

The Fox Guarding the Henhouse: the Tobacco Industry, Illicit Trade, and Codentify

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Disclosures

- Nothing to disclose



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Outline

- **Illicit trade** – trade that involves products not following country requirements
- **Track and trace (T&T) system** - one tool to help monitor and/or eliminate illicit trade
- **Codentify** - a Philip Morris International created identification system
- **This Study** - Codentify on packs in Mexico City
- **Key points** about the industry, illicit trade, and Codentify



Illicit Trade

- There are different types of illicit cigarettes
 - **1. Contraband/Smuggled:** smuggled from abroad without paying domestic duty/tax
 - **2. Illicit White:** manufactured legally in one country, but smuggled to another without any duty paid
 - **3. Counterfeit:** manufactured without the consent of the owner, no duty paid
 - **4. Other kinds:** sales deemed illegal by country regulation (e.g. single sticks, flavor capsule packs)



Illicit Trade Protocol

The 'Protocol' Key Requirements

Licensing

- Introduction of a licensing, equivalent approval or control system by a competent authority for any natural or legal person involved in the manufacture import and export of tobacco products and manufacturing equipment

Due Diligence

- Conduction of due diligence on all agents involved in tobacco industry', to ensure that sales are commensurate with legitimate demand and to report to the competent authority any evidence of activities in contravention of the Protocol

Tracking and Tracing

- Set of unique identification markings which will assist in determining the origin and the potential point of diversion and will enable the monitoring and control of the movement of tobacco products and their legal status

Record Keeping

- Control that all natural and legal persons engaged in the supply chain of tobacco, tobacco products and manufacturing equipment maintain complete and accurate records of all relevant transactions

Security and Preventive Measures

- Identification of any necessary measures to prevent the diversion of tobacco products into illicit trade channels to be taken by all natural and legal persons subject to licensing

New Channels

- Further provisions concern sales by Internet, telecommunication or any other evolving technology duty free sales of tobacco products...x

Other Controls

- The obligation to implement effective controls on tobacco and tobacco products in the Free Zones, including not mixing tobacco products with non-tobacco products at the time of removal from a Free Zone

International Cooperation

- Including information sharing and coordination — between law enforcement, prosecutors, scientists, administrators, and other officials and agencies

... from the WHO Framework Convention Tobacco Control (FCTC) and the Protocol to Eliminate Illicit Trade in Tobacco Products

Source: Guidebook on Implementing Article 8: Tracking and Tracing. Framework Convention Alliance (FCA) and Sovereign Border Solutions (SBS).



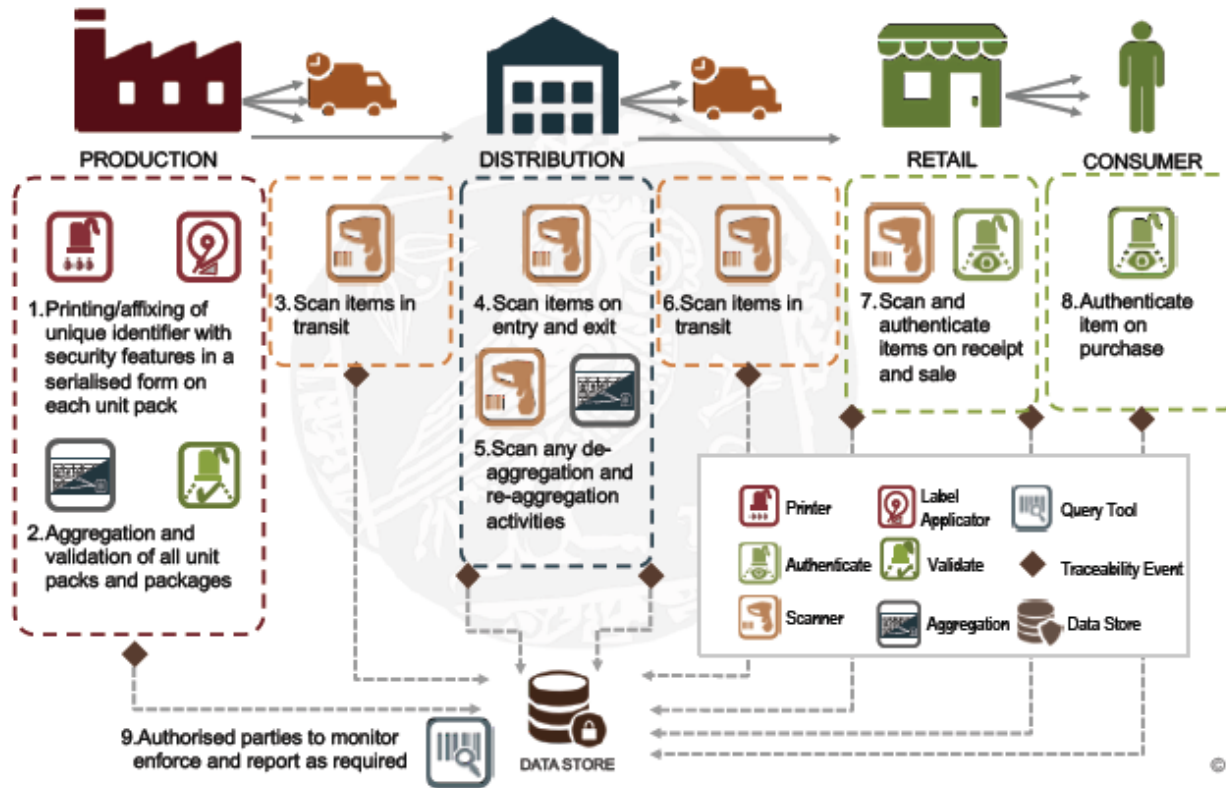
Track and Trace Marking



Source: Guidebook on Implementing Article 8: Tracking and Tracing. Framework Convention Alliance (FCA) and Sovereign Border Solutions (SBS).



Track and Trace System



Source: Guidebook on Implementing Article 8: Tracking and Tracing. Framework Convention Alliance (FCA) and Sovereign Border Solutions (SBS).



Codentify

- Codentify is a Philip Morris International (PMI) created identification system
 - Marking on a pack that they say reduces counterfeiting and can verify the tax status
 - Rebranded as Inexto
 - Front groups and third-party companies promoting the system



Digital Coding & Tracking Association

- DCTA Members:

- Philip Morris International



- British American Tobacco



- Imperial Tobacco Group



- Japan Tobacco International



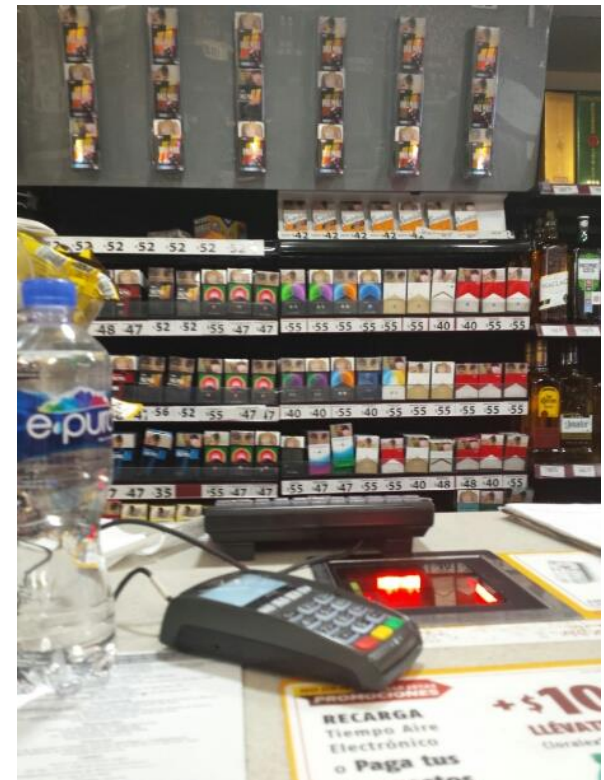
Mexico Situation

- **In Mexico:** part of the 2014 Special Tax on Production and Services Bill (IEPS) required tobacco products to have a security code
- **Mexico plan:** With the absence of an independent track and trace system, the tobacco industry attempted to fill the gap with Codentify
- **Our goal:** Describe the extent of Codentify on packs in Mexico City



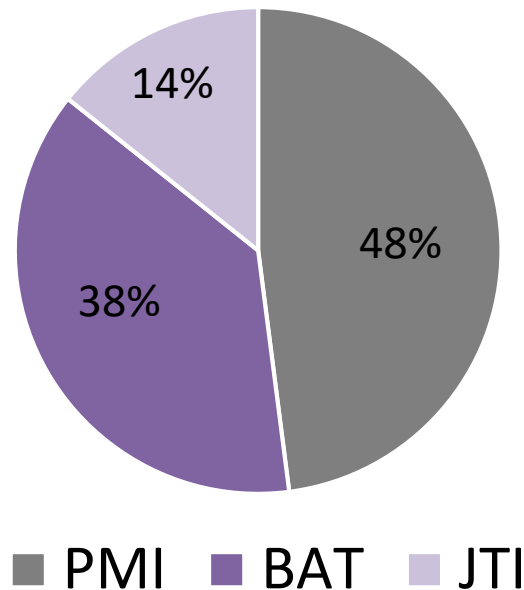
Methods

- In **August of 2017**, we purchased unique cigarette packs in twelve neighborhoods in Mexico City using a systematic protocol
- Two coders reviewed packs to identify the presence of a Codentify marking
- Other information including manufacturer, brand, and price was also collected



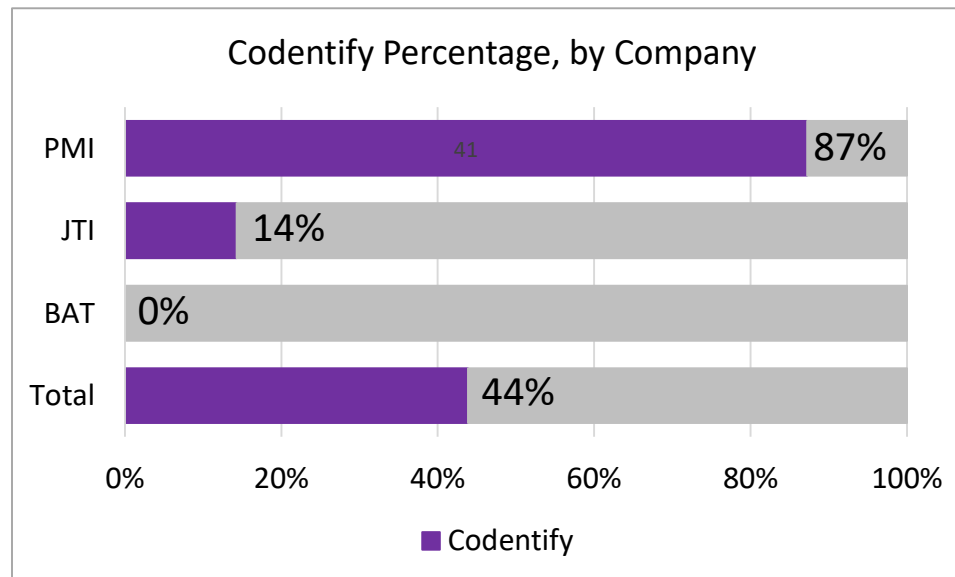
Results

- 98 unique cigarette packs were collected
 - 47 from PMI
 - 37 from British American Tobacco (BAT)
 - 14 from Japan Tobacco International (JTI)



Results

- 98 unique cigarette packs
- 43 packs (44%) featured a Codentify marking:
 - 41 out of the 47 PMI packs (87%)
 - 2 out of 14 JTI packs (14%)
 - none on the 37 BAT packs



Results

- Packs with Codentify (M\$41.35) appear to be priced similarly to packs without Codentify (M\$40.47)

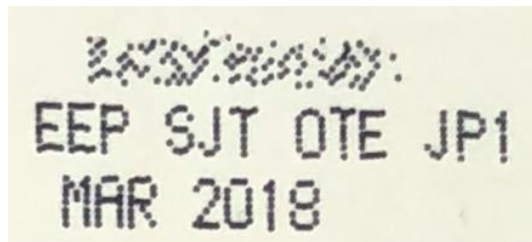
Price Distribution

Pack Type	Mean Price	Minimum	Median	Maximum
With Codentify	41.35	27	42	50
Without Codentify	40.47	27	42	50



Discussion

- Codentify marked packs do appear to be prominent, but not ubiquitous in Mexico City in 2017
- Despite the PMI created system being freely licensed by both BAT and JTI, the presence of Codentify markings was primarily found (95%) on PMI packs
- Codentify is advertised as a system that can be used by all companies, but in practice there appears to be minimal or no uptake by major companies other than PMI



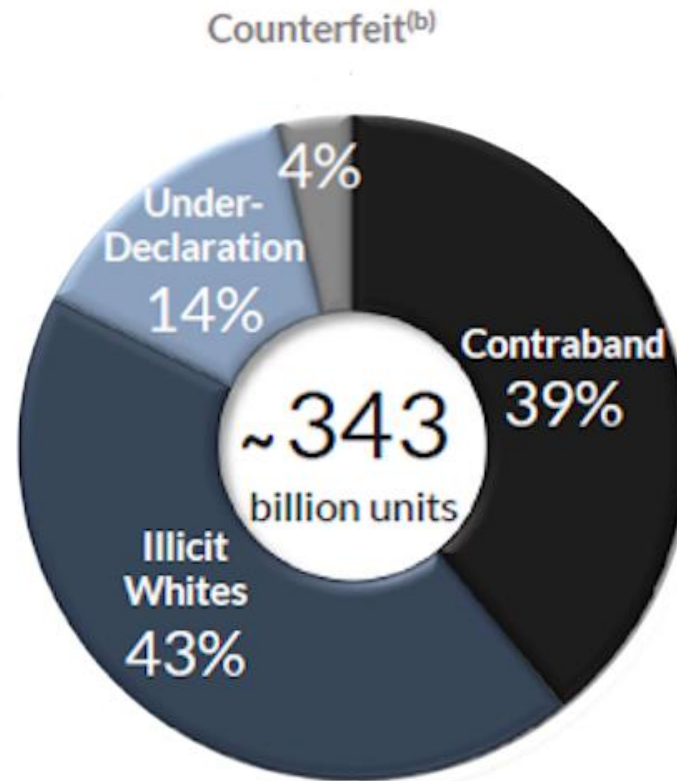
Key Points

- Tobacco Industry and Illicit trade monitoring
- Is the fox guarding the henhouse?
- Should the industry be involved in a track & trace system?
 - 1. Potential for lack of transparency
 - 2. Tobacco industry has been complicit in smuggling in the past



Transparency

- Illicit Trade Overview, 2018
- International Illicit Cigarette Consumption
- Does not include China or the United States
- **Source:** Philip Morris International Investor Information, July 2019



Non Tax-Paid Cigarette Volume^(a)

(a) Excluding an estimated 51 billion units of duty-free cigarette volume and other legitimate imports

(b) Estimate for PMI worldwide and BAT, JT and IMB for selected markets

Source: PMI Financials or estimates



Industry Involvement



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Illegal tobacco trade

– [Fighting the black market](#)

– [WHO Illicit Trade Protocol](#)

[Youth access prevention](#)

Fighting the black market

A united response to a global problem

Fighting the black market in tobacco addresses a threat to our business, while also helping to fight organised crime and preventing smokers from getting access to unregulated tobacco products.

The world of the criminal black market



Source: <https://www.bat.com/tacklingillicittrade#>

Industry Involvement

- Industry complicity in illicit trade

In the 80s and 90s....

Imperial Tobacco Canada Ltd and **Rothmans, Benson & Hedges** entered into settlement agreements over **smuggling** with Canada totaling 1.15 billion CAD in 2008. **RJ Reynolds** (325m CAD) and **JTI-MacDonald** (150m CAD) entered into settlement agreements with **Canada** in 2010.



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Questions?

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