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Situational Analysis of Illicit Trade in Tobacco Products in Kenya

Joseph Kieyah
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KIPPRA Special Paper No. 15
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Abstract

Illicit trade in tobacco products imposes many social and economic costs, including increased health expenditure as a result of increased access to tobacco products, and loss of government revenue through tax evasion. Tobacco consumption in Kenya contributes to about 3 per cent of male deaths annually. While the Kenya government has in the past taken several initiatives in terms of legislation and establishing institutions to fight not only illicit trade in tobacco products but also tobacco consumption, illicit trade in tobacco products as well as consumption are still matters of policy concern.

The purpose of this study is to investigate the nature and extent of illicit trade in tobacco products in Kenya, and review the relevant institutional framework with a view to gaining insight on the various dimensions of illicit trade in tobacco products.

The study used complementary approaches, including key informant interviews; analysis of seizure data; review of literature; analysis of the legal framework; and review of international best practices. The results show that cigarette is the main illicitly-traded tobacco product in Kenya. Counterfeit cigarette smuggled through the sea is the main illicit tobacco import, while diverted exports by road form the main illicit product originating from the domestic economy. The key institutional challenges include weak fines, limited resources for Anti-Counterfeit Agency, and weak coordination and information sharing among different agencies. Regionally, the East African Community (EAC) countries are at different stages of enacting legislation on illicit trade, and this continues to pose challenges in establishing concerted effort to curb the problem.

The main conclusion from this study is that illicit trade in tobacco products is a complex problem requiring inter-agency collaboration. Second, effective monitoring, enforcement and punitive fines are necessary for deterring the vice. The study recommends that minimum fines should be prescribed in relevant laws. Also, there is need to increase funding to enforcement agencies, especially the Anti-Counterfeit Agency. Moreover, the various agencies should be obliged to compile and share data to facilitate monitoring of illicit trade and the impact of policies. In the regional context, there is need to advocate for approval of the EAC anti-counterfeit policy and enactment of the EAC Anti-counterfeit Bill to enhance regional coordination in the fight against illicit trade.

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Abbreviations and Acronyms

ACA	Anti-Counterfeit Agency
EAC	East African Community
FCTC 2004	Framework Convention on Tobacco Control 2004
ILA	International Institute for Legislative Affairs
ITTP	Illicit Trade in Tobacco Products
KDHS	Kenya Demographic and Health Survey
KRA	Kenya Revenue Authority
PWC	PriceWaterhouseCoopers
WHO	World Health Organization

Definition of Key Terms

Bootlegging: Legal purchase of small quantities of products from low tax jurisdictions in amounts that exceed limits set by Customs regulations for illegal sale in high tax jurisdictions without payment of applicable taxes.

Contraband: Genuine tobacco products diverted from legitimate supply chain and sold without payment of applicable taxes.

Counterfeits: Manufactured products protected by intellectual property rights without authorization from the rights owners and with the intent to copy the genuine brand to deceive the consumer.

Illicit trade: Trading unlawfully in products that are illegitimate in the sense that laws and regulations are violated in the production and distribution by evading taxes and/or infringing intellectual property rights.

Illicit whites/cheap whites: Brands manufactured legally in one country intentionally for smuggling into another country without payment of applicable taxes.

Roll-Your-Own: Smoking tobacco hand-made from loose tobacco and rolling paper

Tobacco: Tobacco plant, including its seeds and leaves.

Tobacco product: A product composed partly or wholly of tobacco for use by smoking, inhalation, chewing, sniffing or sucking.

Unbranded tobacco: Tobacco sold as finely cut loose leaves and carries no labelling or health warning.

1. Introduction

1.1 Background of the Study

Illicit trade in tobacco products imposes social costs in various forms. First, it leads to increased health expenditure driven by non-insured tobacco users as well as non-users whose health expenditures are attributable to second-hand smoking (Allen, 2013). The World Health Organization (2014) estimates that globally, tobacco kills 6 million people annually, of which 10 per cent are as a result of second-hand smoking. In Kenya, it is estimated that tobacco accounts for 3 per cent of male deaths (Eriksen et al., 2012). Illicit trade in tobacco products increases accessibility to tobacco products, thus exacerbating the situation. Second, it leads to loss of government revenue through tax evasion and counterfeiting of tax stamps (East African Community, 2009), and diversion of government resources (World Customs Organization, 2013). Third, illicit trade in tobacco products circumvents government policies such as teenage use of tobacco products (HM Revenue Customs and UK Border Agency, 2011) and is also linked to organized crime (Shelley and Melzer, 2008). Globally, it is estimated that 600 billion cigarettes, accounting for 10 per cent of cigarettes consumed, are illicit, resulting to US$ 40-50 billion in lost tax revenues (Allen, 2013). Increases in excise duty on tobacco products by the government galvanizes the tobacco industry, who fear the unintended consequences of a such initiative in incentivizing illicit trade in tobacco products.

This study investigates the nature and extent of illicit trade in tobacco products in Kenya. The term 'nature' as used in this study refers to types of tobacco products (e.g. cigarettes, cigars, and cigarillos), channels of supplying illicit tobacco products, and categories of illicit tobacco products, including counterfeits and contrabands. Illicit trade is understood to include cross-border smuggling of contraband and counterfeit tobacco products, as well as domestic production and distribution of contrabands and counterfeit products (Figure 1.1). Tax evasion is experienced on both genuine and counterfeit imports[1] through concealment, corruption, and use of informal alternative channels (Bhagwati, 1981), or abuse of legal privileges in form of duty free imports and bootlegging (Allen, 2013). Counterfeiting infringes trademarks by mimicking genuine popular brands with sophistication that can easily pass checkpoints unnoticed in the absence of close monitoring and limited use of technology. Given that counterfeits are often disguised as genuine products, they can be legally imported and relevant taxes paid for. The key motivation for trade in counterfeit product is to earn high profit

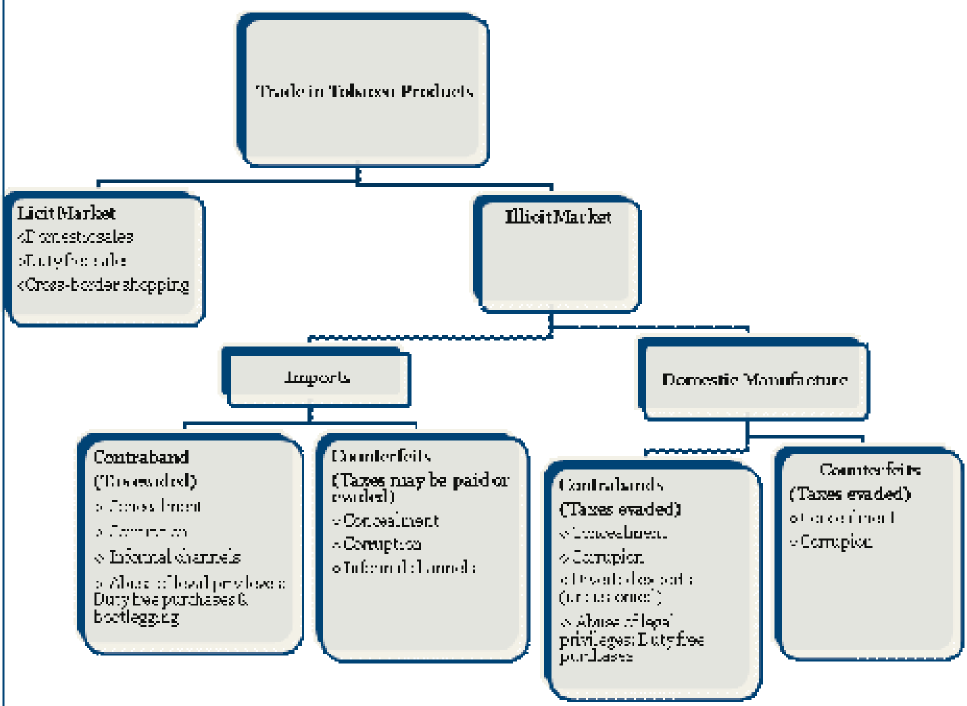
[1] In Kenya, export taxes are charged on raw hides and skins, and scrap metal only to encourage local processing (See Fourth Schedule, Part I of Government of Kenya (2012a). Therefore, the focus of this study with regard to tax evasion relates to imports only.

margins given that counterfeiters often use cheap substandard inputs and do not incur research and development costs. Furthermore, they do not bear marketing costs as they free-ride on the goodwill established by the genuine products.

Tobacco products[2] include cigarettes, cigars, snuffs, chewing tobacco, and 'roll-your-own'. As global trends dictate, cigarette is the primary illicitly-traded tobacco products due to its attributes as a fast-moving consumer good, often highly taxed product resulting to high profit margins (Allen, 2013; Joossens et al., 2010).

Evidently, cigarette features prominently as one of the most counterfeited products (TNA Research International/Consumer Federation of Kenya, 2010). While tobacco consumption generates private benefits, it also imposes social costs in form of increased health cost (Government of Kenya, 2010a). In 2003, tobacco use prevalence rate was estimated at 25 per cent of male and 3 per cent of female, respectively (Government of Kenya, 2004). The most recent national survey, however, shows that 18 per cent of male and 2 per cent of female aged 15-49

Figure 1.1: Possible channels of illicit tobacco products



Source: Authors' construct

[2] See Annex 4 for detailed description of various tobacco products.

use tobacco products (Government of Kenya, 2010b).[3] Conjecturally, the female prevalence is likely to be higher because women are more likely to conceal their tobacco use status due to social cultural factors (Government of Kenya, 2010b). While smoking prevalence of men had decreased from 25 per cent to 18 per cent between the two surveys, use of pipe and other tobacco products (e.g. snuffing, and chewing) is on the increase.[4] For example, the proportion of men using pipe tobacco increased from 0.1 per cent to 1.4 per cent while use of 'other' tobacco products including chewing tobacco, and snuffs increased from 2.0 per cent to 3.2 per cent (Government of Kenya, 2010b).

Both theoretical and empirical literature shows that tobacco consumption confirms an inverse relationship between the prices and quantity demanded. Further, long-run demand responses to price increase are higher than short-run price responses (Becker et al., 1994; Kiringai et al., 2002).

Use of tax and prices as policy instruments to counter tobacco consumption is provided for in Article 6 of the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC).[5] To deal with illicit trade in tobacco products, Article 15 of the WHO FCTC requires signatory states to implement measures to reduce the supply of illicit tobacco products. Kenya ratified the WHO Framework on 25th June 2004[6] and domesticated it through the enactment of Tobacco Control Act, 2007 to reduce consumption of tobacco products[7] and implement effective measures to eliminate illicit trade in tobacco products.[8]

1.2 Tobacco Industry Structure in Kenya

The market structure of manufacturing and distributing tobacco products in Kenya is oligopolistic, with the British American Tobacco (BAT) Kenya and the Mastermind Tobacco Kenya controlling 78.0 per cent and 20.3 percent, respectively (ILA, 2011). Other players in the market include Alliance One Tobacco Kenya Ltd, Ken Tobacco EPZ Ltd, Phillip Morris International[9] and Cut Tobacco Kenya Ltd.[10] In 2009, value added for tobacco products was estimated at Ksh

[3] See Annex 3 for detailed statistics by socio-economic and demographic characteristics.

[4] Statistics for women is not readily available.

[5] The WHO (2004) is the first international treaty negotiated under the auspices of WHO in response to globalization of tobacco epidemic. It was adopted by the World Health Assembly on 21st May, 2003 and entered into force on 27th February, 2005.

[6] See WHO FCTC parties to the convention at http://www.who.int/fctc/signatories_parties/en/

[7] See Section 12, Government of Kenya (2007).

[8] Government of Kenya (2007), Section 3(g).

[9] Phillip Morris International has a distribution representative office in Kenya. Alliance One Tobacco and Ken Tobacco mainly export cured tobacco.

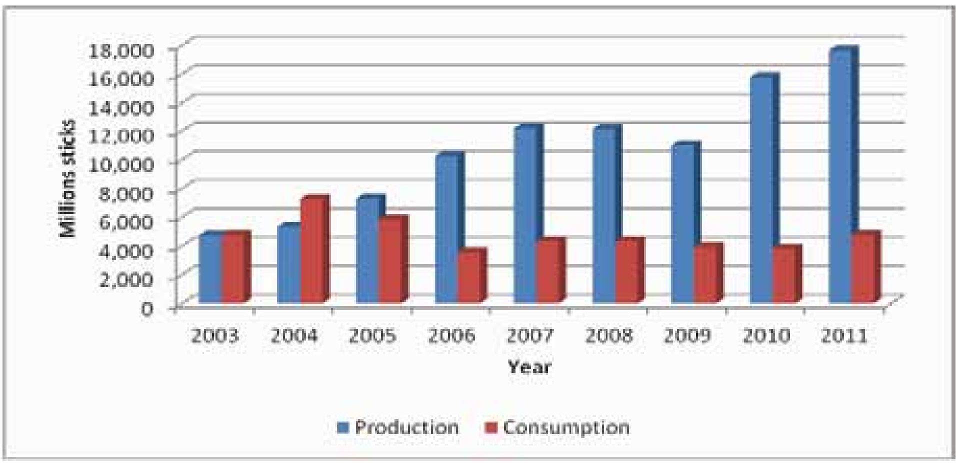
[10] Cut Tobacco has been battling court cases with KRA since 2004 over allegations of tax arrears.

4.3 billion shillings (Kenya National Bureau of Statistics, 2013) accounting for about 0.2 per cent of gross domestic product. Prior to liberalization in 1980s, the market was monopolistic with sole dominance by BAT Kenya. Cigarettes are both domestically-manufactured and imported. Only 2-5 per cent of cigarettes, mainly high-end brands, are imported, while the rest are manufactured domestically.[11] About 31,000 tobacco farmers grow tobacco on an estimated area of 20,000 hectares under strict contractual agreement with tobacco companies, in contrast with 5,000 independent farmers (ILA, 2013). Figure 1.2 shows that about 17.7 billion and 4.8 billion of cigarette and cigar sticks, respectively, were produced and consumed in 2011. Kenya imports tobacco products from various countries including Uganda, United Arab Emirates, China, Zimbabwe, Switzerland, Singapore, Poland, Egypt, India, Cyprus, South Africa, Malawi, and D.R. Congo.[12]

The Democratic Republic of Congo and Egypt account for the largest share of Kenya's exports of cigarettes to the Common Market for Eastern and Southern Africa (COMESA) as shown in Figure 1.3. Within the COMESA market, D.R. Congo, Egypt and Burundi account for about 60 per cent of cigarette exports.

In terms of institutional framework, the key institutions mandated to curb tobacco consumption include the Tobacco Control Board, established by the Tobacco Control Act of 2007, with a mandate to advise the Cabinet Secretary for

Figure 1.2: Domestic production of cigarettes and cigars in Kenya

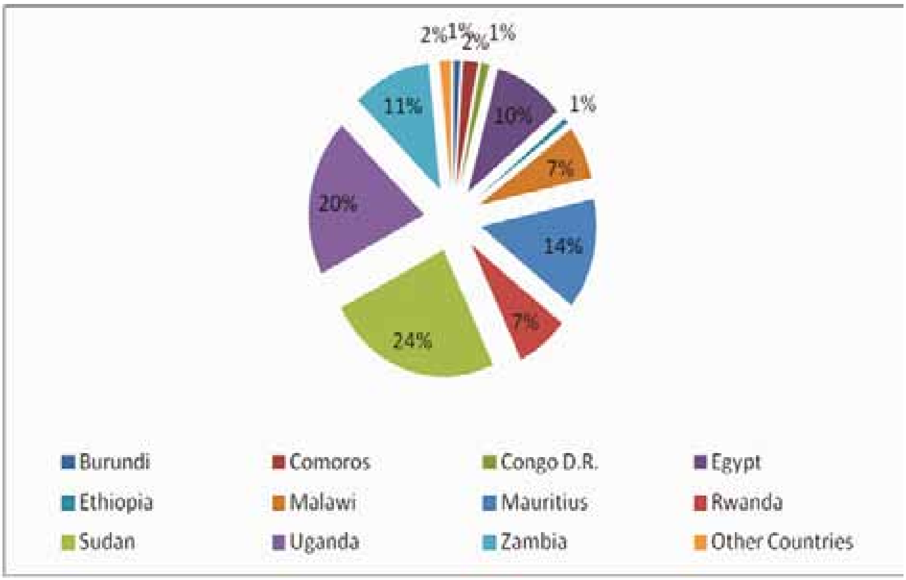


Data source: Kenya National Bureau of Statistics (2012)

[11] Data Source: Key Informant Interview with Kenya Revenue Authority (KRA).

[12] Source: Key informant data from Kenya National Bureau of Statistics.

Figure 1.3: Exports destinations of cigarettes from Kenya



Data Source: Kenya National Bureau of Statistics (2012)

health on tobacco control policy measures in Kenya. The Ministry of Health bears the major responsibility of formulating a multidisciplinary policy framework to meet the objective of the Act. Selectively, such activities may include trade policies related to tobacco products, and alternative livelihoods for tobacco farmers. Tobacco products in Kenya are subject to excise duty and value added tax that originates with the National Treasury. The Commissioner of Customs and Excise annually licenses the tobacco firms, while the Cabinet Secretary of the National Treasury is statutorily empowered to adjust specific rate of excise duty to take account of inflation.[13] The KRA Customs Department is statutorily[14] mandated to fight illicit tobacco products. The Kenya Bureau of Standards established by the Standards Act (Cap 496) is another critical agency that ensures that products meet specification standards.

1.3 Snapshot of Literature on Illicit Trade in Tobacco Products

Empirical evidence shows that illicit trade in tobacco products is higher in developing countries where cigarette prices are lower (Joossens et al., 2010). This finding contradicts the common industry belief that high prices necessarily drive

[13] See Section 119(7) of Government of Kenya (2012a) and Section 3 of Government of Kenya (2012b).

[14] Customs and Excise Act, and Customs and Excise (Excisable Goods Management Systems) Regulations 2013.

smuggling and illicit trade. However, this could be explained by theories of illegal trade (Becker et al., 2006; Baghwati, 1981) which postulate that illicit trade is driven by opportunity costs imposed on suppliers through monitoring, enforcement and punishment. A study by Joossens (2003), for instance, reveals that Spain, which has the lowest tobacco prices in the European Union, had significant tobacco smuggling problems that were later significantly reduced through increased monitoring, border controls and punishment of offenders. The observation of high incidence of illicit trade in low tax countries could be attributed to other factors besides price. Merriman et al (2000), even after controlling for income and other factors, establish that high corruption levels significantly explain high levels of cigarette smuggling.

Empirical evidence on illicit trade in tobacco products in Kenya is sparse (Tobacco Control Situational Analysis Consortium, 2008) due to scarcity of data, and the underground economy nature of the trade. It is within this context that this study was undertaken to establish the nature of illicit trade in tobacco products, and analyze strengths and weaknesses of a legal framework in addressing various dimensions of illicit trade in tobacco products in Kenya.

1.4 Statement of the Problem

The Kenyan government's policy initiatives to control consumption of tobacco are being compromised by proliferation of illicit trade in tobacco products. This assertion is supported by the fact that cigarettes are among the most counterfeited products in Kenya, which is part of the broader illicit trade. Illicit trade in tobacco products, including counterfeits and contrabands, amplifies the social costs of tobacco consumption. By the obscure nature of the illicit trade, it increases the availability of tobacco products and thus consumption, consequently undermining the health objectives of tobacco control. It also magnifies the scope of tax evasion, resulting to loss of government revenue. The limited information on the scope, sources and types of illicit trade in tobacco products renders local and regional mitigation strategies ineffective.

1.5 Objectives of the Study

1.5.1 Overall objective

The overall objective was to establish the nature and extent of illicit trade in tobacco products in Kenya and review relevant institutional framework in place.

1.5.2 Specific objectives

(i) To establish the volume of illicit tobacco products in Kenya with respect to seizures;

(ii) To establish the sources (domestic versus external) and channels of entry (e.g. roads, ports, air, online purchase, etc) of illicit tobacco products in Kenya;

(iii) To establish the types (e.g. cigarettes, pipes, cigars, roll-your own, etc) and categories (unbranded, contraband and counterfeit) of illicit tobacco products in Kenya;

(iv) To provide an overview of the regulatory and institutional framework to combat illicit tobacco trade in Kenya;[15]

(v) To evaluate the regional collaborative efforts to combat illicit tobacco trade; and

(vi) To review international best practices in combating illicit trade in tobacco products.

[15] This will include assessment of coordination of agencies mandated to combat illicit trade in the country.

2. Literature Review

2.1 Theoretical Literature

Theoretical analysis of illicit trade has gained thrust following the seminal work of Baghwati and Hansen (1973), who concluded that smuggling lowers public welfare. Various theoretical extensions have since been developed, including Johnson (1974) and Sheikh (1974), who postulate that taxes and other restrictions lead to smuggling, though critiqued by Baghwati (1981) for assuming that genuine and illicit goods can be traded in the domestic market at identical prices. According to Pitt (1981), illicit trade obscurely thrives better in the coexistence of legal trade.

Baghwati (1981) offers alternative theories of illegal trade, which postulates that illicit trade can take place through formal or informal channels. Formal channels, on one hand, entail customs' approval of illicit products through concealment or bribery. While such approval imposes additional cost to the importer, it reduces the likelihood of detection once the product is in the market. On the other hand, illicit products are smuggled in through the porous borders without customs' approval. In a more recent work, Becker et al. (2006) found that enhanced enforcement and punishment, including detection, confiscation and imprisonment raises the market price of illicit goods, hence lowering demand. They postulate that an increase in punishment to suppliers of illicit goods increases the cost of production, thus lowering expected profits.

The theories discussed thus far generally focus on smuggling that involves cross border trade. However, illicit trade, both tax evasion and counterfeits can arise from domestic economy. In a more holistic theory, Becker (1968) developed a model of crime and punishment which views criminals as rational individuals who view illegal trade as alternative economic activities. Becker (1968) postulates that the decision to engage in crime by an individual depends on policy variables, including probability of detection, apprehension, conviction and magnitude of punishment.

The review of theoretical literature reveals that illicit trade can be analyzed by considering it as an economic problem.

2.2 Empirical Literature

The underground nature of illicit trade poses measurement challenges. However, limited extant empirical literature shows that illicit trade is driven by a multiplicity of factors, including corruption, weak enforcement and penalties on conviction (Joossens, 2003). Demand elasticity plays an important role in supply of illicit products as a substitute for genuine products, in the absence of effective monitoring and enforcement. Tobacco consumption conforms to the law of demand with relatively higher elasticity of demand in the long-run (Kiringai et al., 2002; Chaloupka, 1991). Kiringai et al. (2002) establish that in Kenya, a one per cent increase in price of cigarettes results in 0.49 per cent and 1.78 per cent reduction in demand of cigarettes in the short-run and long-run, respectively. The lower short-run elasticity is attributable to rigidities in substitution, either to other products or quitting due to addiction (Becker et al., 1994; Kiringai et al., 2002). Deloitte (2011), using a survey of consumers in Australia, established that over 60 per cent of respondents cite lower prices as the chief reason for purchasing illicit tobacco products. However, though industries often lobby governments to lower taxes so as to stifle illicit trade (ILA, 2013; Joossens and Raw, 2000; Joossens and Raw, 1998), this notion has been challenged (Joossens and Raw, 2000), demonstrating that illicit trade is a product of a multiplicity of factors including corruption (Joossens and Raw, 1998). It has been established that, on average, countries with lower cigarette prices have relatively higher incidence of illicit trade in tobacco products (Joossens et al., 2010; Joossens and Raw, 2000). Countries where cigarette prices are low are, however, generally developing countries where monitoring and control of illicit trade is also low (Joossens et al., 2010).

In terms of types of tobacco products, cigarettes have been established to be the primary target by illicit traders globally, since they are fast moving consumer goods and highly taxed product resulting to high profit margins (Allen, 2013; Joossens et al, 2010). In a cross-country study, Joossens et al (2010) establish that 11.6 per cent of global cigarette consumption is illicit: 16.8 per cent in low income countries, 11.8 per cent in middle income countries and 9.8 in high income countries. In terms of distribution channels, counterfeits and other illicit products have been observed to change tactics. According to the Kenya Association of Manufacturers (2012), illicit products that were previously distributed through informal channels are infiltrating legitimate supply chains. Global evidence, including developed countries, has implicated the tobacco industry in smuggling syndicates (Joossens and Raw, 2000; Joossens and Raw, 1998), an indication of prevalence of contrabands which is even more difficult to detect than counterfeits.

With respect to counterfeits, most of the products are distributed through retail shops, with the Internet providing new opportunities to sell products through auction sites (Kenya Association of Manufacturers, 2012). Similar findings are reported by PWC (2010) using a consumer survey in Australia, which established that consumers source illicit tobacco products through multiple sources such as convenience stores, local markets, milk bars and supermarkets. Various types of tobacco products can be traded simultaneously. For example, Scollo and Winstanely (2012) and PWC (2010) established that in Australia, both manufactured and unbranded tobacco is traded. Well known brands, or 'brand power', has been established to be the prime target by counterfeiters (Joossens and Raw, 1998; Kenya Association of Manufacturers, 2012), suggesting a profit motive by illicit suppliers.

Institutional framework has also been observed to affect incidence of illicit trade, both from supply and demand perspectives (Allen, 2013; Joossens and Raw, 2000). Some factors including weak enforcement, non-deterrent penalties and low risk of detection of suppliers affect the supply side, while demand-side factors include weak or no penalties, ease of access to illicit products, low or no risk of detection and prosecution of consumers (Kenya Association of Manufacturers, 2012). These findings are in line with theoretical postulations that enhanced probability of detection and prosecution increases the cost of supplying illicit products. According to Joossens and Raw (2000), Spain defied industry lobby to reduce tobacco taxes, but instead enhanced intelligence, customs activity, and enhanced border patrols. Similar initiatives were used by the UK government by investing in a network of scanners, public awareness, increased punishment and enhanced number of customs officers (Joossens and Raw, 2000). Generally, the problem of illicit tobacco trade is more acute in developing countries due to weak monitoring and porous borders resulting to high expected profit margins for traders in illicit products (Joossens et al., 2010). Spain's efforts to curb smuggling developed close collaborations with authorities in Ireland, Andora, Britain, France and the European Anti-Fraud Office, consequently reducing the share of contraband cigarettes from 12 per cent in 1997 to about 5 per cent in 1999 (Joossens and Raw, 2000).

Existing research shows that there is a tendency for illicit trade estimates from the industry-commissioned research to be higher relative to academic estimates (Stoklosa and Ross, 2013; Blecher, 2010). Eriksen et al (2012) find that industry estimates is about two-fold those of academic estimates in three countries: South Africa, Poland, and the UK. According to Stocklosa and Ross (2013), the discrepancy between academic and industry-commissioned estimates is attributable to different methodologies used and over-representation bias of industries.

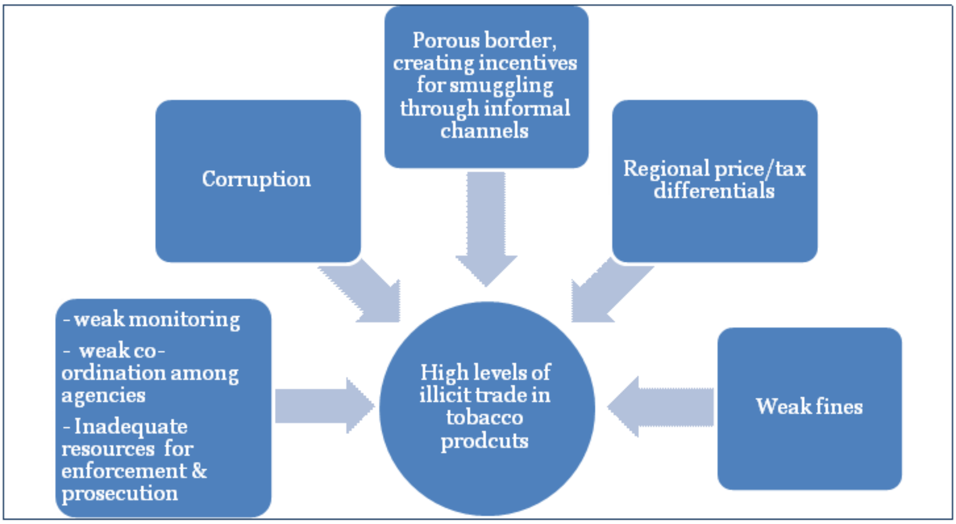
3. Methodology

3.1 Conceptual Framework

The market for illicit tobacco is driven by suppliers' profit motive and utility maximization of consumers. In Kenya, supply of tobacco is not banned but consumption is highly regulated. Enforcement and punishment contributes to the cost of supplying illicit products. If the expected return on supply of illicit products is greater than the expected return on supply of genuine products, suppliers have higher incentives to engage in illicit trade. In conventional economic theory, a rational supplier will engage in illicit trade if the benefits outweigh costs (Becker and Grossman, 2006). The costs encompasses the probability of detection, criminal sanctions, other additional costs such as searching alternative supply channels, or higher costs in bribery (Becker and Grossman, 2006; Bhagwati, 1981). Additional opportunity costs of illicit supply include potential costs of conviction if discovered, foregone incomes in genuine trade and costs of capital used. Illicit trade is thus an increasing function of the wedge between licit and illicit market prices, taking into account all opportunity costs.

Illicit tobacco products can arise either through cross-border smuggling or domestic manufacture. Smuggling can be for either genuine products for which tax is evaded, or it can be counterfeits for which tax may be evaded or paid. In the case of counterfeits for which tax is paid, the illicit supplier may still gain because he/she does not incur various production costs, including research and development, marketing costs and compliance with health and safety regulations. Border surveillance, probability of detection and magnitude of punishment upon conviction determines the extent to which smuggling will thrive (Baghwati, 1981). On the other hand, illicit products arising from the domestic economy can be in form of either manufacture of counterfeits by illegal manufacturers or tax evasion on genuine products through under declaration of production, or declaring production for exports but diverting it back to the domestic economy. Exports of tobacco products, similar to most other commodities are tax exempt. Therefore, in absence of effective track and trace system, diversion of products declared for exports can be profitably diverted back to the domestic economy. Figure 3.1 illustrates the drivers of illicit trade.

Figure 3.1: Drivers of illicit trade in tobacco products



Source: Authors' construct

3.2 Overview of Alternative Methodologies

There are various approaches to estimate illicit trade in tobacco products but no single methodology is exhaustive (Merriman, 2001). Quantification of illicit tobacco trade is imperative in tobacco control policy, but the illegal and hidden nature of the activity poses key estimation challenges. Merriman (2001) provides five approaches to estimate illicit trade in tobacco products, including: Survey of consumers about sources of their purchase; estimation based on seizures by law enforcement agencies; information gathered from academic, trade and professional publications; monitoring of discrepancies between trade statistics for smuggled tobacco products; comparing tobacco sales and consumption surveys; and comparing tobacco sales against consumption using econometric modeling.

3.3 Choice of Methodology[1]

In order to meet the objectives, the study used a situational analysis based on two main approaches:[2]

Estimation based on seizures by law enforcement agencies: To gain insights, key informant interviews were administered to government agencies and industry

[1] See Annex 1 for detailed methodology to answer each objective and data sources.

[2] Details of approach for each objective are shown in Annex 1.

players.[3] Questionnaires were administered to key informants to collate data and information on illicit tobacco trade. Seizure data of illicit tobacco products by various government agencies, including Kenya Revenue Authority (KRA) Customs Services Department, Anti-Counterfeit Agency, and the Kenya Bureau of Standards (KEBS) was used to estimate trends in illicit tobacco trade.

Literature review and legal analysis on the overview of tobacco industry in Kenya was also done, specifically focusing on the institutional and regulatory framework of the tobacco industry.

Seizures data approach, corroborated with review of literature and key informant interviews, was preferred so as to understand the problem of illicit trade in tobacco products holistically, both in terms of trends and institutional framework. The approach will also help in articulation of the problem for field surveys.

Further, a stakeholder validation workshop was organized where preliminary findings were shared and recommendations considered.

[3] See annex 2 for list of key informants.

4. Results and Analysis

4.1 Seizures of Illicit Tobacco Products in Kenya

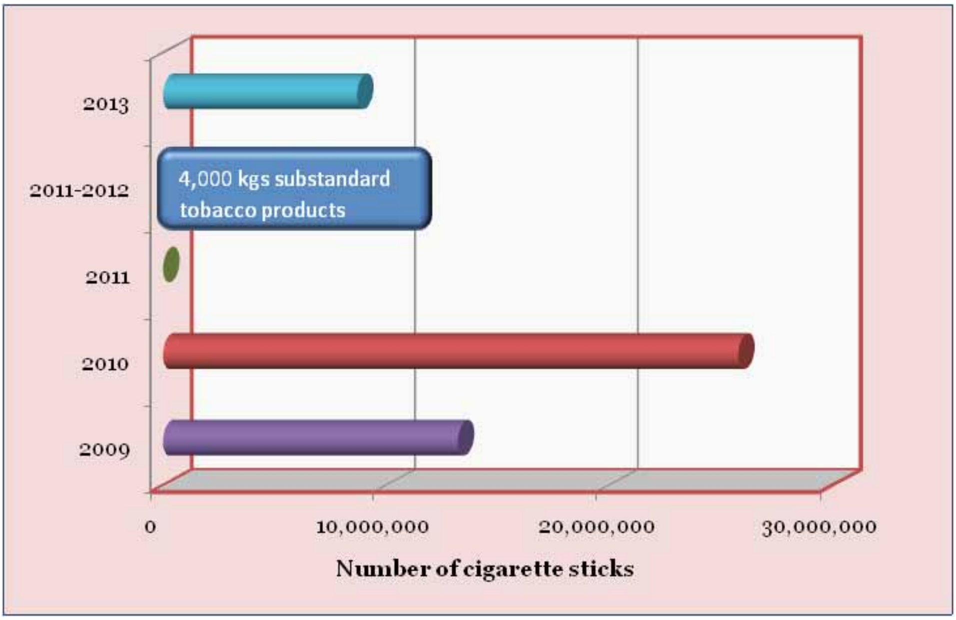
The data from enforcement agencies reveals that illicit trade in tobacco products exists in form of imported and locally-manufactured cigarettes. Also, the review shows that illicit tobacco products in Kenya are mainly counterfeits smuggled through the sea and uncustomed (diverted exports) cigarettes smuggled by road. Imports are mainly counterfeits introduced into the country primarily through concealment. In terms of domestic manufacture, illicit tobacco products are mainly uncustomed cigarettes, which evade taxes entirely. The quantities of counterfeit cigarettes seized vary but could be as large as 850 cartons (each with 10,000 cigarette sticks) seized by Kenya Revenue Authority (KRA) in 2010 and could be as few as 1,120 sticks seized by the Anti-Counterfeit Agency in 2011. Interestingly, the value of fines imposed (see Figure 4.1 below) for uncustomed cigarettes was as low as Ksh 10,000 for 12 cartons of uncustomed cigarettes for export in 2001 and Ksh 20,000 for 214 cartons in 2010, to Ksh 150,000 for 500 cartons of uncustomed cigarettes for export in 2003, and Ksh 1.6 million for a similar offence and quantity in 2009. Further, in 2009, a fine of Ksh 2.1 million was imposed for 645 cartons of uncustomed cigarettes. The variations could be explained by different laws under which the enforcement took place and the fact that most of the laws do not prescribe minimum fines. A key challenge in analysis is the scanty data, since the agencies are not obligated to report seizures of illicit products to a central agency.

Figure 4.1: Variation in seizures of uncustomed cigarettes and fines imposed

Data Source: KRA (2013)

*2003 and 2009 shows that though the seizures were similar (i.e 500 cartons), fines divergence (Ksh 150,000 against Ksh 1.6 million) was very large.

Figure 4.2: Seizures of counterfeit cigarettes



Data Source: KRA (2013); Anti-Counterfeit Agency (2013b) and Kenya Bureau of Standards (2013)

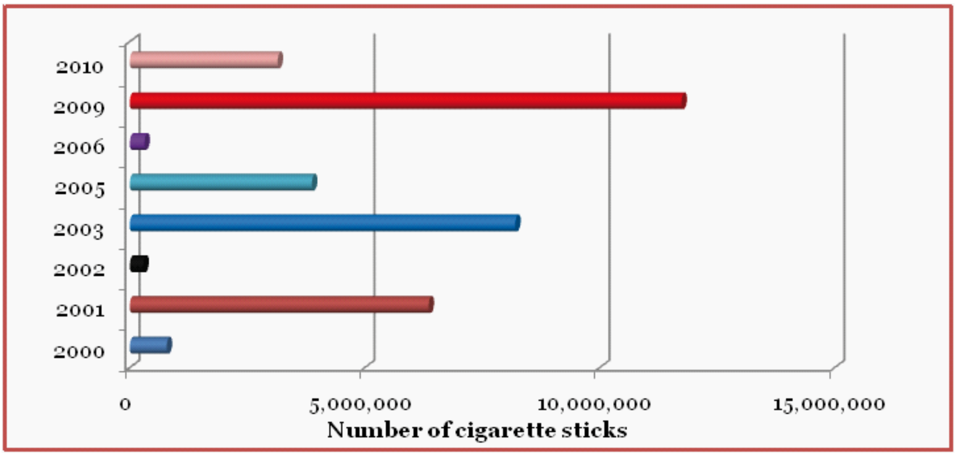
Between 2009 and 2013 alone, over 47.7 million counterfeit cigarette sticks valued at Ksh 239 million and lost tax revenue estimated at Ksh 152 million[1] were seized by the Kenya Revenue Authority, Anti-Counterfeit Agency and the Kenya Bureau of Standards. However, major proportions of the seizures, according to the data, were done by the Kenya Revenue Authority. The Port of Mombasa was the major smuggling point for the counterfeit cigarettes. China was the major source of counterfeit products, but in some instances the products are channeled through the United Arab Emirates and India. Figure 4.2 provides a summary of counterfeit seizures.

With regard to diverted exports,[2] between 2000 and 2010, about 34.7 million diverted cigarette exports were intercepted by the Kenya Revenue Authority, mainly along the Eldoret Highway. The value of total seizures was estimated at

[1] Retail selling price of Ksh 100 for the most popular brand packet of cigarettes and tax rates for 2010 estimated to be 63.8 per cent as per the WHO (2010) estimate was assumed.

[2] Also referred to as uncustomed goods, which are dutiable goods on which the full duties due have not been paid, and any goods, whether dutiable or not, which are imported, exported, carried coastwise or in any way dealt with contrary to the provisions of the Customs and Excise Act, Cap 472 (Government of Kenya, 2012a).

Figure 4.3: Seizures of uncustomed (diverted) exports*



Data Source: KRA (2013)

* Seizure data for the year 2004, 2007 and 2007 is not provided

Ksh 174 million, with an estimated tax loss of Ksh 111 million,[3] given that tobacco products declared for exports do not attract taxes. Figure 4.3 provides a summary of seizures of uncustomed (diverted) exports.

Most of the seizures were made by the Customs Department of the Kenya Revenue Authority. The Anti-Counterfeit Agency reported only three seizures of counterfeit cigarettes. Table 4.1 provides a summary of seizures by respective government agencies.

Table 4.1: Summary of seizures of illicit tobacco products by seizing agency

Agency making seizures	Description of seizures
Anti-Counterfeit Agency	2011: two seizures of 1,120 sticks of counterfeit cigarettes valued at Ksh 5,600 were seized in Nairobi. The two court cases are yet to be finalized 2010: 7.2 million sticks of counterfeit cigarettes of a local brand valued at Ksh 36 million was seized in Mombasa, originating from China. The container was disguised as imports of cotton buds

[3] Retail selling price of Ksh 100 for the most popular brand packet of cigarettes and tax rates for 2010 estimated to be 63.8 per cent as per the WHO (2013a) estimate was assumed.

Kenya Bureau of Standards	2009: 1,090 packets of substandard cigarettes were seized in Mombasa, coming through the sea 2011-2012: 4,000 kilogrammes of various substandard tobacco products, consisting of cigarettes and chewable tobacco were seized at the Eldoret Airport. The products were channeled from India to Dubai, and finally Eldoret Airport
Kenya Revenue Authority (Customs Department)	September 2009: 470 cartons of cigarettes @10,000 sticks of cigarettes, originating from India were seized in Mombasa Container Terminal. The consignment was declared as cigarettes with no brand name; nature of IPR violation: trademark and product label December 2009: 850 cartons of cigarettes @10,000 sticks seized in Kilindini Port; originating from India and destined for South Sudan; nature of IPR violation: trademark and product label January 2010: 850 cartons of cigarettes @10,000 sticks seized in Kilindini Port; originating from India and destined for South Sudan; nature of IPR violation: trademark and product label February 2010: 720 cartons of cigarettes @10,000 sticks originating from China were seized in Mombasa. The consignment was declared as cotton buds; nature of IPR violation: trademark and product label July 2010: 610 cartons of cigarettes @10,000 sticks per carton, originating from the United Arab Emirates were seized in Mombasa. The cartons were wrapped in black gunny bags; nature of IPR violation: product label August 2010: 400 cartons of cigarettes @10,000 sticks were seized at Kilindini Port, originating from the United Arab Emirates. The consignment was declared as electronics; nature of IPR violation: Product label

Data Source: Key Informants: KRA (2013); Anti-Counterfeit Agency (2013a) and Kenya Bureau of Standards (2013)

The main seizures of illicit tobacco products are cigarettes. In terms of volume, between 2009 and 2013, 47.7 million sticks of counterfeit cigarettes were seized mainly by the KRA through interceptions at the Port of Mombasa. Further, 34.7 million sticks of diverted exports were seized by KRA, mainly along the Eldoret highway. Counterfeits originate from imports, mainly from China through the Port of Mombasa. Diverted exports, on the other hand, are genuine cigarettes manufactured locally and declared for export to take advantage of tax exemptions. It is important to note that the seizures are just an indication of the nature of illicit trade and does not exhaustively capture true value. The seizures reported are mainly large-scale interceptions and do not include small-scale smuggling such as bootlegging.

4.2 Institutional Framework to Combat Illicit Trade in Tobacco Products in Kenya

Other than the Tobacco Control Act No. 4 of 2007, which is the principal law governing tobacco control in the country, Kenya has a number of laws[4] that touch on illicit trade directly or indirectly. Under the Constitution, Kenyans have the right to be protected against unhealthy or unsafe goods such as counterfeit goods and can seek for compensation for any loss or injury arising from defective goods.

4.2.1 Anti-Counterfeit Act No. 13 of 2008

This Act established the Anti-Counterfeit Agency, whose primary mandate is to combat counterfeits. According to this law, the manufacture, production, possession, trade, sale, hire, exchange and distribution of counterfeit goods is an offence. The law empowers inspectors designated from different relevant enforcement agencies to jointly conduct raids, seize and detain suspected goods, and can even arrest suspects. The enforcement agencies include the Kenya Police, Kenya Revenue Authority, Kenya Industrial Property Institute, Kenya Bureau of Standards, Weights and Measures, amongst others.[5] Some inspectors including Anti-Counterfeit Agency also have powers to prosecute. The inspectors are to operate under the direction of their respective enforcement agency but are also required to report matters that relate to counterfeit goods to the Anti-Counterfeit Agency on a monthly basis.[6] The reporting provisions are, however, not anchored in the Anti-Counterfeit Act.

Legitimate businesses in Kenya with registered trademark, service mark, holder of a patent, utility model or industrial design who has had their intellectual property infringed can make a complaint if they suspect someone is dealing in counterfeit goods. The Act clearly spells out the process the agency/inspector undertakes in the event of raids and seizures, including preparing the necessary documentation, storage and subsequent disposal of the seized goods. Seizures usually form evidence in court proceedings.

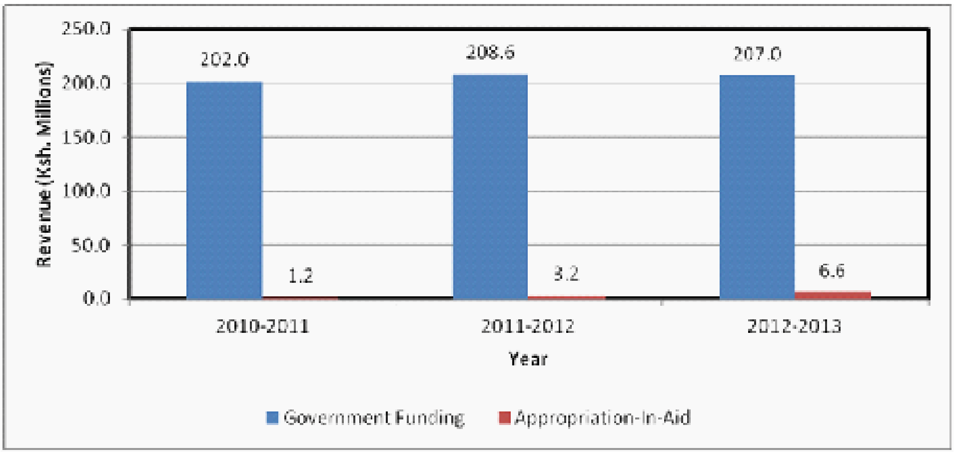
The criminal sanctions of the Act vary with the nature of the conviction. The first conviction attracts a fine of not less than three times the value of the prevailing retail price of the counterfeited good, or a jail term not exceeding five years, or both. Second and subsequent conviction attracts a stiffer penalty of a

[4] These include the Anti-Counterfeit Act, 2008; Customs and Excise Act, Cap 472; Trade Descriptions Act, Cap 505; Trademarks Act, Cap 506; Standard Act, Cap 496; Anti-Corruption and Economics Crime Act, Cap 65; Proceeds of Crime & Anti-Money Laundering Act; and the Constitution of Kenya 2010.

[5] See section 22 of Government of Kenya (2008a).

[6] This is provided in section 6(2) Government of Kenya (2010c).

Figure 4.4: Anti-Counterfeit Agency budgetary allocations and own-source revenues



Data Source: Anti-Counterfeit Agency (2013a)

fine of not less than five times the value of the prevailing retail price of goods, or a jail term of 15 years or both. The Act, however, ties minimum fines to the value of seizures and can therefore lead to low penalties based on piecemeal consignments, overlooking the overall undetected trade that may be voluminous cumulatively. A critical challenge in the application of this law is that the intellectual property right holder; the successor; a licensee or agent are the only ones who can make a complaint and are subsequently critical once the case goes to court.

There have been initiatives to revise this law, including reviewing the definition of counterfeit with the aim of removing the definition of counterfeit medicine, given the 2012 High Court ruling that declared the definition of counterfeit medicine unconstitutional given it poses a constraint to access of essential medicine[7] and to include counterfeit labels, packaging, and security labels.[8] Enforcement challenges that exist within the Anti-Counterfeit Agency relate to the limited resources. The funds allocated to the Anti-Counterfeit Agency are low, relative to the multi-billion size of counterfeit trade. Figure 4.4 shows trends in annual budgetary allocations to the Agency.

4.2.2 Customs and Excise Act, Cap 472

According to Schedule 8 (Prohibited and Restricted Goods) of the Customs and

[7] Government of Kenya (2012).

[8] Anti-Counterfeit Agency (2013b).

Excise Act, importation of counterfeit products is prohibited.[9] A person who imports, unloads, acquires or is in possession of such goods commits an offence and is liable to imprisonment for a term up to five years or a fine equal to three times the amount of duty and any other taxes payable on the goods subject to a maximum of Ksh 1.5 million or to both the fine and imprisonment.[10]

The Customs and Excise Act classify tobacco products as excisable goods, whereby the manufacturing license is issued by the Commissioner. With respect to the packaging, the law provides that an excise stamp must be affixed,[11] which applies to manufactured and imported cigars and cigarettes. The manufacturer or importer applies[12] for the supply of excise stamps accompanied with the necessary payments prior to manufacture or importation. Similar to the Anti-Counterfeit Act, the Customs and Excise Act also provides detailed procedures on seizures, empowering customs or police officers to undertake seizures. Similar to the Anti-Countefeit Act, which gives designated officers prosecutory powers, the Customs and Excise Act empowers designated KRA officers with prosecutory powers.

The Customs and Excise Act governs the administration of excise tax in Kenya, which is amended from time to time to give effect to annual Budget Statements. The Act also provides the excise duty that applies to tobacco products as indicated in Table 4.2 below.

Table 4.2: Excise duty on tobacco and tobacco products

Tariff Description	Excise Duty
Cigars, cheroots, and cigarillos containing tobacco	130%
Other cigars, cheroots and cigarillos and other cigarettes containing tobacco substitutes	130%
Smoking tobacco, whether or not containing tobacco substitutes in any proportion	130%
Homogenized or reconstituted tobacco	130%
Other manufactured tobacco and manufactured tobacco substitutes	130%
Cigarettes	Ksh. 1,200 per mille or 35% of retail selling price

Source: Government of Kenya (2012a)

[9] See Eight Schedule of Government of Kenya (2012a).

[10] See Section 175 of Government of Kenya (2012a).

[11] With exception to cigarettes destined for Navy, Army, Air Force Institution and Armed Forces Organization Canteen stores, duty free and diplomatic shops.

[12] Customs and Excise (Excisable Goods Management System) Regulations 2013.

Prior to 2003, excise tax on cigarettes was charged on *ad valorem* system, based on ex-factory selling price that was replaced with a four-tier specific tax based on retail selling prices (WHO, 2012). Annex 6 shows cigarettes excise tax regimes in Kenya over the last 10 years. Between 2005 and 2007, excise tax rate per mille increased by one per cent while those on high end cigarettes increased by about 30 per cent.[13] In 2008, the Ministry of Finance introduced taxation based on product and packaging characteristics, but was reversed by Parliament in 2010 following industry lobbying (WHO, 2012). Introduction of harmonized[14] tax structure in 2011 raised taxes on the lower-end tobacco products by approximately 82 per cent while causing a global increase of approximately 35 per cent (WHO, 2012).

The Customs and Excise Act also provides some import exemptions for certain tobacco products for specific groups (such as diplomatic or duty-free privileges). For instance, cigarettes, cigars, cheroots, cigarillos, tobacco, and snuff not exceeding 250g is exempted on imports by passengers, provided that the passenger has attained 18 years and the products are for household use by the passenger.[15]

4.2.3 Customs and excise (Excisable Goods Management System) regulations 2013

This regulation, published under Legal Notice No. 110 of 2013 (which repeals the Customs and Excise–Excise Duty Stamps–Regulations of 2008), prescribes procedures and guidelines for the operation of excisable goods management system. It came into force on 5th November 2013, requiring manufacturers and importers of excisable goods to start online activation of excise stamps. Excisable Goods Management System as defined in the regulation include excise stamps, track and trace system, production accounting system, and related software and hardware. Both domestic manufacturers and importers of excisable goods are required to register with the Commissioner-General of KRA, install the system[16] in their production or import facilities, and affix every package of excisable goods with an excise stamp.

The regulation further requires that excise stamps should facilitate tracking of the excisable goods along the supply chain; enable accounting for the production

[13] Statistics based on computations in Annex 6.

[14] The harmonization involved abolishing of tiers and replacing them with a single rate of Ksh 1,200 per mille or 35 per cent of retail selling price, whichever is higher.

[15] Government of Kenya (2010d); Government of Kenya (2012a), Third Schedule.

16 This refers to the Excisable Goods Management System comprising of excise stamps authentication and validation equipment; devices for identification and association of each package with individual excise stamp; production accounting equipment; and devices for the control, registration, recording and transmission of data on the quantities of excisable goods to the Commissioner (Government of Kenya, 2013).

of excisable goods manufactured or imported; and facilitate persons in supply chain to authenticate the stamps and excisable goods. Players in the supply chain, including manufacturer, importer, distributor, or a retailer are required to verify and authenticate the stamps and excisable goods before admitting them into their premises. Therefore, enforcement of this regulation will address both tax evasion and trade in counterfeits, including counterfeiting of tax stamps with regard to excisable goods.

Non-compliance of the regulation, including fraudulent acquisition of excise stamps, failure to keep excise stamp register in a prescribed format, deliberate filing of incorrect returns, counterfeiting of excise stamps, or failure to furnish the commissioner with required information attracts a criminal liability.[17] Further, where a manufacturer or importer fails to account for the excise stamps issued, the commissioner may impose excise duty and other taxes on the unaccounted excise stamps based on the highest rate of excise duty, value and volume of excisable goods manufactured or imported by the person.

4.2.4 Trademarks Act, Cap 506

This law provides for the registration of trademarks indicating the origin of the goods and granting the user the exclusive right as a proprietor or licensee to use the mark in the course of business and/or trade.[18] Offences under this Act are punishable with a fine of up to Ksh 200,000 or to imprisonment for a term not exceeding five years, or both.

4.2.5 Trade Descriptions Act, Cap 505

This law prohibits false or misleading indications on goods, in advertisements or any customs entry. Under the Act, it is unlawful for a person to supply or possess goods with false or misleading trade descriptions. This includes products that infringe existing trademarks of patents, imported goods with incorrect country or place of manufacture or production, and products with inaccurate information. The law empowers inspectors to undertake necessary inspections and to seize, detain and test goods.[19] A person who commits an offence under the Act is liable to a fine of up to Ksh 2 million or imprisonment for a term of up to two years, or to both.

[17] Imprisonment not exceeding 3 years or a fine between Ksh 100,000 and Ksh 1.5 million or both

[18] Trademarks Act, Cap 506.

[19] The 'inspector' refers to an inspector of weights and measures as appointed and provided for in Government of Kenya (2012d).

4.2.6 Competition Act (No. 12 of 2010)

The aim of the Act is to promote and safeguard competition and protection of consumers from unfair business conduct, such as false or misleading representations of goods and services. The Act empowers the Competition Authority to undertake investigations and conduct inspections. The false or misleading representation in various aspects as provided in the Act includes standards and safety.[20] Infringement of the Act through false and misleading representations attracts a criminal liability of jail term not exceeding 5 years or at most Ksh 10 million fine or both.

4.2.7 Consumer Protection Act (No. 46 of 2012)

Further provisions of consumer protection from unfair trade practises are provided in the Consumer Protection Act. Unfair trade practices, including misrepresentation that the goods or services are of a particular standard, quality, grade, or style is prohibited. Under the Act, a consumer can initiate legal action in the court, including the right to terminate agreements. A person convicted under the Act is liable to a fine not exceeding Ksh 1 million or to imprisonment not exceeding three years, or both.

4.2.8 Standards Act, Cap 496

This law promotes the standardization of specific commodities and provides for establishment of the Kenya Bureau of Standards. As regards tobacco, the Kenya Standard Methods for Test for Tobacco and Tobacco Products was declared under the Standards Order, 1986, which manufacturers and sellers are expected to comply with. On conviction of any offence under this law, the court may, in addition to the penalty imposed (fine not exceeding Ksh 50,000 or imprisonment not exceeding 6 months), make an order confiscating all or part of any goods in respect of which the offence was committed, and prohibiting the manufacture or sale of that commodity unless it complies with the relevant Kenyan standard. This law can only apply if the product is substandard.

4.2.9 Tobacco Control Act (No. 4 of 2007)

The purpose of the Tobacco Control Act of 2007 is to regulate the manufacture, importation, distribution, labelling, advertising, sponsorship and use of tobacco

[20] Matters concerning the standards, specification and quality of goods are in consultation with the Kenya Bureau of Standards, which is established under Government of Kenya (2012e).

products in the country with the aim of protecting the health and well-being of consumers and non-smokers. Retailers, for instance, are required to post signs to inform the public that sale of tobacco products is prohibited to persons under the age of 18.[21]

One of the objectives of this law is to adopt and implement measures to eliminate illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting. The Act empowers the Cabinet Secretary in charge of health to advice the Tobacco Control Board. Other prohibited activities under this law include supply of tobacco products to persons under the age of 18 years; and false, misleading or deceptive information. Consumers are further protected from misleading and deceptive inducement to use tobacco products through various strategies including education, sensitization, awareness programmes and labelling.[22] The labelling requirements provided in the law include the following statements:

- "Sales only allowed in Kenya" with regard to tobacco for retail or wholesale in Kenya.
- "For export only" with regard to tobacco for exports.
- "WARNING" followed by the prescribed health warnings is a prescribed format.
- Statements as to the tar, nicotine and other constitutes as may be prescribed should be clearly provided.
- Manufacture, importation, or distribution of tobacco products, contrary to provision of this law attracts a fine not exceeding Ksh 1 million, or to imprisonment not exceeding five years, or to both.[23]

4.2.10 Anti-Corruption and Economic Crimes Act, 2003

The Anti-Corruption and Economic Crimes Act provides for the prevention, investigation and punishment of corruption; economic crimes involving fraudulent acquisition or damage of public property[24] and dishonesty in connection with taxes. This law also provides for failure to pay any taxes, fees, levies or charges payable to a public body and other offences involving dishonesty under any written law

[21] The penalty for contravening this provision is a fine of not more than Ksh 50,000 and/or imprisonment of not more than six months (Government of Kenya, 2007).

[22] See Sections 3, 9 and 15 of Government of Kenya (2007).

[23] See Section 14 (4) of Government of Kenya (2007).

[24] "Public property" means real or personal property, including money of a public body or under the control of, or consigned or due to a public body (Section 45(3) of Government of Kenya (2012f)).

providing for the maintenance or protection of public revenue.[25]

Therefore, the law applies in the case of corrupt government officials who may facilitate illicit trade, including manufacturing or importation of illicit goods. The Anti-Corruption Commission is empowered to recover benefits accrued from corruption or economic crime. Inferably, the proceeds of contraband tobacco products that are often smuggled into the country without payment of applicable taxes can be confiscated. Additionally, a person convicted of corruption or economic crime is required to compensate the rightful owner for the loss. Offences of corruption and economic crimes attract fines not exceeding one million shillings, or imprisonment not exceeding 10 years, or both. Further, if the person received quantifiable benefit or another person suffered quantifiable loss, additional fine equal to two times the amount of the benefit or loss is imposed.

4.2.11 Proceeds of Crime and Anti-Money Laundering Act No. 9 of 2009

This law, which became operational in June 2010, provides for measures to counter money laundering through identification, tracing, freezing, seizure, and confiscation of the proceeds of crime. This law is critical given that financial institutions inevitably act as conduits for transferring proceeds of illicit trade. The Act provides for the establishment of the Financial Reporting Centre (FRC) to help in the identification of the proceeds of crime and combating of money laundering. The FRC, established in April 2012, is mandated to share information on proceeds of crime and money laundering, to investigate authorities, supervisory institutions and other relevant bodies. The FRC is also mandated to exchange information with bodies in other countries with regard to money laundering activities. FRC is empowered to the right of entry and inspection of records of a reporting financial institution and submit findings of the inspection to law enforcement agency, intelligence agency or supervisory body.

A reporting institution is required to file reports of all cash transactions exceeding US$ 10,000 or its equivalent in any other currency. An individual who engages in a transaction involving proceeds of crime is liable to imprisonment to a term not exceeding 14 years and/or a fine not exceeding Ksh 5 million or value of the property involved, whichever is higher. In the case of a body corporate, the fine shall not exceed Ksh 25 million, or the amount of the value of the property involved in the offence, whichever is higher. Failure to report suspicious transaction in the case of an individual attracts imprisonment for a term not exceeding seven years, or a fine not exceeding Ksh 2.5 million, or to both. In the case of a body corporate, the fine shall not exceed Ksh 10 million or the value of the property involved in the

[25] See Sections 2 and 45 of Government of Kenya (2012f).

offence, whichever is higher.

Section 53(1) of the FRC Act provides for the Asset Recovery Agency as semi-autonomous body under the office of the Attorney General. The yet to be stablished Agency will assist in recovery of assets lost through crime or which form part of proceeds of crime. This law will generally play a significant role in dealing with large-scale smuggling, with magnitudes that can easily be detected through monitoring of financial systems.

Summary of Institutional Challenges in Kenya

As discussed above, there are numerous regulatory agencies mandated to address illicit trade in Kenya, with some agencies including KRA and the Anti-Counterfeit Agency further empowered to undertake seizures and investigations with prosecutory powers. The review of institutions reveals various challenges. First, there is weak coordination in information sharing, which adversely affects track and trace of illicit trade, and also poses challenges in terms of monitoring the impact of policy initiatives due to lack of centralized information sharing.

Though the Anti-Counterfeit Regulations of 2010 require different agencies to share information on counterfeits with the Anti-Counterfeit Agency on monthly basis, this is not being implemented because it is not anchored in the Anti-Counterfeit Act, which is superior to the Regulation. Second, there is lack of collaboration to facilitate consolidated fines for related counts of crime with regard to illicit trade, which would make fines more punitive. Agencies carry out their own investigations and prosecutions but do not do so in collaboration with other agencies. Third, since most of the laws fail to prescribe minimum fines, there is wide discretion on penalties imposed. Further, some laws such as the Anti-Counterfeit Act tie fines to seizures and, therefore, piecemeal smuggling but voluminous trade will likely have consequences of low deterrence.

Table 4.3 provides a summary of relevant laws, administering agency and fines for relevant offence. It is notable from the table that fines differ greatly under different laws, which in the absence of effective coordination and consolidated fines leave room for weaker fines depending on the law under which the offence is prosecuted.

Table 4.3: Summary of institutions and relevant fines

Law	Relevant Offence	Institute	Relevant Fines on Conviction
Trade Descriptions Act, 1980 (Rev. 2012)	Misleading information on patents, trademarks and false advertising	Department of Weights and Measures	Fine: ≤ Ksh 2 million or jail term of ≤ 2 years, or both
Standards Act, 1981 (Rev. 2012)	Products not meeting 'Kenyan Standards'	Kenya Bureau of Standards	Fine ≤ Ksh 50,000 or imprisonment ≤6 months. Additionally, the court may make an order to confiscate all or part of any goods in respect of which the offence was committed
Trademarks Act, 1982 (Rev. 2009)	Forgeries, replicas or knockoffs	Kenya Industrial Property Institute	Fine: Ksh 200,000 depending on offence, or jail term ≤ 5 years, or both
Customs & Excise Act, 1996 (Rev. 2013)	Prohibited goods including counterfeits, and uncustomed goods	Kenya Revenue Authority	Jail term of ≤5 years or fine equal to three times amount of duty and other taxes payable on the goods, subject to maximum of Ksh 1.5 million
Anti-Corruption and Economic Crimes Act of 2003	Corruption and Economic Crimes	Anti-Corruption Commission	Fine ≤ Ksh 1 million or jail term ≤ 10 years or both. If the person received quantifiable benefit or another person suffered quantifiable loss additional fine equal to two times the amount of the benefit or loss is imposed
Tobacco Control Act (No. 4 of 2007)	Misleading manufacture, importation, or distribution of tobacco products	Tobacco Control Board	Fine ≤ Ksh 1 million or imprisonment ≤ 5 years or both

Anti-Counterfeit Act (No. 13 of 2008)	Counterfeit goods	Anti-Counterfeit Agency	1st Conviction: Fine ≥ 3 times value of retail price of counterfeited goods, or jail term ≤ 5 years, or both
Proceeds of Crime and Anti-Money Laundering Act No. 9 of 2009	Laundering of proceeds of crime	Financial Reporting Centre	Jail term: ≤ 14 years or fine: ≤ Ksh 5 million or value of property involved, whichever is higher. In the case of a body corporate, the fine ≤ Ksh 25 million, or the amount of the value of the property involved in the offence, whichever is higher. Failure to report suspicious transaction in the case of an individual attracts imprisonment for a term not exceeding seven years, or a fine not exceeding Ksh 2.5 million, or to both. In the case of a body corporate, the fine shall not exceed Ksh 10 million or the value of the property involved in the offence, whichever is higher
Competition Act (No. 12 of 2010)	False or misleading representation of goods or services	Competition Authority of Kenya	Fine: ≤ Ksh 5 million or jail term ≤ 5 years or both
Consumer Protection Act (No. 46 of 2012)	Unfair trade practices including representation that the goods or services are of a particular standard/quality	Kenya Consumers Protection Advisory Committee	Fine: ≤ Ksh 1 million or imprisonment: ≤ three years, or both

Customs and Excise (Excisable Goods Management System) Regulations 2013	False declaration of production or importation of excisable goods; counterfeiting of tax stamps; tax evasion	Kenya Revenue Authority	Fines: Ksh 100,000 - Ksh 1.5 million, or imprisonment ≤ 3 years, or both. For unaccounted excise stamps: Excise duty and other taxes based on highest rate of excise duty, value and volume of excisable goods manufactured or imported by the person

Source: Authors' construction from relevant laws

The analysis of legal framework is corroborated with key informant interviews with relevant agencies to gain more insights. The challenge of weak collaboration among agencies is evident from information elicited from key informants. Table 4.4 provides a summary of key informant interviews.

Table 4.4: Summary of key informant interviews

Key informants	Challenges identified
Kenya Revenue Authority (KRA)	• Weak collaborative efforts among different agencies • Tax rates in the region vary, which may be contributing to the illicit trade and providing incentive for corruption and smuggling • Weak collaboration and information sharing by enforcement agencies in the region stifles monitoring efforts. However, recently, KRA officers are able to access Uganda Revenue Authority system to access some information such as entry number and whether taxes have been paid for cargo • Weak institutional framework to facilitate information sharing

Anti-Counterfeit Agency	• Weak linkages and collaboration between different agencies posses some challenges. For example, the Kenya Bureau of Standards is interested only in whether a product meets minimum requirements. However, some illicit products meet minimum requirements • Weak information sharing by other agencies with regard to counterfeits • Limited resources, both financial and human, hinder monitoring of counterfeits • Limited consumer awareness and lack of mechanisms for distinguishing counterfeits and genuine products • Weak reporting of counterfeit activities by copyright owners, which could be attributed to fear of possible brand loss due to negative perception of the brand by the public
Weights and Measures Department	• Inadequate resources contribute to challenges in implementation of laws • Ligation challenges, including problems of getting cooperation from complainants once goods are seized. Complainants often fail to show up in courts and there are limited expert witnesses • Weak penalties • Corruption by enforcement agencies • Low levels of reporting • Regional countries lack adequate coordination towards addressing the problem

Kenya Association of Manufacturers (KAM)	• Limited capacities of enforcement institutions • Limited inter-agency collaboration, cooperation and coordination contributing to enforcement challenges • Conflict of interests within enforcement agencies given their different mandates and reporting mechanism • Implementation of the EAC Common Market Protocol has made it easy for goods to move across the borders; coupled with existence of porous borders (illegal routes), which have resulted to increased flow of illicit goods • Lengthy response time/turnaround time in addressing reported cases • Lack of regional policy to combat the problem

Source: Key informant interviews

Summary of the findings of key informants

The views of key informants can be summarized in four common denominators: Weak collaboration and information sharing among agencies; weak regional coordination and policy framework; weak reporting by intellectual property holders and consumers; and weak capacities of institutions such as the Anti-Counterfeit Agency due to resource constraints.

4.3 Regional Collaborative Efforts to Combat Illicit Trade in Tobacco Products

The EAC countries are at different stages of enacting laws against illicit trade, with Kenya being in the lead. Uganda is working on Anti-Counterfeit Goods Bill. Though Uganda introduced the Prosecutor's Manual on Illicit Trade in January 2013, there is lack of a punitive legal framework to address various categories of illicit trade in tobacco products. In Tanzania, the Merchandise Marks Act of 1963 (Revised 2007) is the primary law that addresses illicit trade. In 2008, Tanzania introduced the Merchandise Marks Regulation in an effort to step up the fight against counterfeits. Lack of harmonized laws on illicit trade in the EAC has continued to pose challenges in terms of coordinating efforts to curb the problem. This issue was also raised by various key informants.

4.3.1 East African Community (EAC) Anti-Counterfeit Bill

Collaboratively, the EAC partner states are formulating the Anti-Counterfeit Policy and a Bill is with the East African Legislative Assembly (EALA). The EAC Anti-Counterfeit Bill, once enacted, will prohibit trade in counterfeit goods and establish national anti-counterfeit boards in each member country to coordinate the fight against illicit trade in the region.

4.3.2 East African Community Customs Management Act 2004

This law has been in use to combat illicit trade enforcement in the region. Section 7 of the Act grants every Customs officer the powers, privileges and protection of a police officer of the partner state in which the officer performs his duty. The Act also grants the Commissioner of Customs the power to compound an offence and impose a fine that would be applicable if the person had been prosecuted and convicted. The Commissioner, therefore, does not have to rely on the courts in the event of an offence.[26] The Act further prohibits imports and exports of counterfeit goods and use of unauthorized exits.

Upon conviction under this law, a person is liable to a fine not exceeding US$ 1,000 and any goods in respect of which such offence is committed are liable to forfeiture.[27] A person who imports, exports, carries coastwise, acquires or conceals counterfeits, pirated goods, or uncustomed goods is upon conviction liable to a fine equal to 50 per cent of the dutiable value of the goods involved, or imprisonment for a term not exceeding five years, or both.[28] This law, therefore, makes it an offence to smuggle illicit products both through official and unofficial channels.

4.3.3 Protocol on the Establishment of the East African Community Common Market

The Protocol requires member states to promote the interests of the consumers by adopting appropriate measures that ensure protection of consumer health, and also prohibit practices that affect free trade. As one of the strategies for minimizing trade distortions, the protocol requires partner states to harmonize tax policies and

[26] East African Community (2009), Section 219.

[27] See Section 15 East African Community (2009).

[28] See Section 200 of East African Community (2009).

laws to remove tax distortions. As measures for combating intellectual property rights, Article 43(3) of the Protocol requires member states to:

- Put in place measures that address infringement of Intellectual Property Rights (IPR)
- Co-operate in fighting piracy and anti-counterfeit activities
- Exchange information relating to IPR
- Promote public awareness on IPR
- Enhance capacity in the IPR
- Put in place IPR policies

4.3.4 EAC Competition Act 2006

The objectives of this law are to enhance the welfare of the people of the member states, enhance competitiveness of Community enterprises, and create an environment conducive to investment. The Act prohibits an undertaking from falsely representing that goods are of a particular standard, quality or composition; or make false representation concerning the place of origin of goods. The Act applies to all economic activities and sectors having cross-border effect.

The Act further provides that a partner state or a person may file a complaint with the EAC Competition Authority against a partner state or a person for breaches committed under the Act. Decisions made by the Authority are enforceable by partner states' enforcement authorities.

A person who contravenes the provisions of this law commits an offence and is upon conviction liable to a fine not exceeding US$ 10,000. A person who fails to comply with an order of the EAC Competition Authority is liable to a fine not exceeding US$ 5,000 or to imprisonment for a term not exceeding six months, or both.

4.3.5 Operation 'Meerkat'

Regionally, an operation named "Meerkat" conducted in seven Eastern and Southern African countries in July 2012 involved joint police and customs interdictions on illicit tobacco products. The operation was supported by Interpol's Regional Bureaus in Nairobi and Zimbabwe and by officials from the Word Customs Organization (WCO) Secretariat and Interpol's Trafficking in Illicit Goods Programme (World Customs Organization, 2013). In a total of 40 raids conducted between 23rd and 27th July 2012 at seaports, inland border points, markets and shops in Kenya, Tanzania, Mozambique, Namibia, South Africa, Angola, and Zimbabwe, seizures of 32 million sticks of cigarettes (about 1.6 million cigarette packets), and 134 tonnes of raw tobacco were made.[29] As a result of these seizures, national authorities have initiated a number of administrative investigations into tax evasion and other potential criminal offences.[30]

4.4 International Experiences

There are two international protocols that control both licit and illicit tobacco products. The WHO Framework Convention on Tobacco Control (FCTC)[31] outlines measures to reduce demand for[32] and supply of[33] of tobacco products. The Protocol to Eliminate Illicit Trade in Tobacco Products (PEITTP) was adopted by the Conference of the Parties[34] on 12th November 2012 at its fifth session in Seoul, Republic of South Korea. The PEITTP complements the WHO FCTC with the objective of eliminating all forms of illicit tobacco trade by requiring parties to take measures to control the supply chain of tobacco products and to co-operate internationally by establishing global tracking and tracing systems (WHO, 2013a).

Three countries, namely New Zealand, Australia and South Africa, were considered for review of international experiences. The choice of international experiences was informed by Joossens et al (2010), with the selected countries being amongst those with lowest incidence of illicit cigarette market as a percentage of legal sales. Indicators for comparisons include expenditures on tobacco control, regional collaborative efforts, prosecutory powers of relevant agencies, and punitive nature of fines with regard to whether minimum penalties are prescribed. Figure 4.5 shows comparative incidence of illicit cigarette sales for Kenya and comparator countries.

In terms of enforcement expenditures, tobacco control expenditures as a percentage of GDP in Kenya is low compared to the comparator countries as shown in Figure 4.6.

Experiences from Australia

[29] See Interpol (2013).

[30] Interpol (2013)

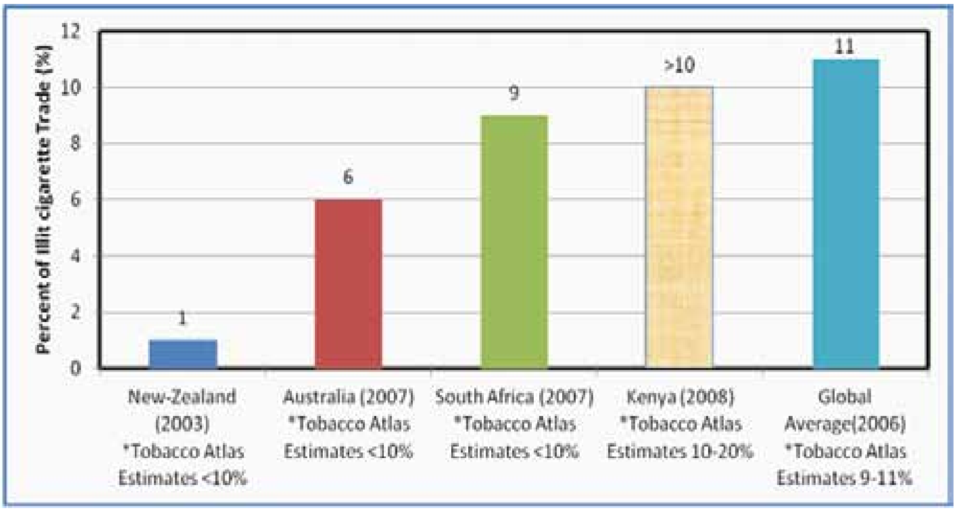
[31] WHO FCTC was adopted by the World Health Assembly on 21st May 2003 and entered into force on 27th February, 2005.

[32] Articles 6-14.

[33] Articles 15-17.

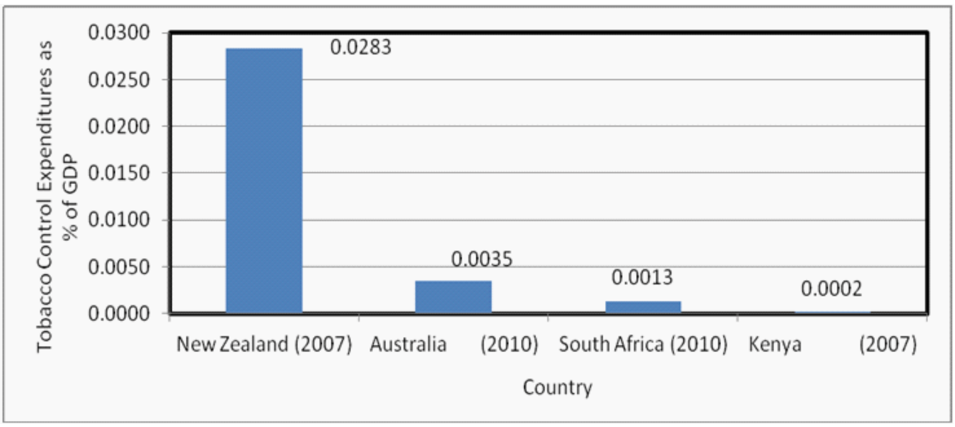
[34] The Conference of the Parties is the governing body of the WHO FCTC and comprises all parties to the Convention.

Figure 4.5: Incidences of illicit cigarette sales



Data Source: For New-Zealand, Australia and South Africa: Joossens et al. (2010); For Kenya: Allen (2011). For Global Average (Joossens, 2007). The estimates for the Tobacco Atlas Estimates were obtained from Eriksen et al. (2012). In parenthesis are the years of study.

Figure 4.6: Comparative tobacco control expenditures as % of GDP



Data Source: For control expenditures (WHO, 2011); For GDP (World Bank 2013). In parenthesis are the years of expenditure.

As a strategy to check affordability, Australia regularly increases cigarette taxes to keep pace with inflation (WHO, 2010). This mitigates possibility of real value of tobacco taxes falling over time as price levels increase. According to WHO (2010), only Australia and New Zealand have implemented this model of inflation indexation. In Kenya, as noted earlier, the Customs and Excise Act, Cap 472 was only recently amended through the Finance Act 2012 to empower the Finance Cabinet Secretary to adjust specific rate of excise duty to take account of inflation.[35] Both manufactured and unbranded tobacco is illicitly traded in Australia (Scollo and Winstanley; 2012; Deloitte, 2011; PWC, 2010).

In 2009, the Australian government adopted a national action plan aimed at curtailing illicit trade in tobacco products through[36] development and implementation of a national strategy and international agreements to tame illicit trade in tobacco products, banning of retail sale of tobacco products through internet, and prohibition of duty free sales of tobacco products. Further, the government recently enhanced an institutional framework to tame illicit trade through enactment of the Tobacco Advertising Prohibition Act 2012, which prohibits sale of tobacco on internet. In 2009, penalties on tobacco offences were increased by up to ten-fold.[37] The Customs Amendment (Smuggled Tobacco) Act 2012 creates criminal offences for those conveying or possessing contrabands,[38] which is punishable by up to 10 years in jail.

Experiences from South Africa

Incidences of illicit trade in tobacco products in South Africa are attributable to taxes on tobacco products and existence of informal networks[39] (Lemboe and Black, 2012). According to the Tobacco Institute of South Africa (2005), illicit trade in tobacco products was non-existent in South Africa prior to 1994 when a new tobacco tax was introduced, resulting into a total tax incidence of 50 per cent of retail price. The two findings confirm that illicit trade is affected by multiplicity of factors. Measures adopted to combat illicit trade in tobacco products in South Africa include:

- Inter-agency collaborations: South African Revenue Services, police services and the national defence forces enhance enforcement (Trademarks South Africa, 2014).

[35] See Section 119(7) of Government of Kenya (2012a) and Section 3 of Government of Kenya (2012b).

[36] Government of Australia (2009).

[37] Deloitte (2011).

[38] Australian Government, Customs Amendment (Smuggled Tobacco) Act 2012.

[39] The emergence of informal networks is attributed to the Apartheid regime as alternative trading platforms (Lemboe and Black, 2012).

- Prescription of minimum fines for tax evasion. Fines on tax evasion attracts a fine of R8,000 or three times the value of seizures, whichever is greater, or imprisonment of up to four years.[40] Counterfeiting, on conviction, attracts a fine not exceeding R5,000 or imprisonment not exceeding three years.[41]
- Collaboration of enforcement agencies and legitimate traders to counter illicit trade by providing avenues of intelligence and use of industry resources (Allen, 2012).

Prescription of minimum fines like in the case of South Africa is ideal to deter piecemeal smuggling but voluminous trade. Inter-agency collaboration would further facilitate smooth coordinated efforts in tracking and tackling the problem of illicit trade. Collaboration with the industry is important in leveraging on limited public resources, but it requires clear strategies to prevent industry interference.

Experiences from New Zealand

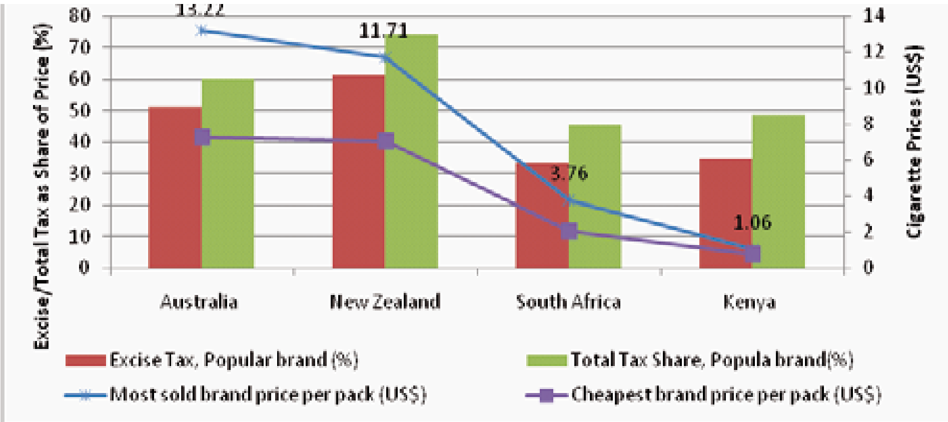
The Copyright Act 1994 and Trademarks Act 2002 are the principal legislations that provide criminal offences for production and distribution of counterfeit and pirated goods. The Trade Marks Amendment Act 2011 empowers Customs and National Economic Unit of the Ministry of Economic Development with police power to investigate and prosecute counterfeiting and piracy offences. As a strategy for regional collaboration, New Zealand is a member of the Anti-Counterfeiting Trade agreement (ACTA) to combat counterfeiting and piracy among key trading partners. Similar to Australia, tobacco taxes are indexed to inflation to minimize value of taxes falling as price level increases. This also minimizes rapid increases ('jumps') in taxes. Paynter and Joossens (2010), however, note that the low levels of illicit trade, especially bootlegging, in New Zealand may be attributable to its geographical location (island). Figure 4.7 shows comparative cigarette taxes and prices for Kenya, Australia, New Zealand and South Africa. Cigarette prices in Kenya are low compared to the comparator countries. The taxes in the figure relate to most popular brands.

In Table 4.4, we summarize the regulatory best practices from other countries: Canada, UK, Spain, and the US. Some of the best practices adopted include investment in monitoring, enhanced penalties and supply chain management.

[40] South Africa Revenue Service Act.

[41] South Africa Revenue Service Act.

Figure 4.7: Average cigarette prices, excises and total taxes as % of price in 2012



Data Source: WHO (2013b)

Table 4.4: Summary of regulatory best practise from selected countries

Intervention	Impact	Country
Specific licensing of all elements of supply chain	Small retailers were forced to comply due to threats of a license suspension or revocation attributable to frequent site inspections. This positively impacted the magnitude of illicit tobacco products as evidenced by decreased percentage of seizures of illicit tobacco products per inspection	California, US introduced in 2003 This licensing is a requirement under the Cigarette and Tobacco Products Licensing Act 2003
Increased investment in investigations	Increased investments assisted in disrupting cigarette smuggling under the Anti-Smuggling Initiative implemented in 1994/95	Canada
	Increased inspection capacity lead to an increase in the number of investments and a decline in the number of seizures	California, US reported in the 2004/5 Investigation Division Annual Report
	Investments included scanners to detect high volume of cigarette shipments, which lead to increased detection	UK

Increased border patrol and enforcement capacities	This contributed to a decrease in illicit activity	Spain
Sharing of Information	Information is shared between the Canadian police, provincial authorities, the border agency and the revenue authority. In some cases, joint taskforces and joint-agency enforcement officers were implemented	Manitoba, Cornwall, and Ontario, Canada
	High levels of cooperation with other countries is amongst the factors contributing to the low levels of illicit tobacco trade in the country	New Zealand
	Multi-agency approach to enforcement under the "North of England Tackling Illicit Tobacco for Better Health Programme", which includes the Police, Trading Standards, Licensing Officers and HM Revenue & Customs	UK
Supply chain regulations	Tobacco Products Duty Act 1979 makes tobacco manufacturers responsible for ensuring tobacco products are not supplied to persons likely to facilitate smuggling into the UK. Tobacco manufacturing companies are also expected to have a supply chain policy. The UK Supply Chain Legislation in 2006 introduced new measures to improve supply chain controls	UK
Stiff penalties	Proceeds of Crime Act of 2002 provides for confiscation of proceeds of counterfeiting activity, in addition to fines up to £5,000 and bans in tobacco trading	UK

Authors' compilation. Literature sources: Sweeting et al (2009); UNICRI and BASCAP (2013), Paynter and Joossens (2010); HM Revenue & Customs and UK Border Agency (2011)

Other suggestions for combating illicit tobacco trade provided in literature include supply chain regulation through use of technology and enforcement; inter-agency collaboration in data sharing; and punitive penalties, for example by taking into account past proceeds of crime (Joossens and Raw, 2003; Paynter and Joossens, 2010; and Sweeting et al., 2009).

Summary of international and regional experiences

From the analysis of regional and international experiences, the following emerge as key success factors:

- Enhanced inter-agency collaboration
- Stiff penalties with minimum fines to deter the offence
- Confiscation of proceeds of illicit activities to make penalty deterrent, including accrued assets from the illicit activity
- Enhanced supply chain regulations to facilitate track and trace of tobacco products
- Increased investments in customs' information technology
- Increased expenditure in tobacco control
- International collaboration
- Partnership with the industry for enhanced intelligence and to leverage on industry resources

4.5 Relationship between Taxation and Illicit Trade in Tobacco Products

Global experience shows that taxation is a significant but not sole driver of illicit trade in tobacco products (Allen, 2013; Cooper and Witt, 2012; Merriman et al, 2000). We compiled data from Merriman et al (2000) and established possible correlations. The results as shown in Figure 4.8 demonstrate correlations between levels of cigarette smuggling, cigarette prices and transparency index. Countries with high cigarette prices experience relatively low levels of cigarette smuggling. The Spearman's correlation coefficient between cigarette smuggling and transparency index was -0.46 and significant at five per cent significance level, indicating negative correlation between smuggling and transparency index.[42] The correlation for cigarette smuggling and cigarette prices is also negative at -0.41 and significant at 5 per cent. However, this should not be interpreted as causality. Countries with low levels of illicit trade are generally high income countries where tobacco control expenditures are also high. Geographical regions such as Europe and Western Pacific with high excise taxes and cigarette prices experience lower levels of illicit cigarette trade in contrast to Africa where cigarette prices are

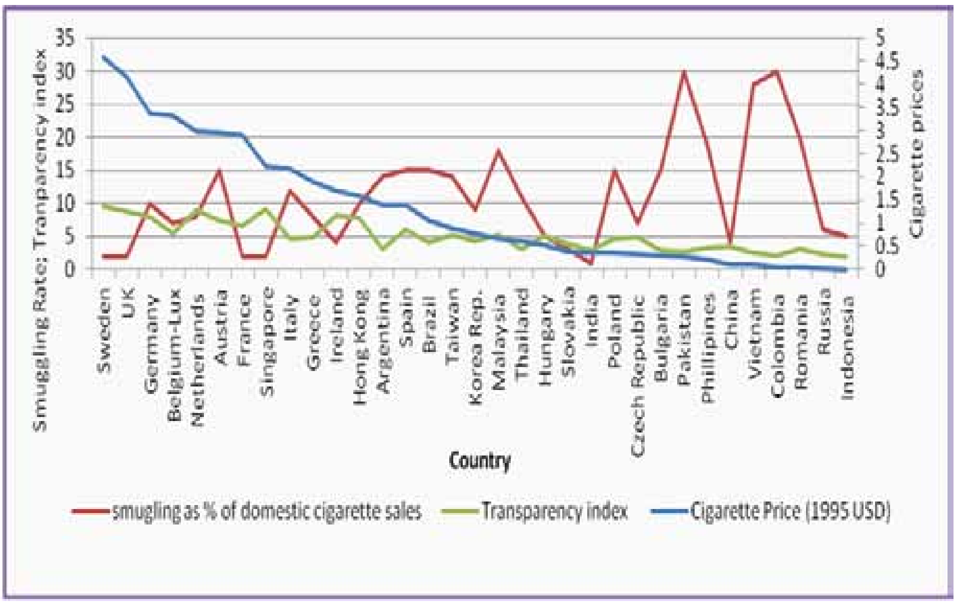
[42] The analysis is based on data compiled by Merriman et al. (2000).

low but incidence of illicit trade is high. This could be attributed to high levels of corruption in developing countries. For example, a study by Merriman et al (2000) shows correlation between transparency index and illicit trade; countries that score poorly on transparency index demonstrate high levels of illicit trade. Also, porous borders and weak monitoring due to limited resource allocation for tobacco control monitoring in developing countries is a contributing factor.

4.5.1 Comparative Regional Tax System and Structure

Within the Eastern African countries, cigarette prices vary across different categories, including most popular brands, cheapest brands and high-end imported brands. Figure 4.9 shows comparative regional average cigarette prices and taxes within Eastern African countries. There is large variability in cigarette prices, particularly with regard to most sold/popular brand. Such price differentials could potentially create incentives for smuggling, including bootlegging in the absence of effective monitoring and enforcement. To address this, the WHO (2010) recommends raising tobacco excise taxes so that they account for at least 70 per cent of retail prices.

Figure 4.8: Relationship between cigarette prices, cigarette smuggling and transparency index.

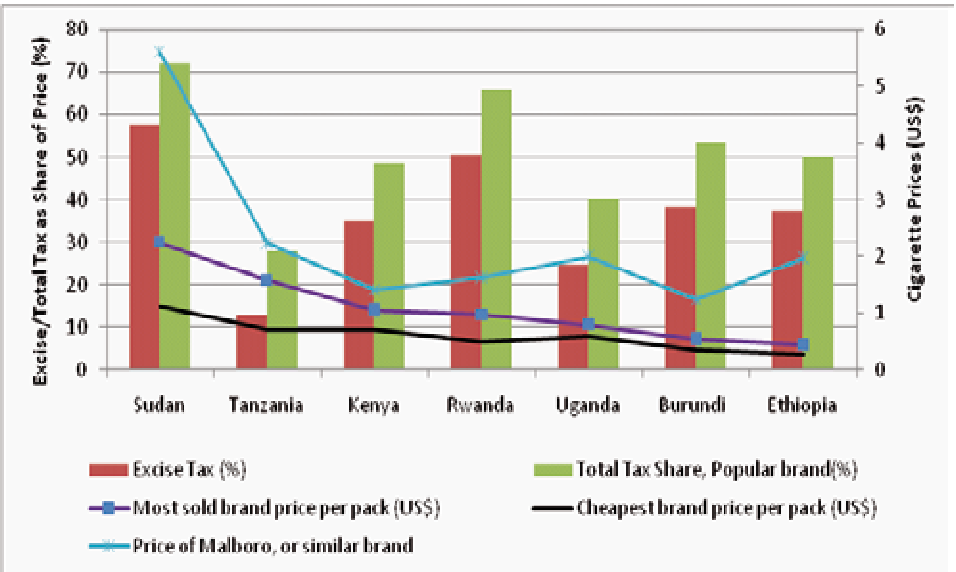


Data source: Merriman et al. (2000)

Save for Sudan, the total tax share in retail selling price for the most popular brands of cigarettes within Eastern African countries are, however, below the WHO recommendation of 70 per cent. Tobacco taxes are structured in different ways, including: Single tier system, which can either be specific tax (monetary amount per cigarette) or *ad valorem* (calculated as a percentage of the price); and mixed tax system which combines specific and *ad valorem* tax systems. The mixed system, for example, classifies cigarettes into different categories based on such factors as retail price, or the length of the cigarette.

With regard to the most popular brands, among the Eastern African countries Kenya, Rwanda, Burundi, Sudan and Ethiopia use *ad valorem* excise tax system while Uganda and Tanzania use specific tax system, with all the countries further imposing value added tax.[43]

Figure 4.9: Average cigarette prices, excises and total taxes as % of price in 2012*



Data Source: WHO (2013b). *Taxes are for the most popular brands (Kenya, Sportsman; Ethiopia, Nyala; Burundi, Supermatch Ordinaire; Rwanda, Intore; Sudan, Brengi; Tanzania, Portsman; and Uganda, Safari).

43 Source: WHO (2013) country profiles.

5. Summary, Conclusion and Policy Recommendations

5.1 Summary and Conclusion

Illicit trade in tobacco products is a complex problem involving trade in both counterfeits and genuine products, which can either be imported or manufactured locally. The problem is driven by the incentive for the supplier to maximize profit attributable to high profit margin. Illicit trade in tobacco products has continued to attract policy attention due to various social costs, including increased health expenditure as a result of increased access to tobacco products, loss of government revenue through tax evasion, and circumvention of government policies such as access to tobacco products by youths. The underground nature of illicit trade in tobacco products, and hence lack of adequate data, pose serious challenges to evidence-based policy decisions in developing countries. The situation becomes further challenging in instances where genuine manufacturers participate in illicit trade through tax evasion, such as diverted exports and undeclared production. Despite data limitations, this study has attempted to shed light on the nature and extent of illicit trade in tobacco products in Kenya; and reviewed the institutional framework in place, including regional collaborative efforts and international experiences. However, it should be noted that seizures data is only an indication of the nature of the problem and not necessarily the exact magnitude of the problem. The following are the key findings:

1. Cigarettes are the key illicitly-traded tobacco products. Imported counterfeit cigarettes are mainly from China, which are sometimes channelled through United Arab Emirates and India. Diverted exports of cigarettes manufactured by the legitimate manufacturer are the main illicit cigarette products originating from the domestic economy. While counterfeit imports are mainly through the sea, diverted exports are transported by road.
2. Kenya has a multiplicity of laws and institutions to curb illicit trade generally. Despite a plethora of institutions, there are challenges that render the laws ineffective in combating the vice. These challenges include weak coordination among different agencies, and limited sharing of data and intelligence between relevant agencies. For example, while the Anti-Counterfeit Regulations of 2010 require designated officers in relevant regulatory agencies to share counterfeit data with the Anti-Counterfeit Agency, this is not well implemented by the agencies. This may be due to the fact that provision for data sharing is not anchored in the Anti-Counterfeit Act or any other law.

3. Inadequate resources for the Anti-Counterfeit Agency. The Agency has limited operation centres in Nairobi, Mombasa and Kisumu. The funding allocations have only averaged Ksh 206 million since its establishment in 2010. Other enforcement agencies have also identified limited resources as a key challenge affecting their effectiveness.

4. The Tobacco Control Fund, established under Section 7 of the Tobacco Control Act, is yet be operationalized as no allocations have ever been made since the establishment of the Tobacco Control Board. The Act envisages utilizing the fund for research on tobacco.

5. Less punitive fines to deter illicit trade. Most of the laws including Anti-Counterfeit Act, and the Customs and Excise Act tie fines to value of seizure or fail to define minimum fines (see Table 5.1). It should, however, be noted that while the Customs and Excise Act does not define absolute minimum fines, the Customs and Excise (Excisable Goods Management System) Regulations 2013 set a minimum fine of Ksh 100,000. Thus, lack of punitive fines stifles efforts to curb the problem depending on the law under which the offender is convicted. For example, illicit traders engaging in small quantity but voluminous trade can get away with minimal fines.

6. Regionally, East African countries are at different stages of enacting legislation on illicit trade and lack harmonized laws. The draft EAC Anti-Counterfeit Bill and Policy are yet to be finalized. Further, across Eastern African countries, cigarette prices vary, which in the absence of adequate monitoring and enforcement could potentially act as incentives for smuggling, including bootlegging.

7. International experiences show the importance of regional collaboration, political will, adequate prosecutory powers, adequate resources for relevant agencies and punitive fines as critical in fighting illicit trade in tobacco products. Licensing of supply chain, for instance, was found to be effective in combating illicit trade in tobacco products in Canada and California, US.

8. One major challenge with the laws reviewed in this study is that there is no single entity mandated to collect information and data on illicit trade on tobacco products, and generally illicit trade. Statistics on the nature and trends of illicit tobacco trade is therefore scanty. Therefore, it is not easy to establish the impact of certain regulations, thus introducing challenges on the effectiveness of policies and strategies to combat illicit trade.

Table 5.1: Summary of legislations and penalties

Type of Illicit Tobacco Trade	Relevant Law/ Regulation	Penalty
Counterfeits	Anti-Counterfeit Act 2008	1st Conviction: Fine ≥ 3x value of retail price of counterfeited goods, or jail term ≤ 5 years, or both
		2nd Conviction: Fine ≥ 5x retail price of goods, or jail term ≤ 15 years, or both
Trademark infringement	Trademark Act, Cap 506	Fine: Ksh 200,000 depending on offence, or jail term ≤ 5 years, or both
False or misleading description	Trade Description Act, Cap 505	Fine: ≤ Ksh 2 million or jail term of ≤2 years, or both
	Competition Act no. 12 of 2010	Fine: ≤ Ksh 5 million or jail term ≤ 5 years or both
Tax evasion	Customs and Excise (Excisable Goods Management System) Regulations 2013	Fines: Ksh 100,000 - 1.5 million, or imprisonment ≤ 3 years, or both
		For unaccounted excise stamps: Excise duty and other taxes based on highest rate of excise duty, value and volume of excisable goods manufactured or imported by the person
Misuse of legal privileges	Customs and Excise (Excisable Goods Management System) Regulations 2013	For failure to declare to the Commissioner brands manufactured or imported for duty free; or failure to indicate "Duty Free" for sale to duty free shops or diplomatic shops Fines: Ksh 100,000–1.5 million, or imprisonment ≤ 3 years, or both
	Customs and excise Act, Cap 472	Failure to comply with import duty free limit of 250 gramme on cigarettes, cigars, cheroots, cigarillos, tobacco and snuff

Source: Authors' Compilations

Two conclusions can be drawn from this study. First, illicit trade in tobacco products is a complex problem requiring inter-agency collaboration. Second, increased opportunity costs for engaging in illicit trade through punitive fines and effective monitoring is vital.

5.2 Policy Recommendations

1. There is need to enhance enforcement. Fines imposed for illicit trade are often less punitive. Most often, the existing laws fail to prescribe minimum fines, or as in the case of Anti-Counterfeit Act tie fines to market price of goods seized. To address this challenge, there is need to prescribe minimum fines so as to make penalties punitive. Furthermore, most laws do not attach 'proceeds of crime' penalties, which would provide a stronger deterrent as established in review of country practises. A further consideration would be to promote joint actions such as raids and prosecutions amongst the different enforcement agencies.
2. There is need to enhance inter-agency collaboration. Relevant agencies that should be prioritized for collaboration include the Anti-Counterfeit Agency, KRA, Financial Reporting Centre, Ethics and Anti-Corruption Commission, Asset Recovery Agency (which is provided for under Section 51 of the Proceeds of Crime Act, but yet to be established), and the Kenya Police Service. Inter-agency collaboration is crucial in at least two fronts: first, to facilitate track and trace of previous proceeds of illicit trade to ensure that fines imposed take into account both seizures and past benefits of illicit trade. This will also entail intelligence sharing among the agencies. The second front of collaboration is with regard to prosecution. Illicit traders found with multiple offences should be charged jointly in a single case even if the offence is established in the different laws. Maximization of benefits from such collaboration requires capacity building for all relevant enforcement agencies on the different laws, offences and sanctions.
3. The Anti-Counterfeit Agency, mandated to curb counterfeits, is curtailed both in terms of financial and human resources. As a first step, more funding should be allocated to the Agency to expand their operations beyond Nairobi, Mombasa and Kisumu. Best practice reveals that increased investment in tackling illicit tobacco products and trade often result in a decrease in tax evasion and consequent increase in government revenue and a decrease in illicit activity. Other enforcement agencies also identify resource constraints as a key impediment.

4. No funding allocation has ever been made to the Tobacco Control Fund established under Section 7 of the Tobacco Control Act. A key objective of the fund is to meet expenses related to research and dissemination of information on tobacco and tobacco products. The funding constraint thus poses constraints to the achievement of objectives of the law. It is recommended that the Fund be operationalized and utilized partly for research on illicit trade in tobacco products.

5. Lack of quality, accurate and up to date data stifles research and policy decision. There is therefore need for obligation on different agencies mandated to curb illicit trade to compile data. This could be achieved first by amending the Anti-Counterfeit Act to obligate other agencies submit counterfeit data on illicit trade in a prescribed format. This provision is currently in the Anti-Counterfeit Regulations 2010, but is not adhered to. KRA should also systematically compile data on contrabands.

6. As indicated in the study, the Tobacco Act provides that the health Cabinet Secretary in consultation with other stakeholder ministries may formulate a multi-disciplinary policy framework to ensure that the objectives of the Tobacco Control Act are achieved. In this regard, therefore, the Ministry of Health should spearhead the establishment of a consortium for effective interagency approach to combat illicit trade in tobacco products. Best practice illustrates the importance and effectiveness of an inter-agency approach to combat this vice.

7. Full implementation of the Customs and Excise (Excisable Goods Management System) Regulations 2013 is imperative in addressing both counterfeits and contrabands. Strong inter-agency collaboration would then benefit resource-constrained institutions such as the Anti-Counterfeit Agency.

8. Regionally, EAC countries are at different stages of implementing laws on illicit trade in tobacco products. In the medium term, the government should advocate for finalization and enactment of EAC Anti-Counterfeit Bill to help in addressing the problem of illicit trade in the region. Urgent finalization of the EAC anti-counterfeit policy is imperative to facilitate formulation of legislation in light of well-thought policy.

9. To help curb cross-border smuggling, there is need for efforts to coordinate harmonization of tobacco taxes in the EAC region. Substantial price differentials exist in cigarette prices, which can act as an incentive for smuggling in the absence of effective monitoring and stiffer penalties.

5.3 Areas for Further Research

A key challenge in illicit trade research is lack of comprehensive data due to the underground nature of the trade. To complement this study, it is recommended that a baseline survey of consumers on purchasing behaviour of illicit tobacco products be undertaken. Such initiatives should, however, be cognisant of immense financial resource requirements, which are a major deterrent factor.

Future research should also consider impact analysis of track and trace system introduced by the Customs and Excise (Excisable Goods Management System) Regulations 2013.

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Annexes

Annex 1: Specific research objectives and methodology

Specific objectives	Methodology	Data source
To establish volume of illicit tobacco products in Kenya with respect to seizures	• Trend analysis of annual seizures of illicit tobacco products • Administer questionnaire to key informants	• Key informants including the Tobacco Control Board, KRA Customs Department, Anti-Counterfeit Agency, and the Kenya Bureau of Standards
To establish sources (domestic versus external) and channels of entry (e.g. roads, sea, air) of illicit tobacco products in Kenya	• Descriptive statistics of seizures by source: domestic vs external; and channels of distribution • Administer questionnaires to key informants	• Key informants, including the Anti-Counterfeit Agency, KRA Customs Department, Kenya Bureau of Standards; and the Weights and Measures Department
To establish types (e.g. cigarettes, pipes, cigars, roll-your own, etc) and categories (unbranded, contraband and counterfeit) of illicit tobacco products in Kenya	• Descriptive statistics of seizures by types and categories • Administer questionnaires to key informants	• Number and value of seizures by types and categories • Key informants, including tobacco manufacturing companies, Anti-Counterfeit Agency, Kenya Revenue Authority Customs Department, and Kenya Bureau of Standards
To provide an overview of the regulatory and institutional framework to combat illicit trade in Kenya	• Review relevant laws and policies that address illicit trade in Kenya • Key informant interviews with government agencies	• Review of relevant laws and regulations • Key informants

To evaluate regional collaborative efforts to combat illicit tobacco trade and ascertain their effectiveness	• Review of relevant EAC policies and protocols • Administer questionnaires to determine effectiveness of regional efforts	• EAC laws and regulations • Key informants
To review international best practices in combating illicit trade in tobacco products	• Desktop review of selected countries' policies, practices and regulatory measures	• Relevant laws and literature for New Zealand; Australia, South Africa, and other selected countries

Annex 2: List of key informants

Kenya Revenue Authority (KRA) Customs Department

Anti-Counterfeit Agency (ACA)

Kenya Bureau of Standards (KEBS)

Tobacco Control Board

British American Tobacco (BAT) Kenya

Kenya Association of Manufacturers (KAM)

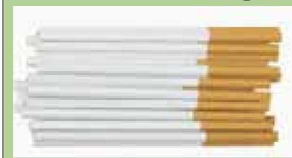
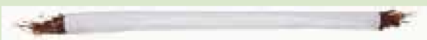
Weights and Measures Department

Annex 3: Percentage of men who use tobacco products: 2003 vs 2008-09*

Age	Cigarettes	Pipe	Other tobacco products
15-19	2.7 (5.4)	0.0(0.0)	0.3(0.2)
20-24	15.1(21.0)	0.4(0.1)	1.5(0.9)
25-29	20.1(27.6)	1.1(0.0)	2.2(2.3)
30-34	25.5(34.2)	1.6(0.0)	3.4(2.0)
35-39	24.5(33.8)	1.7(0.1)	4.1(1.9)
40-44	25.9(33.9)	3.0(0.0)	4.7(4.3)
45-49	29.6(26.0)	2.7(0.4)	9.1(6.1)
Residence			
Urban	17.2(23.5)	0.3(0.1)	0.8(0.6)
Rural	17.6(22.7)	1.5(0.0)	3.5(2.5)
Education			
No education	19.8(16.9)	1.2(0.2)	18.3(15.8)
Primary incomplete	19.1(25.0)	2.3(0.1)	4.0(1.6)
Primary Complete	19.8(25.3)	1.0(0.0)	3.0(0.8)
Secondary +	15.1(20.5)	0.5(0.0)	0.7(0.7)
Wealth Quintile			
Lowest	16.7(16.9)	2.9(0.2)	6.3(6.5)
Second	17.1(22.0)	1.0(0.0)	3.9(2.9)
Middle	19.3(21.9)	1.6(0.0)	3.8(1.0)
Fourth	19.6(28.4)	0.9(0.0)	1.8(0.4)
Highest	15.4(23.0)	0.2(0.1)	0.4(0.9)
Total			
Men age 15-49	17.5	1.1	2.8
Men age 50-54	28.6	5.1	9.7
Total men 15-54	18.2(22.9)	1.4(0.1)	3.2(2.0)

*Source: Government of Kenya (2010b; 2004). * In parenthesis are figures for KDHS (2003)*

Annex 4: Types of tobacco products[1]

Main types of tobacco products	
Smoking tobacco: Consumed through burning dried or cured tobacco leaves and inhaling the smoke	**Smokeless tobacco:** Consumed through oral or nasal inhalation without combustion. They can be chewing tobacco, snuff, or dissolvable
Manufactured cigarettes  Consists of shredded tobacco processed with chemicals and flavors such as menthol and rolled into a paper-wrapped cylinder. It is usually tipped with cellulose acetate filter and they are lit on one end and inhaled through the other	**Chewing tobacco**  Oral tobacco product that is placed in the mouth or inner lip and sucked or chewed. May be referred to as 'spit tobacco' due to tendency by users to spit excess juices and saliva
Roll-Your Own (RYO)  Fine cut loose tobacco is hand-filled into cigarette paper. RYO smoking usually exposes smoker to high concentration of tobacco particulates, tar and nicotine.	**Moist Snuff**  Consists of ground tobacco held in the mouth between the cheek and the gum

1 The table shows tobacco products are used globally, and may not be necessarily used in Kenya.

Pipes  Pipes are usually made of materials such as briar, slate or clay; tobacco is placed in the bowl and the smoke inhaled through the stem	**Dry snuff**  Powdered tobacco that is inhaled through the nose or taken orally
Kreteks  Are clove-flavoured cigarettes that may contain exotic flavourings and eugenol, which has anesthetic effect	**Dissolvable smokeless tobacco**  Tobacco with added constituents that dissolve in the mouth without expectoration
Bidis  Comprise of small amount of crushed tobacco hand-wrapped in dry temburni or tendu leaves (plants native to Asia)	**Water pipes (*Shisha*)**  Operates by indirect heat and water filtration. Flavoured tobacco is burned in a smoking bowl covered with fowl and charcoal. The smoke is cooled through by filtration through a basin of water and consumed through as hose and mouthpiece

Source: Eriksen et al (2012)

Annex 5: Summary of stakeholder workshop proceedings

A stakeholder validation breakfast meeting was held in December 2013. Participants were drawn from both public and private sectors, including National Authority for Campaign Against Alcohol and Drug Abuse; Ministry of Health; Ministry of East African Affairs, Commerce and Tourism; Anti-Counterfeit Agency; Ministry of Defense; Kenya National Police Services; Financial Reporting Centre; Competition Authority of Kenya; Kenya Bureau of Standards; Tobacco Control Board; Kenya Tobacco Control Alliance; Kenya Industrial Property Institute; Parliamentary Budget Office; Kenya Revenue Authority; Ethics and Anti-Corruption Commission; National Commission for Science, Technology and Innovation; Kenya Association of Manufacturers; Kenya Private Sector Alliance; Institute of Economic Affairs; Consumer Information Network; Coulson Harney Advocates; and other industry players including the British American Tobacco.

The objective of the workshop was to share and validate findings of the study through stakeholder participation. The workshop, therefore, provided an opportunity to share the findings of the study and engage stakeholders to gain more insights. Stakeholder participation is also important given that public participation in policy making process is enshrined in the Constitution of Kenya 2010.

Some recommendations proposed by stakeholders included:

1. Enhanced market surveillance by the different enforcement agencies;
2. Harmonization of illicit trade laws in the region that can effectively address the problem;
3. Need to enhance data sharing amongst enforcement agencies to facilitate compilation and availability of up to date reliable data;
4. Collaborative approach to combat illicit trade in tobacco products, which should include industry players by pooling of resources;
5. Need to address implementation of the laws that deal with illicit trade;
6. Public sensitization of the presence of counterfeit tobacco products is essential for consumers;
7. Improved coordination amongst oversight bodies;
8. Undertaking a study with a wider scope to review various forms of illicit trade in-depth. The participants expressed concerns that tax

evasion is also a key problem, though counterfeits often receive more attention in policy debates.

Source: (KIPPRA, 2013), Workshop Proceedings

Annex 6: Cigarette excise tax regimes in Kenya: 2003-2013

Year	Description	Excise Chargeable		
		Category	**Retailing selling price per mille**	**Excise rate per mille (Ksh)**
2003 and 2004	Cigarettes are classified into four categories The Finance Act 2003 amended the Fifth Schedule of the Customs and Excise Act Further, Part II of the Fifth Schedule provided that the Commissioner may from time to time through notice in the gazette adjust the retail selling price for each category of cigarettes	A B C D	Up to Ksh 1,500 Ksh 1,501-2,500 Ksh 2,501-3,500 More than Ksh 3,500	450 650 900 1,400
		In September, 2003 various retail prices were gazetted by the Commissioner of Customs and Excise vide Gazette Notice No. 6776 dated 23rd September 2003 as follows:		
		Category	**Brand**	**Excise rate per mille (Ksh)**
		A	Rooster, Score, Crescent and Star, Comet, Rocker, Polo	450
		B	Supermatch, Kings, Supermatch Menthol, Safari Kings, Ralli, Horseman Menthol, Horseman Kings, Safari Super, Safari Menthol, Champion, Crown Bird	650

		C	Sportsman King Size, Sweet Menthol	900
		D	Embassy King Size, Embasy Lights, Embassy Superlights Embassy Menthol, Sportsman Light, Benson & Hedges Lights, Benson & Hedges Special Filter, and all other cigarette brands	1,400
2005	The Minister for Finance through Finance Act No. 6 of 2005 increased excise tax by deleting Section 2 of Part II of that Schedule and replaced it with rates shown in the right column	**Category**	**Retail selling price per mille**	**Excise rate per mille (Ksh)**
		A B C D	Up to Ksh 1,500 Ksh 1,501-2,500 Ksh 2,501-3,500 More than Ksh 3,500	495 715 990 1,540
2006	The Minister of Finance through Finance Act No. 10 of 2006 increased the rate of excise tax on cigarettes by amending Section 2 of Part II of the Fifth Schedule as follows	**Category**	**Retail selling price per mille**	**Excise rate per mille (Ksh)**
		A B C D	Up to Ksh 1,500 Ksh 1,501-2,500 Ksh 2,501-3,500 More than Ksh 3,500	495 715 990 1,690
2007	Paragraph 2 of Part II of the Fifth Schedule was amended by Finance Act No. 9 of 2007 as follows:	**Category**	**Retail selling price per mille**	**Excise rate per mille (Ksh)**
		A B C D	Up to Ksh 1,500 Ksh 1,501-2,500 Ksh 2,501-3,500 More than Ksh 3,500	500 800 1,200 2,000

2008, 2009 and 2010	The Minister for Finance proposed through the Finance Bill No. 12 of 2008 that the criteria for charging excise tax be based on the physical characteristics of cigarettes or the retail selling price. The Finance Act No. 8 of 2008, which became operational on 13th June 2008 adopted the proposal and Section 2 of Part II of the Fifth Schedule of Customs and Excise Act was amended	**Category**	**Retail selling price per mille**	**Excise rate per mille (Ksh)**
		A	Plain cigarettes with RSP of up to Ksh 2,500 per mille	700
		B	Soft-sup cigarettes of 72mm or less, or soft cap cigarettes of 72mm or less with RSP 2,5001-3,500	1,000
		C	Soft-cap cigarettes of 72mm or less, or soft-cap cigarettes of more than 72mm with RSP of 3,501 to Ksh 4,500 per mille	1,500
		D	Hinge lid cigarettes or hinge lid cigarettes with RSP of more than Ksh 4,500 per mille	2,500
2011, 2012, 2013	Harmonization of tax structure to reduce complexities.* The Finance Act 2012 provided for deletion of Part II and substitution with the following Part II		Ksh 1,200 per mille or 35% of RSP, whichever is higher	

Source: Government of Kenya (2011); Government of Kenya (2008b)

*NB: Two reasons were given by the Minister of Finance for the harmonization of excise tax regime: The excise tax structure for tobacco was complex, compared to global trends; and to reduce incentives for substitution among different brands in line with the public health objective of reducing tobacco consumption (Government of Kenya, 2011).

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