend our volume monitoring further into the supply chain to increase our ability to detect unusual purchasing patterns that may reflect diversion somewhere down the supply chain. This means that when significant and recurrent volume variation is reported, we can, as appropriate, decide to take action and limit the volumes provided to that customer.

#### **Training for our employees**

Well-informed and properly trained employees are a key pillar of our Know-Your-Customer program. In 2016, PMI affiliates trained 9,483 employees in the Fiscal Compliance Program and Supply Chain Controls. PMI Duty Free business also conducts regular anti-diversion training for employees in the field, marketing and finance functions.

#### **Reporting suspected compliance violations**

PMI employees must report any suspected violation of the law or of our compliance Principles & Practices, and have a number of options for how to report. Under our Know-Your-Customer and related anti-diversion policies, employees are required to report suspected compliance violations of a potential diversion occurring in our supply chain.

#### **Tracking and tracing**

We have made large investments to implement a broad range of measures and technologies that meet and exceed our historic EC Agreement contractual commitments and current regulatory requirements. These measures and technologies are effective solutions to prevent the diversion of genuine products from the legal supply chain.

Our tracking and tracing systems operate successfully across our global supply chain. Today, we have more than 700 tracking locations in 133 markets, an effort that has required an investment of more than EUR 100 million.

PMI's tracking and tracing technologies have proven instrumental in helping law enforcement identify the origin of seized cigarettes. Our sales conditions make clear to all PMI customers that tracking and tracing data may be shared with law enforcement. Whenever a PMI customer is identified as having been involved in a transaction that eventually led to a seizure of PMI cigarettes in contraband channels, our affiliates are required to perform prompt follow-up through a variety of actions, including warning letters, additional training, face-to-face meetings to thoroughly investigate the issue and enhance volume and order monitoring, along with volume caps, if appropriate.

#### **Seizure follow-up**

Our seizure follow-up processes ensure that our customers are informed of seizures involving products they purchased and that, together with them, we take the necessary actions to sell in volumes commensurate with consumer demand in the intended market of distribution. Our customers, in turn, must performing fulsome Know-Your-Customer follow-up with their own customers.

For example, in 2015, the UK Customs authorities informed us of a seizure of Polish domestic PMI cigarettes. PM Poland analyzed the tracking and tracing data col-

lected and identified three customers as a potential point of diversion. Discussions with those direct customers identified a subsequent customer that was potentially involved in the diversion of products. Having already been warned and subjected to quotas because of potential involvement in a previous seizure of diverted products, our customer decided to terminate its business relationship with the downstream buyer under suspicion of diversion.

#### **Law enforcement cooperation**

As a private company there is a limit to what we can do to thwart the activities of serious organized crime groups who exploit the high profitability and relatively low risk of smuggling of tobacco products.

In this complex situation, we need, seek, and welcome cooperation with law enforcement and government authorities. In our ongoing cooperation with law enforcement authorities and in public-private partnerships we strive to be as transparent and effective as possible.

During 2016, PMI cooperated on many levels with authorities worldwide, including inspecting 392 seizures in 31 countries and delivering training to over 2,418 law enforcement officers on anti-illicit trade across all PMI regions. We are eager to continue and enhance such cooperation in the future, which can be achieved, for example, by direct cooperation agreements between PMI and each individual country and or authorities through a Memorandum of Understanding (MoU).

Currently, PMI has more than 50 MoUs in force in 40 countries related to the fight against the illicit trade of tobacco products. In some countries we have multiple MoUs, given the various departments within a single country that could—and many times do—contribute to this fight.

#### **PMI IMPACT Grant Program**

Launched in May 2016, PMI IMPACT is a global initiative for which PMI has pledged USD 100 million to support public, private, and non-governmental organizations to develop and implement projects against illegal trade and related crimes, such as corruption, organized crime, human trafficking and money laundering. We consider this a leading private sector initiative.

The program is overseen by a council of seven external independent experts from the fields of law, anti-corruption and law enforcement, who review and select funding proposals for projects to enable innovation in three key areas in the fight against smuggling and related crimes—research, education and awareness, and action. Proposals can come from private, public, or non-governmental organizations.

For its first funding round, PMI IMPACT called for projects that have an impact on illegal trade and related crimes in the European Union, even if implemented elsewhere.

#### **RECOMMENDATIONS**

In our view, key elements for private industry to be effective in controlling the illicit tobacco trade include:

- Use of research and intelligence to better understand the problem and its drivers;
- Effective supply chain controls;
- Tracking and tracing systems based on open standards that can be used by all relevant stakeholders in the supply chain, across different technological platforms, geographies and industries, to prevent product diversion;
- Control of all elements of the supply chain—including the supply of the key components for manufacturing cigarettes, such as cellulose acetate tow;
- Education campaigns that raise public awareness of the problem and its effect on society;
- Innovative programs, such as the PMI IMPACT USD 100 million grant program, to fund innovative solutions to fight against illicit trade; and
- Cooperation between brand owners and shipping and transport companies that generates best practices and self-regulation; one example is the Declaration of Intent to prevent the maritime transportation of counterfeit goods to which PMI is a signatory.

But one company or even an industry alone cannot stop illicit trade. We need partners in government and law enforcement, and believe those efforts will be most successful if they are focused on the following:

- Well-funded and fully staffed law enforcement teams, with a clear mandate to take action against illicit tobacco as a key government priority;
- Transnational legal tools and mechanisms ensuring effective exchange of information between national law enforcement and judicial authorities to investigate, punish and deter cross-border trafficking;
- Transparent implementation of the World Health Organization's Framework Convention on Tobacco Control's Protocol to Eliminate Illicit Trade in Tobacco Products, with the inclusion of true subject matter experts, such as members of the legal industry, tobacco farmers, law enforcement agencies, and Ministries of Justice and Finance;
- Regulation of tobacco operations in Free Trade Zones (FTZs), starting with basic common-sense measures such as enhanced due diligence, annual licensing of tobacco operators, and the ban of cash payments above USD 10,000.
- A policy framework that regulates the legal supply chain and severely penalizes those involved in illicit trade;
- Properly trained officers who are knowledgeable about the issue and with the right tools, such as container scanners, mobile scanners for trucks and sniffer dogs;
- Clear ethics policies and fair compensation for enforcement authorities to overcome corruption;
- Funding intelligence efforts, enabling law enforcement to investigate criminal networks;
- Deterrent legislation, such as asset forfeiture laws and laws that provide for deterrent prison sentences for convicted illicit tobacco traders; and
- Public-private partnerships with the legitimate industry, which are critical for sharing information, yet often unfairly attacked.

#### CONCLUSION

Chairman Wicker, Co-Chairman Smith, thank you again for the invitation to testify before the Helsinki Commission and share our thoughts and what we at PMI believe are industry best practices. We value the opportunity to work with this Commission and the US government in the fight against illicit trade. I look forward to your questions and our discussion here today.

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- i) <https://2009-2017.state.gov/documents/organization/250513.pdf>
  - ii) <http://216.55.97.163/wp-content/themes/bcb/bdf/articles/InternationalAnticonterfetingdirectory.pdf>  
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  - iv) [http://www.inta.org/Communications/Documents/2017\\_impact\\_study.pdf](http://www.inta.org/Communications/Documents/2017_impact_study.pdf)
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