

Parliamentary Joint Committee Inquiry into Illicit Tobacco

SUPPLEMENTARY SUBMISSION BY ROHAN PIKE

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Introduction

Despite regular seizure announcements and numerous regulatory and legislative amendments that have been introduced in recent years, the illicit tobacco market in Australia continues to flourish. There is little evidence that the prevalence, price or popularity of illicit tobacco has been impacted by the increased enforcement efforts. As such, illicit tobacco continues to undermine both the health and budgetary objectives of the Australian Government.

While legislative changes to increase penalties, the abolishment of tobacco warehousing and the continuation of the ABF-led Taskforce are welcome, an overarching strategy is still lacking and this is preventing more substantial gains. The failure of government policy agencies, led by the Department of Health, to understand the scope and nature of the issue has meant that no National Illicit Tobacco Strategy has been created to help guide an effective response. This policy failure becomes most obvious at the retail level where the lack of enforcement allows criminals to freely accumulate massive profits.

This supplemental submission should be read in conjunction with my original submission, dated 12 January 2017, and is made with the benefit of having reviewed recent written submissions and observed the hearings conducted on 6 December 2019. While I am grateful for the efforts and consequential actions of the Inquiry thus far, this paper will highlight the matters that I consider are still to be addressed in order to effectively counter this serious issue.

World Health Organisation Framework Convention on Tobacco Control (WHO FCTC)

Australia is a signatory to and has ratified the WHO FCTC. This document is considered the primary international tobacco control instrument. The FCTC comprises 38 Articles addressing many aspects of tobacco control.

Article 15 and its sub-Articles, which relate to illicit tobacco have not yet been fully implemented. Put simply, Australia is failing to uphold its obligations under this Convention. The primary reason for this is that Article 15 refers specifically to illicit tobacco which is a law enforcement issue and the Department of Health, which has overall responsibility for the FCTC, lacks the expertise to fully comprehend and implement these clauses.

You will note from the full Article below, that Australia has not acted on a number of these matters.

Article 15

Illicit trade in tobacco products

1. The Parties recognize that the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting, and the development and implementation of related national law, in addition to subregional, regional and global agreements, are essential components of tobacco control.

2. Each Party shall adopt and implement effective legislative, executive, administrative or other measures to ensure that all unit packets and packages of tobacco products and any outside packaging of such products are marked to assist Parties in determining the origin of tobacco products, and in accordance with national law and relevant bilateral or multilateral agreements, assist Parties in determining the point of diversion and monitor, document and control the movement of tobacco products and their legal status. In addition, each Party shall:

(a) require that unit packets and packages of tobacco products for retail and wholesale use that are sold on its domestic market carry the statement: "*Sales only allowed in (insert name of the country, subnational, regional or federal unit)*" or carry any other effective marking indicating the final destination or which would assist authorities in determining whether the product is legally for sale on the domestic market; and

(b) consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade.

3. Each Party shall require that the packaging information or marking specified in paragraph 2 of this Article shall be presented in legible form and/or appear in its principal language or languages.

4. With a view to eliminating illicit trade in tobacco products, each Party shall:

(a) monitor and collect data on cross-border trade in tobacco products, including illicit trade, and exchange information among customs, tax and other authorities, as appropriate, and in accordance with national law and relevant applicable bilateral or multilateral agreements;

(b) enact or strengthen legislation, with appropriate penalties and remedies, against illicit trade in tobacco products, including counterfeit and contraband cigarettes;

(c) take appropriate steps to ensure that all confiscated manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products are destroyed, using environmentally-friendly methods where feasible, or disposed of in accordance with national law;

(d) adopt and implement measures to monitor, document and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties within its jurisdiction; and

(e) adopt measures as appropriate to enable the confiscation of proceeds derived from the illicit trade in tobacco products.

5. Information collected pursuant to subparagraphs 4(a) and 4(d) of this Article shall, as appropriate, be provided in aggregate form by the Parties in their periodic reports to the Conference of the Parties, in accordance with Article 21.

6. The Parties shall, as appropriate and in accordance with national law, promote cooperation between national agencies, as well as relevant regional and international intergovernmental organizations as it relates to investigations, prosecutions and proceedings, with a view to eliminating illicit trade in tobacco products. Special emphasis shall be placed on cooperation at regional and subregional levels to combat illicit trade of tobacco products.

7. Each Party shall endeavour to adopt and implement further measures including licensing, where appropriate, to control or regulate the production and distribution of tobacco products in order to prevent illicit trade.

World Health Organisation Protocol to Eliminate Illicit Trade in Tobacco Products (Protocol)

Recognising that the matters agreed in the FCTC would consequently bring about a rise in excise-avoiding criminal activity, the "Protocol" was developed to give countries guidance as to how to extend their anti-illicit tobacco enforcement efforts. Its recommendations are designed to help countries protect themselves from the threat.



The Protocol places a range of obligations on the contracting parties and tobacco manufacturers including supply chain control measures, such as licensing of manufacturers and distributors, enforcement in free trade zones, controls on duty-free and internet sales and the implementation of tracking and tracing technologies. Other important clauses relate to international information sharing and availability of investigative powers that our ABF do not possess.

Many countries, including the UK, have signed the Protocol which now has sufficient signatories for it to have come into force. Australia is not a signatory. The primary reason given by the Department of Health as to why this is the case in the past has been their reluctance to agree to using track and trace technology which is one of the requirements of the Protocol. This is despite the use of this technology being one of the recommendations of the Black Economy Taskforce and the Protocol allowing a 5-year grace period for countries to implement this clause.

Australia's refusal to sign up to the Protocol highlights the problem with having a non-law enforcement agency as the head agency of a law enforcement problem. The illicit tobacco problem will not be comprehensively understood nor appropriately addressed until we have a National Illicit Tobacco Strategy that is developed and led by a law enforcement agency. This national strategy must include plans to address the problem at all points along the supply chain including the point of sale.

Point of Sale

Organised crime syndicates continue to distribute their illegal product risk-free, without fear of any enforcement activity at the retail level. This is the point where their massive profits are realised and yet they are able to operate illegally without consequence. As I stated in 2017, deterrence is where prevention begins. Illicit tobacco sellers and buyers must believe that there is a real chance they will get caught and if they are caught, something will happen to them. The punishment could be any of prosecution, loss of licence or fines, but a credible mechanism is about creating the perception that there is a cost in engaging in this conduct.

I note the submission to this Inquiry by the Police Federation of Australia and am pleased to see their interest in the issue. No doubt, state police agencies are concerned by the growth of organised crime syndicates and the distribution to communities by the unfair work practices being exhibited.

Having noted the lack of interest and ability of Federal and State agencies to take any effective action at the retail level, I fully support the recommendations of Police Federation of Australia, particularly those in relation to developing appropriate state-based legislation that allows state police to use their powers and resources to make a real difference in the marketplace.

The Committee should seize on the recommendation of Police Federation to bring together all Australian Police Forces to develop a National Illicit Tobacco Strategy. Police Forces are the only agencies with the most appropriate powers, knowledge and resources to comprehensively deal with this organised crime issue.



Measurements of the size of the Illicit Market

The key to developing an effective plan and subsequently applying an appropriate level of resources in the resolution of any issue is to understand its scale. It therefore continues to frustrate that government efforts to measure the illicit tobacco trade do not to capture the totality of the problem. Official government figures are purely based on the extrapolation of seizure figures. Any estimates based on seizure figures are bound to be inadequate as they merely reflect the effort being put in to identify and seize products. This effort can vary from month to month depending on the quantity of skilled resources dedicated to the task. It also necessarily includes a guess as to the quantity of goods not seized. Without any effort to understand the fluctuations in the marketplace that their seizures may produce, this guess is going to be ill-informed.

Agencies such as the HMRC (UK), which have a long-established national strategy and the world's best practice response plan, have never used this "bottom-up" method. They simply calculate the total amount of tobacco consumed in the UK, via several comprehensive surveys and marketplace studies, and then subtract the legal market from the figure.

I note that when I first made a submission in 2017, government agencies were fully supportive of waste-water analysis as an accurate means of measuring tobacco consumption. That methodology was subsequently expanded to cover the vast majority of Australian waste sites. The findings from that testing were that, despite reductions in legal sales, there were no discernible differences in consumption levels. The obvious implication from this was that illicit tobacco was growing at the rate that legal tobacco sales were declining. Recently, government confidence in the waste-water analysis methodology has waned.

My own estimates in 2017 used a wide range of factors including government figures that were available to me at that time. Since then I have kept a close eye on the marketplace across various States. I have not seen any marked changes in the levels or methods of usage in that time. In 2017, the Black Economy Task Force examined my methodology and findings and determined that they were worthy of publication in their final report. My calculations estimated the total of evaded revenue at \$3.8 Billion (remembering that my figures included molasses tobacco). If the size of the market now is the same as in 2017, those figures, given current excise rates, equate to \$6.2 Billion of evaded revenue. If that figure were even half accurate, it would seem worthwhile to make a more substantial effort to accurately determine the extent and nature of the problem.

The bottom line is that while the various parties argue over the size of the illicit market, the problem carries on in the marketplace with no discernible change as to the availability of the product. The current government strategies seem to place an emphasis on seizure numbers without any serious analysis of whether their actions are actually reducing the problem itself or its related consequences.

Molasses or Shisha Tobacco

For reasons that are difficult to determine, molasses tobacco continues to be overlooked when discussing the revenue loss from illicit tobacco. This is despite the fact that molasses tobacco, or "shisha" as it is more commonly known, continues to be prevalent in the community. It is now taxed

at a staggering \$1,300 per kilo. Despite this, it is being sold for less than \$100 a kilo. The only conclusion that be reached is that all shisha is smuggled into the country.

I note various recent articles on the subject refer to the popularity and health dangers of shisha, e.g. <https://mobile.abc.net.au/news/2019-10-17/shisha-smoking-how-dangerous-is-it-health-risks-shisha-no-thanks/11613240>, however there is no mention of the hundreds of millions in revenue being lost via this entirely illegal and smuggled product.

As I mentioned in 2017, the change in the methodology of calculating the shisha duty rate in 2012 made importations of molasses tobacco economically unviable. Despite this, smoking shisha continues to be as popular as ever.

If the government is interested in stopping this illegal industry, they should either substantially increase enforcement efforts or significantly reduce excise rates to sensible levels.

The Black Economy Task Force

In 2017, the Black Economy Task Force examined the illicit tobacco problem. This issue was not originally in the BETF Terms of Reference or on their radar however they quickly became aware of how significant this issue is to the Australian revenue base. Having comprehensively educated themselves via hearings and numerous submissions, they examined the problem from their “Treasury” perspective. The BETF made numerous observations about the drivers and consequences of illicit markets more generally, many of which are highly relevant to our tobacco problem. Their findings are worthy of review in this enquiry however in relation to tobacco specifically they concluded:

- The problem is large, run by organised crime with selling being blatant
- Law enforcement efforts are ineffectual and fragmented
- The UK HMRC have demonstrated that the problem is not insurmountable
- A standalone Tobacco Act should be enacted (not implemented)
- There was a significant lack of enforcement at the retail level.
- Funding for the Illicit Tobacco Taskforce should be extended (implemented)
- Agencies should use track and trace technology to determine the status of tobacco products (not implemented)
- The ABF should be given powers under the *Surveillance Devices Act* to equip them to better respond to this organised crime threat (not implemented) **NB:** I note the ABF have highlighted their lack of appropriate powers in their most recent submission.
- Move the taxing point for tobacco products to the border (implemented) **NB:** An issue with transshipment remains, as noted above.
- Alter the excise rate for shisha (molasses tobacco) so that it more accurately reflects the rate for cigarettes (not implemented)

Legislation

I note that a number of legislative changes have now been implemented. It is probably too early to tell whether these will have the desired deterrent effect to reduce the incidence of illicit tobacco importation and distribution.

One of the new measures has been the cessation of warehousing tobacco. While this has caused a one-off windfall for the government, it is hoped it will also save the leakage that was evidence in this area previously.

It should be noted that transshipment continues to be allowed. This means that importers can bring tobacco into the country on the promise that they are going to export it again. There is little, if any, justification for transshipment and it raises another potential vulnerability at the border.

The ABF have limited ability to review what is exported as the majority of threats to the Australian border involve importations and resources are prioritised accordingly. This provides an opportunity for criminals to falsely claim they are transshipping tobacco when in fact nothing is exported.

The potential threat of leakage from transshipment is as large as that previously experienced through warehousing.

Recommendations

It is recommended that the Australian Government:

1. Sign, ratify and implement the World Health Organisation's Protocol to Eliminate Illicit Trade in Tobacco Products
2. Develop and implement a comprehensive National Illicit Tobacco Strategy (NITS) led by a law enforcement agency
3. Conduct a comprehensive "top down" measurement of the size of the illicit market.
4. Review and implement the recommendations from the Black Economy Task Force
5. Reduce Excise rates on shisha tobacco to 10% of current levels.
6. Ban transshipment of tobacco

Conclusion

Many of the countries in South-East Asia are now dealing with the inevitable crime problems that extraordinary excise increases on a product create. Like Australia, none of those countries foresaw those problems but they are now turning their mind to how to address the issue as we are. As I mentioned in 2017, the exponential growth of the illegal tobacco industry over the past 20 years could have been curbed by proportionally increasing the efforts put into regulating the market. This would have required an increase in funding, resources, powers, investigative tools and updated legislation. In fact, none of these things occurred and we are only now starting to play catch up.



Fortunately, our counterparts in the UK were the first to recognise the problems the FCTC created and are easily the most advanced country in responding to the threats. Their response is considered the world's best practice and this committee may wish to review their comprehensive regime as a guide as to what we might implement in response to a very similar issue. Some of their actions are outlined in my original submission.

In short, if the Government wishes to redress the imbalance that has given criminal syndicates a significant advantage and ensure Commonwealth revenues are protected, it needs to create a national illicit tobacco strategy that, through coordinated and consistent enforcement activity, generates compliance with our laws and dissuades criminal syndicates from entering this lucrative but illegal trade.

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