Situational Analysis of Illicit Trade in Tobacco Products in Kenya

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Acronyms and Abbreviations

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.

PWC: Price WaterhouseCoopers.

TCA 2007: Tobacco Control Act 2007.

WHO: World Health Organization.

Abstract

Illicit trade in tobacco products imposes many social and economic costs including increased health expenditures as a result of increased access to tobacco products, and loss of government revenue through tax evasion. Acknowledging the serious health costs of tobacco consumption that is attributable to annual 3 percent of male deaths among others, the Kenya government has in the past taken several initiatives in terms of legislations and establishing intuitions to fight tobacco consumption. Despite policy initiatives to curb illicit trade in Kenya, illicit trade in tobacco products has continued to raise policy concerns in the recent past. The purpose of this study was to investigate nature and extent of illicit trade in tobacco products in Kenya; and review relevant institutional framework. To gain insights into various dimensions of illicit trade in tobacco products the study employed different but 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 products in Kenya. Counterfeit cigarette smuggled through the sea is the main illicit tobacco imports, while diverted exports by road form the main illicit products originating from the domestic economy. Key challenges in legal framework include weak fines, limited resources for anti-counterfeit agency, weak co-ordination and information sharing among different agencies. Regionally, the East African Countries are at different stages of enacting legislations on illicit trade, and this continue to pose challenges in establishing concerted effort to curb the problem. The main conclusion established in this study include: First illicit trade in tobacco products is a complex problem which requires inter-agency collaborations. Second, effective monitoring, enforcement and punitive fines are necessary for deterring the vice. The study makes the following recommendations: - Minimum fines should be prescribed in relevant laws; increase funding resources to enforcement agencies especially the Anti-Counterfeit Agency; and creation of obligations for data compilation and sharing by various agencies to facilitate monitoring of illicit trade and impacts of policies. In the regional context, there is need to advocate for enactment of the East African Community Anti-Counterfeit Bill to enhance regional coordination in the fight against the illicit trade.

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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 tobacco 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 tobacco 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.

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 labeling or health warning.

1.0 Introduction

1.1 Background of the Study

Illicit trade in tobacco products imposed social costs in various forms. First the increased health expenditures driven by non-insured tobacco users as well as non-users whose health expenditures are attributable to second-hand smoking (Allen, 2013). Second the 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 the 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 percent of cigarettes consumed are illicit, resulting to US$ 40-50 billion in lost tax revenues (Allen, 2013). Recent attempts by the Kenyan government to increase excise duty on tobacco products galvanizes the tobacco industry who fear the unintended consequences of a such initiative of 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 (See Figure 1.1 below). Tax evasion is experienced on both genuine and counterfeit imports through concealment, corruption, 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 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 margin given that

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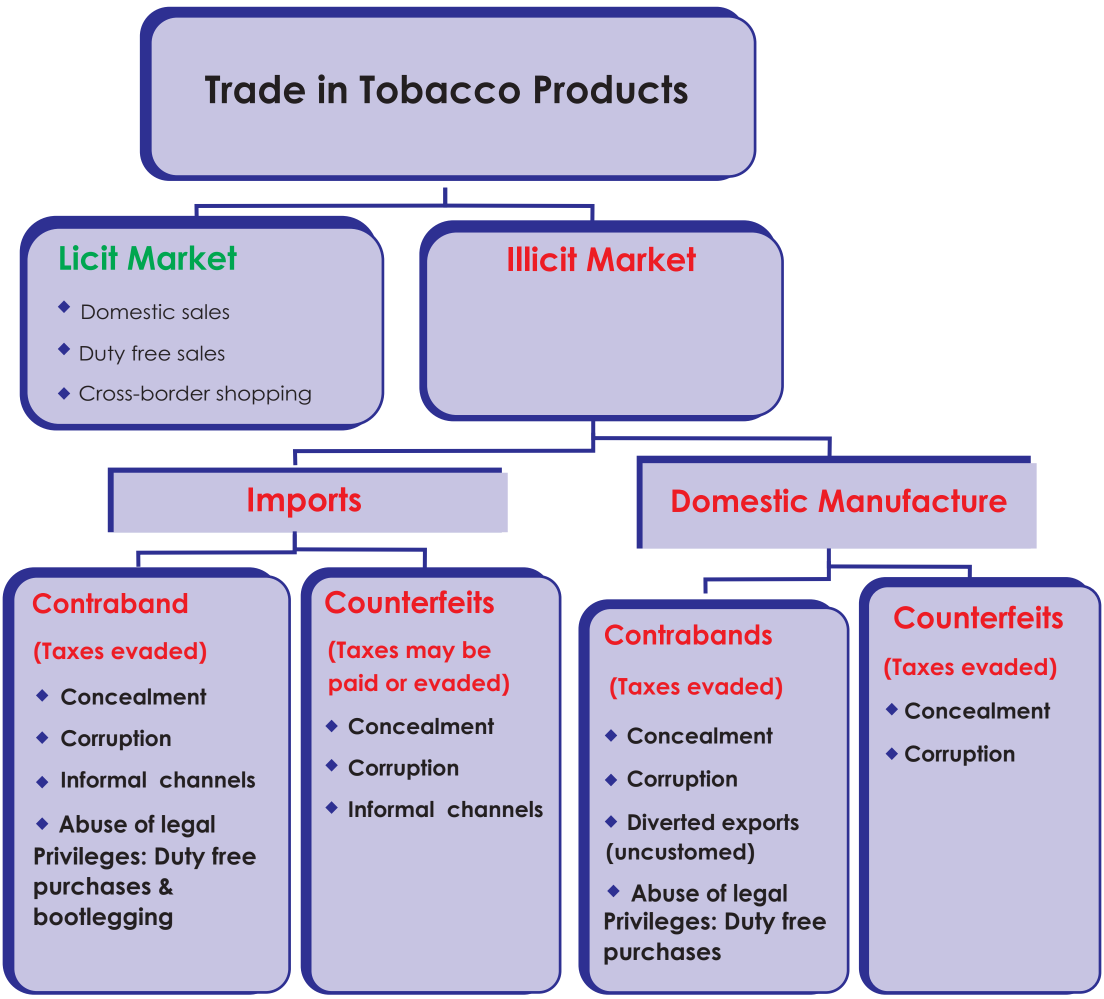
In Kenya export taxes are charged on raw hides & skins; and scrap metal only to encourage local processing (See Fourth Schedule, Part I of Republic of Kenya (2012a). Hence the focus of this study with regards to tax evasion relates to imports only.

counterfeiters often utilize cheap substandard inputs and do not incur research and development costs. Furthermore, they do not bear any marketing costs as they free ride on the good will established by the genuine product.

Figure 1.1: Possible Channels of Illicit Tobacco Products



Source: Authors' Construct

Tobacco products include cigarettes, cigars, snuffs, chewing tobacco, and 'roll-your-own'. As global trends dictate, cigarettes are the primary illicitly traded tobacco products due to its attributes as fast moving consumer goods, often highly taxed tobacco product resulting to high profit margins (Allen, 2013; Joossens *et al,* 2010 Evidently cigarette features prominently as one the most counterfeited products (TNA Research International/Consumer Federation of Kenya, 2010). While tobacco consumption generates private benefit, it also imposes social costs in form of increased health cost (Republic of Kenya, 2010a). In 2003 tobacco use prevalence rate was estimated at of 25 percent of male and 3 percent of female respectively (Republic of Kenya, 2004). Most recent national survey however shows that 18 percent of male and 2 percent of female aged 15-49 use tobacco products (Republic of Kenya, 2010b). Conjecturally, the female prevalence is however likely to be higher because women are more likely to conceal their tobacco use status due to social cultural factors (Republic of Kenya, 2010b). While smoking prevalence of men had decreased from 25 percent to 18 percent between the two surveys, use of pipe and other tobacco products (e.g. snuffing, and chewing) is on increase. For example, proportion of men using pipe tobacco increased from 0.1 percent to 1.4 percent while use of 'other' tobacco products including chewing tobacco, and snuffs increased from 2.0 percent to 3.2 percent (Republic 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 instrument to counter tobacco consumption is provided for in Article 6 of the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC). 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

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

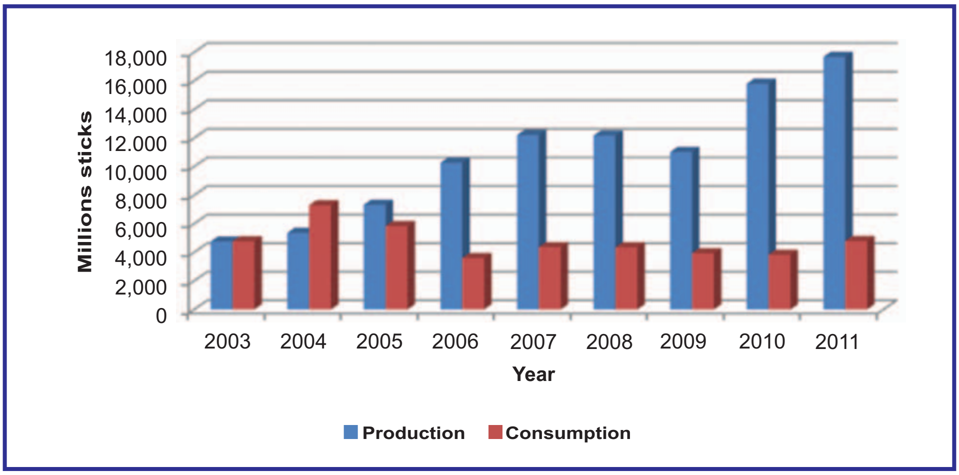
tobacco products. Kenya domesticated the WHO FCTC through the enactment of Tobacco Control Act, 2007 to reduce consumption of tobacco products[6] and implement effective measures to eliminate illicit trade in tobacco products.[7]

1.2 Tobacco Industry Structure in Kenya

The market structure of manufacturing and distributing of tobacco products in Kenya is oligopolistic with the British American Tobacco (BAT) Kenya and the Mastermind Tobacco Kenya controlling 78 percent 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[8] and Cut Tobacco Kenya Ltd[9]. In 2009 value added for manufacture of tobacco products is estimated at Ksh. 4.3 billion shillings (Kenya National Bureau of Statistics, 2013) accounting for about 0.2 percent of gross domestic product. Prior to liberalization in 1980s the market was monopolistic with sole dominance by BAT Kenya. Tobacco products are both domestically manufactured and imported. Only 2-5 percent of cigarettes, mainly high-end brands are imported; while the rest are manufactured domestically[10]. 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 about 17.7 billion and 4.8 billions of cigarettes and cigars sticks were produced and consumed, respectively as of 2011. Kenya imports tobacco products from various countries including Uganda, United Arab Emirates, China, Zimbabwe, Switzerland, Singapore, Poland, Egypt, India, Cyprus, South Africa, Malawi, D.R. Congo etc[11].

[6] See Section 12 Republic of Kenya (2007)
[7] Republic of Kenya (2007), Section 3 (g)
[8] Phillip Morris International has a distribution representative office in Kenya. Alliance One Tobacco and Ken Tobacco mainly exports cured tobacco.
[9] Cut Tobacco has been battling court cases with KRA since 2004 over allegations of tax arrears.
[11] Data Source: Key Informant Interview with KRA

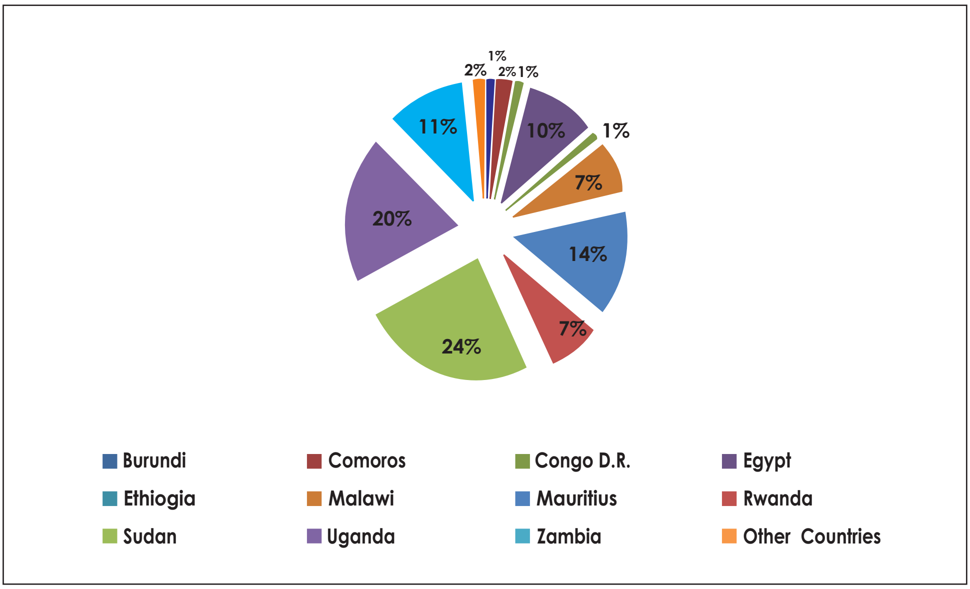
Figure 1.2: Domestic Production of Cigarettes and Cigars in Kenya



Data source: Kenya National Bureau of Statistics (2012)

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 accounts for about 60 percent of cigarette exports.

Figure 1.3: Exports Destinations of Cigarettes in Kenya



Data Source: Kenya National Bureau of Statistics (2012)

In terms of institutional framework, key institutions mandated to curb tobacco consumption include tobacco the Control Board established by the Tobacco Control Act of 2007 with a mandate to advise the Cabinet Secretary for health on tobacco control policy measures in Kenya. The Ministry of Health bears the major responsibility of formulating multidisciplinary policy framework to meet the objective 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 statutory empowered to adjust specific rate of excise duty to take account of inflation[12]. The KRA Customs Department is statutorily[13] 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 a certain 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 smuggling and illicit trade. However, this could be explained by theories of illegal trade (Becker and Grossman, 2006; Baghwati, 1981) which postulates 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 a significant tobacco smuggling problems which 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 other beside price. Merriman *et al* (2000), even after controlling for income and other factors, establish that high corruption levels significantly explains high level of cigarette smuggling.

Empirical evidence on illicit trade in tobacco products in Kenya is sparse (Kenya Tobacco Control Situational Analysis Consortium, 2008) due to scarcity of data and 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 legal framework in addressing various dimensions of illicit trade in tobacco products in Kenya.

1.3 Statement of the Problem

The Kenyan government's policy initiatives to control consumption of tobacco are being compromised by the 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

[12] See Section 119(7) of Republic of Kenya (2012a) and Section 3 of Republic of Kenya (2012b).
[13] Customs and Excise Act, and Customs and Excise (Excisable Goods Management Systems) Regulations 2013

counterfeits and contrabands amplifies 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 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.

1.4 Objectives of the Study

1.4.1 Overall Objective

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

1.4.2 Specific Objectives

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

ii) To establish 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 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[14];

v) To evaluate regional collaborative efforts to combat illicit tobacco trade.

vi) To review international best practices in combating illicit trade in tobacco products; and

[14]This will include assessment of co-ordination of agencies mandated to combat illicit trade in the country.

2.0 Literature Review

2.1 Theoretical Literature

Theoretical analysis of illicit trade has gained thrust following the seminal work of Baghwati and Hansen's (1973) which 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 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 by Becker and Murphy (2006) found that enhanced enforcement and punishment including detection, confiscation and imprisonment raises market price of illegal goods, hence lowering demand. They postulate that an increase in punishment to suppliers of illegal goods increases costs of production, thus lowering expected profits.

The theories discussed thus far generally focus on smuggling which 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 postulates that decision to engage in crime by an individual depends on public policy variables including probability of detection, apprehension, conviction and magnitude of punishment.

The review of theoretical literature reveals that illicit trade can be analysed by considering it as an economic problem rather than purely moral or legal 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 multiplicity of factors including corruption, 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) establishes that in Kenya, a one percent increase in price of cigarettes results in 0.49 percent and 1.78 percent reduction in demand of cigarettes in the short-run and long-run, respectively. The lower short-run elasticity could be attributed to rigidities in substitution, either to other products or quitting due to addiction (Becker *et al*, 1994; Kiringai *et al.,* 2002). Deloitte (2011), using survey of consumers in Australia established that over 60 percent 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 multiplicity of factors including corruption (Joossens and Raw, 1998) and 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, globally cigarettes have been established to be the primary target by illicit traders 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) establishes that 11.6 percent of global cigarette consumption is illicit: 16.8 percent in low income countries, 11.8 percent 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 tobacco industry in smuggling syndicates (Joossens and Raw, 2000; Joossens and Raw, 1998), an indication of prevalence of

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 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 costs of supplying illicit products. According to Joossens and Raw (2000) Spain defied industry lobby to reduce tobacco taxes, but instead enhanced intelligence, customs activity, enhanced border patrols. Similar initiatives were employed by the UK government by investing in network of scanners, public awareness, increased punishment and boosting number of customs officers (Joossens and Raw, 2000). Generally the problem of illicit tobacco trade is more acute in developing countries. This is largely attributable to weak monitoring and porous borders resulting to high expected profit margins for illicit traders (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 share of contraband cigarettes from 12 percent in 1997 to about 5 percent 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 U.K. 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.

3.0 Methodology

3.1 Conceptual Framework

The market for illicit tobacco is driven by suppliers' profit motive and utility maximization of the consumers. In Kenya supply of tobacco is not banned but consumption is highly regulated. Enforcement and punishment contributes to costs of supplying illicit products. If the expected return on supply of illicit products is greater than expected return on supply of genuine products, suppliers have higher incentives to engage in illicit trade. In conventional economic theory 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 like 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 employed. Illicit trade is thus an increasing function of 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 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 supply 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 domestic economy can be in form of either manufacture of counterfeits by illegal manufacturers or tax evasion on genuine products through misdeclaration of production or declaring production for exports. 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 domestic economy. Figure 3.1 illustrates drivers of illicit trade.

Services Department, Anti-Counterfeit Agency, and the Kenya Bureau of Standards (KEBS) was used to estimate trends in illicit tobacco trade. This method was used to answer objectives 1-3.

2. Literature review and legal analysis on the overview of tobacco industry in Kenya for addressing objectives 4 -6. Specifically the analysis focuses on the institutional and regulatory framework of 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.

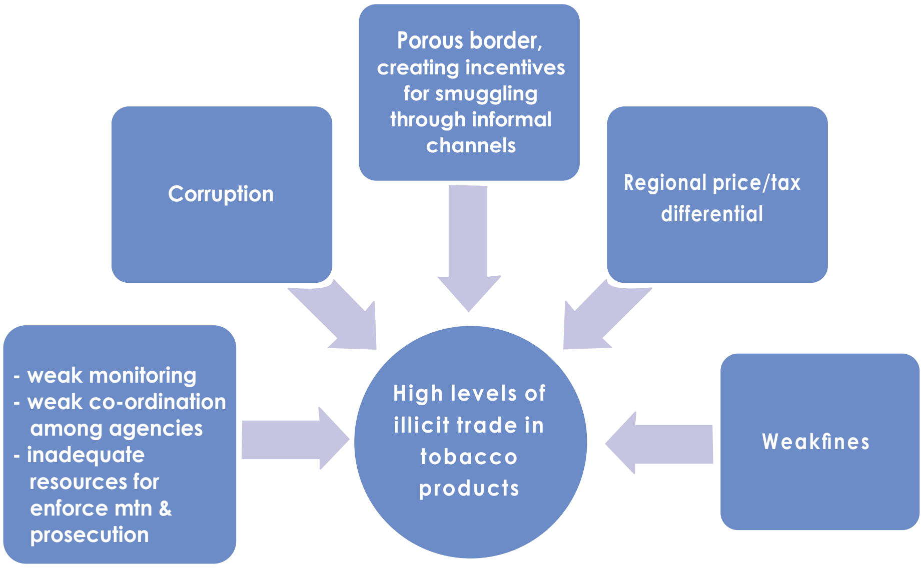
Further, a stakeholder validation workshop was organized where preliminary findings were shared and recommendations considered.

4.0 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 KRA in 2010 and could be as few as 1,120 sticks seized by the Anti-Counterfeit Agency in 2011. What was interesting to discover was the value of the 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 Kshs 20,000 for 214 cartons in 2010, to Ksh. 150,000 for 500 cartons of uncustomed cigarettes for export in 2003; Ksh. 1.6 million for 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 given 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 3.1: Drivers of Illicit Trade in Tobacco Products



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 illegal and hidden nature of the activity pose 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.

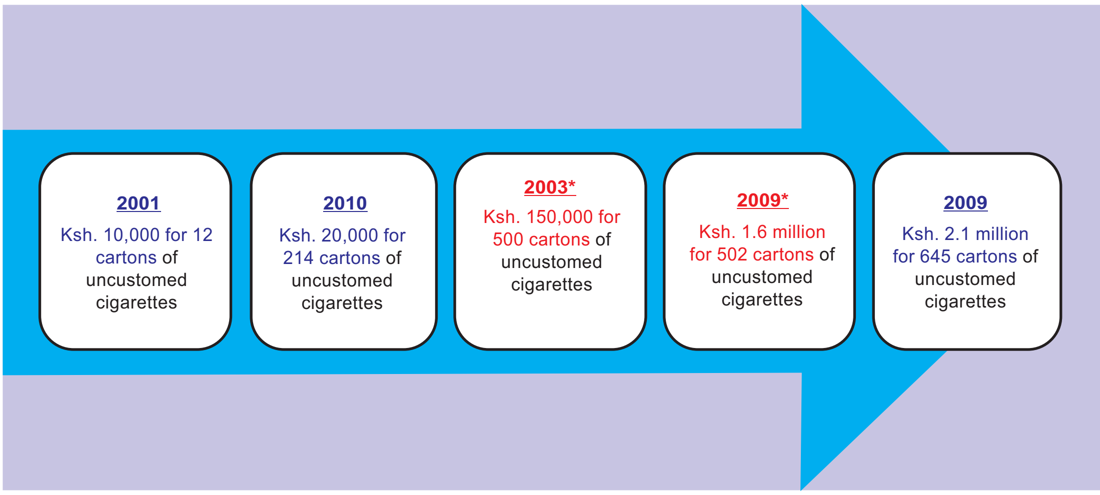
3.3 Choice of Methodology[15]

In order to meet the objectives, the study employed a situational analysis based on two main approaches[16];

1. Estimation based on seizures by law enforcement agencies. To gain insights key informant interviews was administered to the government agencies and industry players[17]. 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

[15]See Annex 1 for detailed methodology to answer each objective and data sources.
[16]Details of approach for each objective are shown in Annex 1.
[17]See annex 2for list of key informants

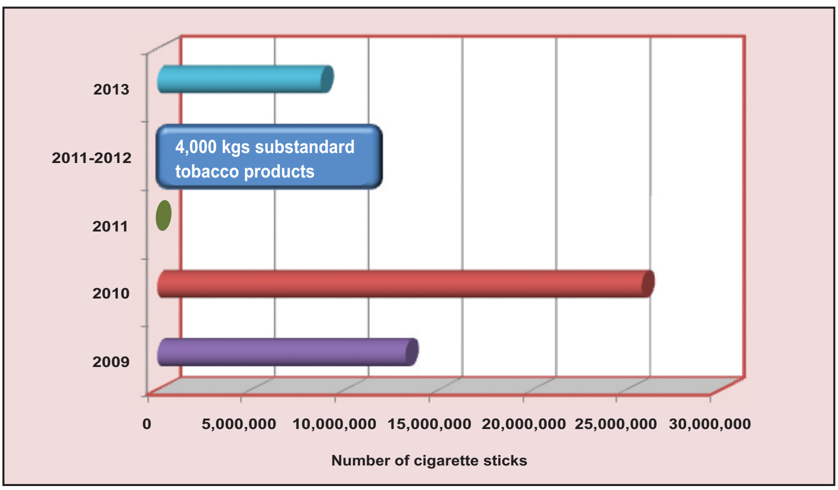
Figure 4.1: Variation in Seizures of Uncustomed Cigarettes and Fines Imposed



Data Source: KRA (2013)

Between 2009 and 2013 alone over 47.7 million counterfeit cigarette sticks valued at Ksh. 239 million and lost tax revenues estimated at Ksh. 152 million 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 emerged as the major source of the counterfeit products, but in some instances the products are channeled through the United Arab Emirates and India. Figure 4.2 provides summary of counterfeit seizures.

Figure 4.2: Seizures of Counterfeit Cigarettes

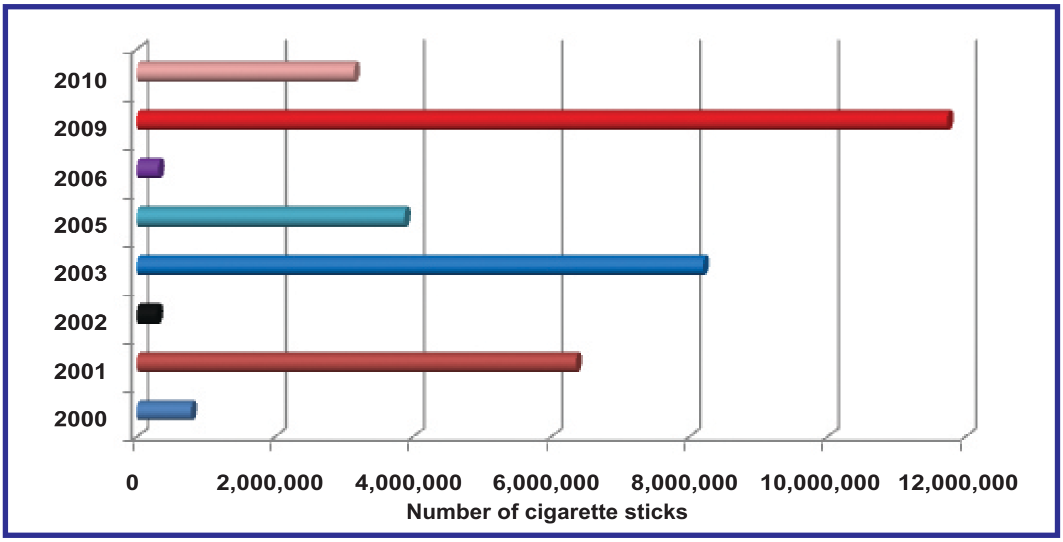


Data Source: KRA (2013); Anti-Counterfeit Agency (2013) and Kenya Bureau of Standards (2013)

[18]Retail Selling Price of Ksh. 100 for the most popular brand packet of cigarettes and tax rates for 2010 estimated to be 63.8% as per the WHO (2010) estimate was assumed.

With regards to diverted exports[19], 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 Ksh. 174 million with an estimated tax loss of Ksh. 111 million[20], given that tobacco products declared for exports do not attract taxes. Figure 4.2 provides a summary of seizures of uncustomed (diverted) exports.

Figure 4.2: Seizures of Uncustomed (Diverted) Exports[21]



Data Source: KRA (2013)

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

[19]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 (Republic of Kenya, 2012a)

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

[21]*Seizure data for the years 2004, 2007 and 2008 not provided*

Table 4.1: Summary of Seizures of Illicit Tobacco Products by Seizing Agency

Agency Seizures	Making Description of Seizures
Anti-Counterfeit Agency	**In 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. **In 2010:** 7.2 million sticks of counterfeits 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.
Kenya Bureau of Standards	**In 2009:** 1,090 packets of substandard cigarettes were seized in Mombasa, coming through the sea. **2011 - 2012:** 4,000 kilograms 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 & 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 & product label. **January 2010:** 850 cartons of cigarettes @ 10,000 sticks seized in kilindini Port; originating from India and destined for South

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

[22]Note: This seizure was the same as the one reported by the Anti-Counterfeit Agency for the 7.2 million sticks of cigarettes. This was the only seizure that was reported by KRA and the Anti-Counterfeit Agency.

Summarize the findings to answer the specific objective

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 exports to take advantage of tax exemptions. It is important to note that the seizures are just indication of 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[23] 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. 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. The reporting provisions are however not anchored in the Anti-Counterfeit Act.

[23]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

[24]See section 22 of Republic of Kenya (2008a)

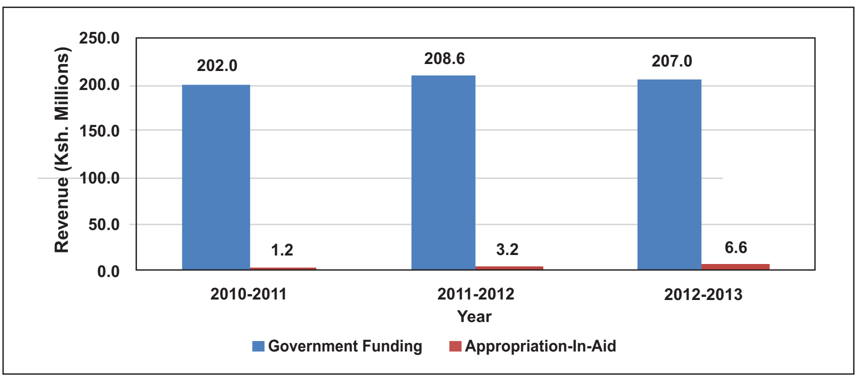
This is provided in section 6(2) Republic of Kenya (2010c)

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 therefore 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 stiffer penalty of a fine of not less than five times the value of the prevailing retail price of goods, or a jail term of fifteen years or both. The Act however ties minimum fines to value of seizures and can therefore lead to low penalties based on piecemeal consignments overlooking the overall undetected trade which 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[26] and to include counterfeit labels[27], packaging, and security labels. Enforcement challenges that exist within the Anti-Counterfeit Agency relate to the limited resources. The funds allocated to the Anti-Counterfeit Agency have remained low, relative to multi-billion size of counterfeit trade. Figure 4.3 shows trends in annual budgetary allocations to the

Figure 4.3: Anti-Counterfeit Agency Budgetary Allocations and Own-Source Revenues.



Data Source: Anti-Counterfeit Agency (2013a)

[25] This is provided in section 6(2) Republic of Kenya (2010c)
[26] Republic of Kenya (2012)
[27] Anti-Counterfeit Agency (2013b)

4.2.2 Customs and Excise Act, Cap 472

According to Schedule 8 (Prohibited and Restricted Goods) of the Customs and Excise Act, importation of counterfeit products is prohibited[28]. 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. 1.5million or to both the fine and imprisonment[29].

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[30], which applies to manufactured and imported cigars and cigarettes. The manufacturer or importer applies[31] 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 of not containing tobacco substitutes in any proportion	130%
Homogenized or reconstituted tobacco	130%
Other manufactured tobacco and manufactured tobacco substitutes Cigarettes	130%
	Ksh. 1200 per mille or 35% retail selling price

Source: Republic of Kenya (2012a)

[28]See Eight Schedule of Republic of Kenya (2012a)
[29]See Section 175 of Republic of Kenya (2012a)
[30]With exception to cigarettes destined for Navy, Army, Air Force Institution and Armed Forces Organization Canteen stores, duty free and diplomatic shops.
[31]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 percent while those on high end cigarettes increased by about 30 percent[32]. 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[33] tax structure in 2011 raised taxes on the lower-end tobacco products by approximately 82 percent; while causing a global increase of approximately 35 percent (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[34].

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[35] in their production or import facilities; and affix every package of excisable goods with an excise stamp.

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

[32] Statistics based on computations in Annex 6

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

[34] Republic of Kenya (2010d); Republic of Kenya (2012a), Third Schedule

[35] 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;

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 commits attract a criminal liability[36]. 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 (TA)

The TA 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[37]. Offences under this Act are punishable by 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 (TDA)

The TDA prohibits false or misleading indications on goods, in advertisements or any customs entry. Under the TDA 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, products with inaccurate information. The law empowers inspectors to undertake necessary inspections and to seize, detain and test goods[38]. A person who commits an offence under the Act is liable to a fine of up to Ksh. two million or imprisonment for a term of up to two years, or to both.

4.2.6 Competition Act (No. 12 of 2010) (CA)

The aim of CA 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 CA 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[39]. Infringement of CA through false and misleading representations attracts a criminal liability of jail term not exceeding 5 years or at most 10 million fine or both.

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production accounting equipment; and devices for the control, registration, recording and transmission of data on the quantities of excisable goods to the Commissioner (Republic of Kenya, 2013).

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

[37]Trademarks Act, Cap. 506

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

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

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. one million or to imprisonment not exceeding three years, or both.

4.2.8 Standards Act, Cap. 496

This law promotes for the standardization of the 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 manufactures or 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 (TCA) is to regulate the manufacture, importation, distribution, labelling, advertising, sponsorship and use of tobacco products in the country with the aim of protecting the health and wellbeing 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[40].

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. TCA 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,

[40]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 (Republic of Kenya, 2007).
[41]See Sections 3, 9 and 15 of Republic of Kenya (2007).

- "Sales only allowed in Kenya" with regards to tobacco for retail or wholesale in Kenya.
- "For export only" with regards 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 one million shillings, or to imprisonment not exceeding five years, or to both[42].

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 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 providing for the maintenance or protection of the public revenue[44].

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 which 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.

[42]See Section 14 (4) of Republic of Kenya (2007).
[43]"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 Republic of Kenya (2012f)).
[44]See Sections 2 and 45 of Republic of Kenya (2012f).

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 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 regards 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 fourteen 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 the 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. 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 Agency, thought yet to be established will assist in recovery of assets lost through crime or which forms part of proceeds of crime. This law generally will play significant role in large scale smuggling, with magnitudes that can be easily be detected through monitoring of financial systems.

Summary of Institutional Challenges in Kenya

As discussed above, there are numerous regulatory agencies which are 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 co-ordination for information sharing and given multiple agencies it adversely affects track and trace of illicit trade, and also poses challenges in terms of monitoring impact of policy initiatives due to lack of centralized information sharing.

Though there is Anti-Counterfeit Regulations of 2010 requiring 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 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 regards to illicit trade which would make fines more punitive. Agencies carry out their own investigations and prosecutions but do not do so in collaborations 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 ties fines to seizures and therefore piecemeal smuggling but voluminous trade will likely have consequences of low deterrence.

Table 4.3 provides summary of relevant laws, administering agency and fines for relevant offence. It is notable from the table that fines differ greatly under different laws

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 & 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 of 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 of loss is imposed.
Tobacco Control Act (No. 4 of 2007)	Misleading manufacture, importation, or distribution of tobacco products. False, or misleading information on tobacco products supply of illicit 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. 2nd Conviction: Fine =5 times retail price of goods, or jail term = 15 years, or both.
Proceeds of Crime & 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 which ever 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 the 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 of misleading representation of goods 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 - 1.5 million, or imprisonment = 3 years, or both. For unaccounted excise stamps: Excise duty & 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 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 maybe 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. E.g. KEBS is interested only in whether a product meets minimum requirements. However, some illicit products meet minimum requirements. • Weak information sharing by other agencies with regards to counterfeits. • Limited resources, both financial and human hinder monitoring of counterfeits. • Limited consumer awareness and lack of lack of mechanisms for distinguishing counterferts 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.

Department of Weights and Measures	• The 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) 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

Summarize 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 *Prosecutor's Manual on Illicit Trade in Uganda* in January, 2013, there is lack of punitive legal framework to address various categories of illicit trade in tobacco products. In Tanzania Merchandise Marks Act of 1963 (Revised 2007) is the primary law that addresses illicit trade. In 2008 Tanzania introduced Merchandise Marks Regulation in an effort to step up fight against counterfeits. Lack of harmonized laws on illicit trade in the EAC region has continued to pose challenges in terms of co-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 Anti-Counterfeit Policy and a Bill that 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 co-ordinate 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 commissioner of customs with the power to compound an offence and impose the fine that would be liable 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[45]. 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 is liable to feature[46]. 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 percent of the dutiable value of the goods involved, or imprisonment for a term not exceeding five years, or both[47]. This law therefore makes it an offence to smuggle illicit products both through official and unofficial channels.

[45] East African Community (2009), Section 219
[46] See Section 15 East African Community (2009a)
[48] See Section 200 of East African Community (2009a).

4.3.3 The East African Community Common Market Protocol

The Protocol requires member states to promote 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 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 Partners 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 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 6 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-27th July 2012 at seaports, inland border points, markets and shops in Kenya, Tanzania, Mozambique, Namibia, South Africa, Angola, and Zimbabwe led to seizures of 32 million sticks of cigarettes (about 1.6 million cigarette packets), and 134 tonnes of raw tobacco[48]. As a result of these seizures national authorities have initiated a number of administrative investigations into tax evasion and other potential criminal offences[49].

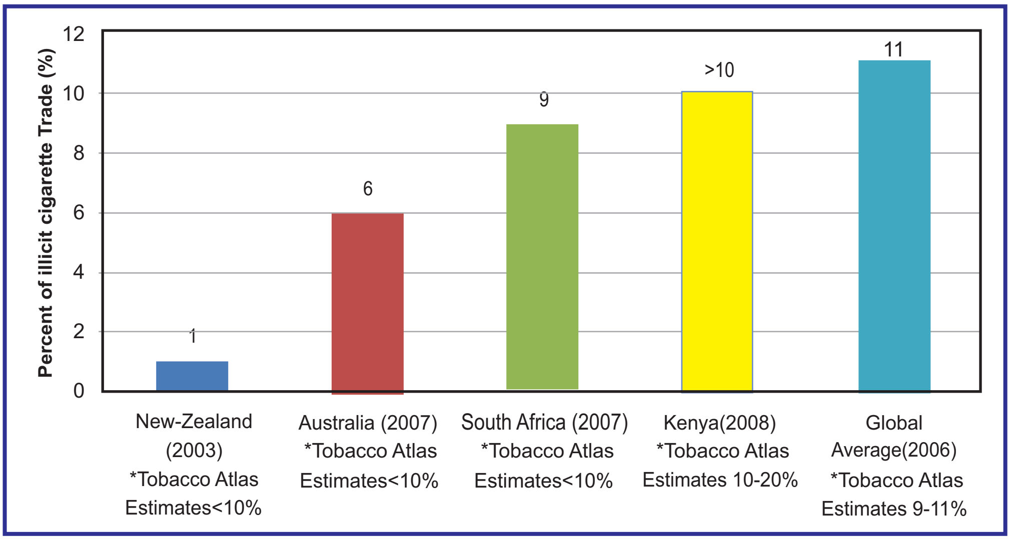
4.4 International Experiences

There are two international protocols that guide control of both licit and illicit tobacco products. The WHO Framework Convention on Tobacco Control (FCTC)[50] outlines measures to reduce demand for[51] and supply of[52] tobacco products. The Protocol to Eliminate Illicit Trade in Tobacco Products (PEITTP) was adopted by the Conference of the Parties[53] 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 system (WHO, 2013a).

Three countries, including 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 percent 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 regards to whether minimum penalties are prescribed. Figure 4.4 shows comparative incidence of illegal cigarette sales for Kenya and comparator countries.

[48] See INTERPOL (2013).
[50] WHO FCTC was adopted by the World Health Assembly on 21st May, 2003 and entered into force on 27th February, 2005.
[51] Articles 6-14
[52] Articles 15-17
[53] The Conference of the Parties is the governing body of the WHO FCTC and is comprised of all parties to the Convention

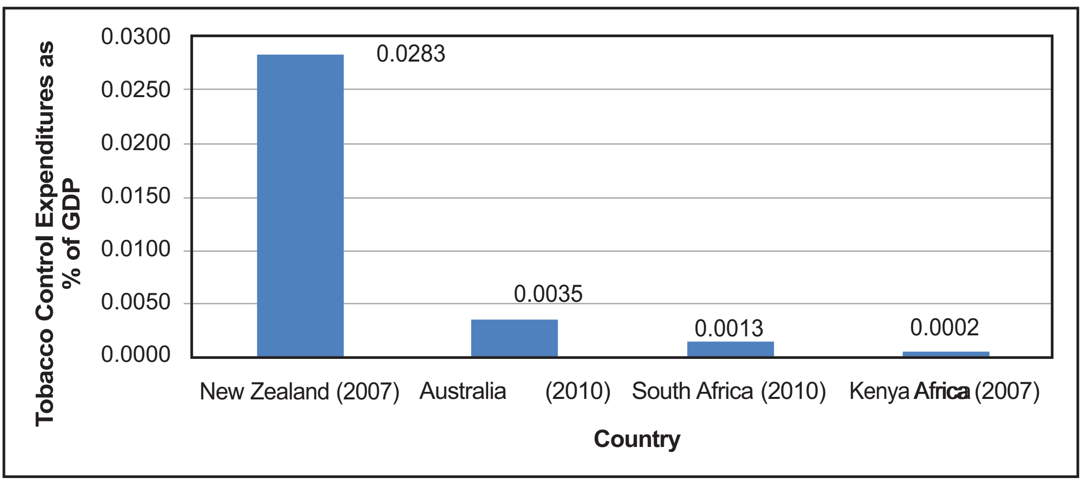
Figure 4.4: Incidences of Illegal Cigarette Sales



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.

In terms of enforcement expenditures, tobacco control expenditures as a percent of GDP in Kenya is low compared to the comparator countries as shown in Figure 4.5.

Figure 4.5: Comparative Tobacco Control Expenditures as Percent of GDP (%)



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

4.4.1 Experiences from Australia

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 adjust specific rate of excise duty to take account of inflation[54]. Both manufactured and unbranded tobacco is illicitly traded in Australia (Scollo and Winstanley; 2012; Deloitte, 2011; PWC, 2010).

Illicit tobacco is distributed through various channels. Most consumers source illicit tobacco products from multiple sources such as tobacconist[55], supermarkets, milk bars, convenience stores, local markets and family/friends; with more than 79 percent of users purchasing from more than one source (PWC, 2010). According to Deloitte (2011) in Australia unbranded tobacco accounts for most (91 percent) consumed illicit tobacco products followed by contraband (5 percent); and counterfeit (4 percent). Over 60 percent of the respondents in Australia cite lower prices as the chief reason for purchasing unbranded tobacco (Deloitte, 2011).

In 2009 the Australian government adopted a national action plan aimed at curtailing illicit trade in tobacco products through[56] 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 institutional framework to tame illicit trade through enactment of the Tobacco Advertising Prohibition Act, 2012 that prohibits sale of tobacco on internet. In 2009 penalties on tobacco offences were increased by up to ten-fold[57]:

4.4.2 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[58] (Lemboe and Black, 2012). According to the Tobacco Institute of South Africa (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 percent of retail price. Measures adopted to combat illicit trade in tobacco products in South Africa include:

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[54]See Section 119(7) of Republic of Kenya (2012a) and Section 3 of Republic of Kenya (2012b).
[55]A tobacconist is an expert dealer in tobacco products.
[56]Government of Australia (2009)
[57]Deloitte (2011)
[58] The emergence of informal networks is attributed to the Apartheid regime as alternative trading platforms (Lemboe and Black, 2012)

i) Interagency collaborations: South African Revenue Services, police services and the national defence forces to enhance enforcement (Trademarks South Africa, 2014)

ii) Prescription of minimum fines for tax evasion. Fines on tax evasion attracts a fine of R8,000 or three times value of seizures, whichever is greater, or imprisonment of up to four years[59]. Counterfeiting, on conviction attracts a fine not exceeding R5,000 or imprisonment not exceeding three years[60].

iii) 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 would be relevant in Kenya to deter piecemeal smuggling but voluminous trade. Interagency collaborations would further facilitate smooth coordinated efforts in tracking and tackling the problem of illicit trade. Collaborations with the industry is important in leveraging on limited public resources, but it requires clear strategy to prevent industry interference.

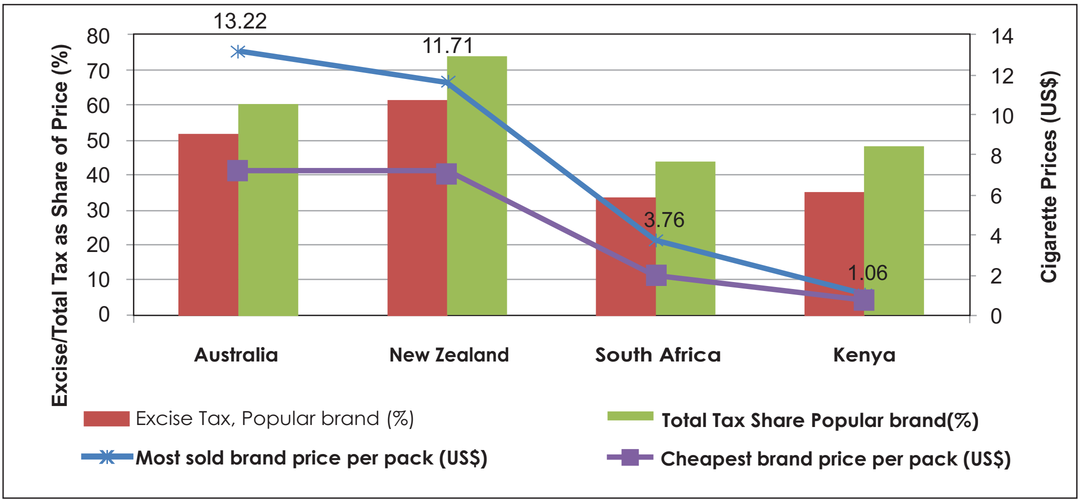
4.4.3 Experiences from New Zealand

The Copyright Act, 1994 & Trademarks Act of 2002 are the principal legislations that provide criminal offences for production & distribution of counterfeit & pirated goods. Trade Marks Amendment Act 2011 empowers Customs & National Economic Unit of 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 New Zealand's geographical location (island) may be attributable to the low levels of illicit trade, especially bootlegging.

Figure 4.6 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.

[59]South Africa Revenue Service Act
[60]South Africa Revenue Service Act

Figure 4.6: Average Cigarette Prices, Excises and Total Taxes as % of Price in 2012



Data Source: WHO (2013b)

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

4.4.4 Summary Experiences from Other Countries

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 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 cigarettes shipments which lead to increased detection.	**UK**
Increased border patrol and enforcement capacities sharing of information	This contributed to a decrease in illicit activity.	**Spain**
	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 co-operations with other countries is said to be 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 Tacking 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 ar 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* confiscation of proceeds of counterfeiting activity. Confiscation of offenders' assets and fines up to $5,000 and bans in tobacco trading.	**UK**

Authors' compilation. Literature sources: Sweeting *et al* (2009); UNICRI and BASCAP (2013), Paynter *et al* (2010); HM Revue & 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; interagency collaboration in data sharing, and punitive penalties, for example by taking into account past proceeds of crime (Joossens and Raw, 2003; Paynter *et al,* 2010; and Sweeting *et al*, 2009)

Summary of international and regional experiences

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

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

4.5 Relationship between Taxation and Illicit Trade in Tobacco Products

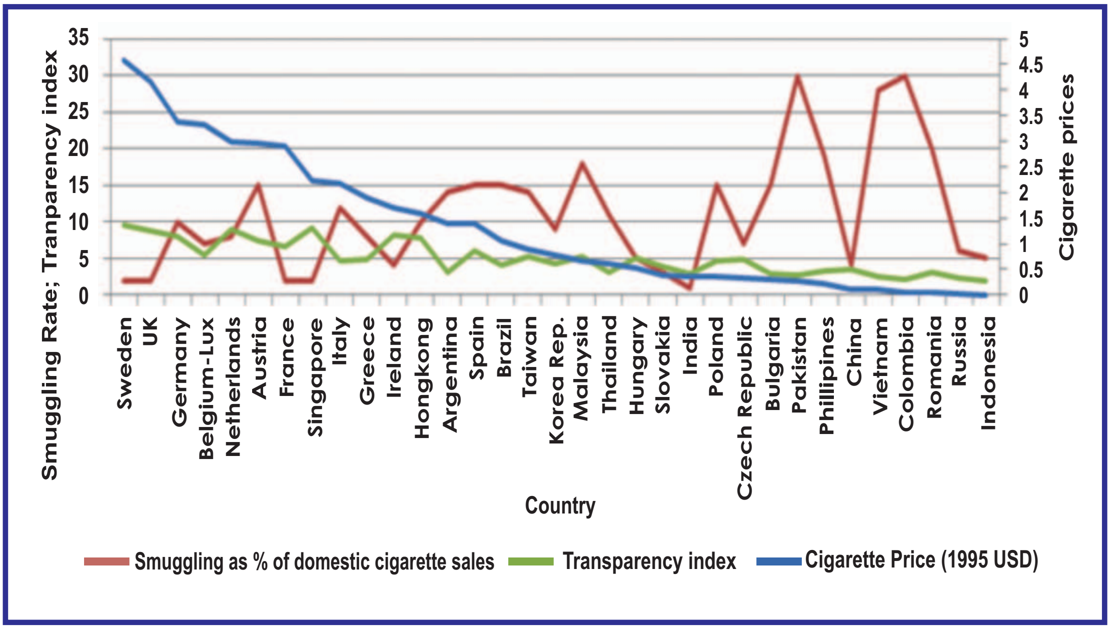
Global experience shows that taxation is a significant, but not sole driver of illicit trade in tobacco products (Allen, 2013; Cooper and Witt, 2012; Merriman *et al,* 2000). We compiled data from Merriman *et al* (2000) and established possible correlations. Our results as depecited in Figure 4.7 demonstrate correlations between levels of cigarette smuggling, cigarette prices and transparency index. Countries with high cigarette prices experience relatively low levels cigarette smuggling. The Spearman's correlation coefficient between cigarette smuggling and transparency index was -0.46 and significant at five percent significance level, indicating negative correlation between smuggling and transparency index[61]. The correlation for cigarette smuggling and cigarette prices is also negative at -0.41 and significant at 5 percent. 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 low but incidence of illicit trade is high. This could be attributed to:

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

i) 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.

ii) Porous borders and weak monitoring due to limited resource allocation for tobacco control monitoring in developing countries.

Figure 4.7: Relationship between cigarette prices, cigarette smuggling and transparencyinde x.

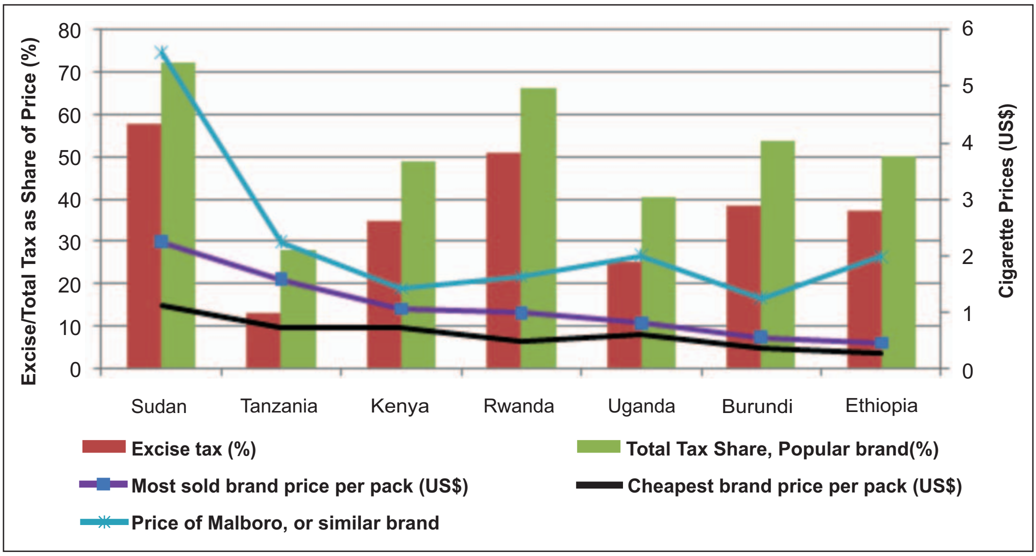


Data source: Merriman *et al.* (2000)

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 4.8 shows comparative regional average cigarette prices and taxes within Eastern African countries. There exists large variability in cigarette prices, particularly with regards 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 percent of retail prices.

Figure 4.8: Average Cigarette Prices, Excises and Total Taxes as Percent 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*)

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%. 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. Switzerland, Mexico and all EU countries adopt mixed system of cigarette taxation[62].

With regards 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[63].

[63]Source: WHO (2013) country profiles.

5.0 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 both by the incentive for the supplier to maximize profit and consumers to save money. Illicit trade in tobacco products has continued to attract policy attention due to social costs including increased health expenditures as a result of enlarged accessibility 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 nature and extent of illicit trade in tobacco products in Kenya, reviewed institutional framework in place including regional collaborative efforts and international experiences. Key findings from the study include:

i) Cigarettes are the key illicitly traded tobacco products. Imported counterfeit cigarettes are mainly from China, which is sometimes channelled through United Arab Emirates and India. Diverted exports of cigarettes manufactured by the legitimate manufacture have been established to be the main illicit cigarette products originating from domestic economy. While counterfeit imports are mainly through the sea, diverted exports are transported by road.

ii) Kenya has multiplicity of laws and institutions to curb illicit trade generally. However, despite plethora of institutions, there are challenges which render the laws ineffective in combating the vice. These challenges include weak co-ordination among different agencies and limited sharing of data and intelligence between relevant agencies. For example, while the Anti-Counterfeit Regulations of 2010 requires 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 attributable to the fact that this provision for data sharing is not anchored in the Anti-Counterfeit Act or any other law.

iii) 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.

v) Tobacco Control Fund, established under Section 7 of the Tobacco Control Act is yet be operationalized as no allocations has ever been made since establishment of the Tobacco Control Board.

v) Less punitive fines to deter illicit trade. Most of the laws tie fines to value of seizures or fail to define minimum fines (see Table 5.1). Thus, lack of punitive fines continues to stifle efforts to curb the problem. For example, illicit traders engaging in small quantity but voluminous trade can get away with minimal fines.

vi) Regionally, East African countries are at different stages of enacting legislations on illicit trade and lack of harmonized laws in the region continues to pose challenges. The draft EAC Anti-Counterfeit Bill and Policy are yet 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, ncluding bootlegging.

vii) International experiences shows importance of regional collaboration, political will, adequate prosecutory powers, adequate resources for relevant agencies and punitive fines are 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 and the protocol provides that members are to establish a mandatory licensing system for manufacturers, importers or exporters of tobacco products and manufacturing equipment.

viii) 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 impacts 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	Fine: Ksh. 200,000 depending on offence, or jail term = 5 years, or both
False of misleading description	Trade Description Act	Fine: = Ksh. 2 million or jail term of =2 years, or both
	Competition Act	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 & 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 Customs and Excise Act	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.
		Failure to comply with import duty free limit of 250 gram on cigarettes, cigars, cheroots, cigarillos, tobacco & snuff.

Source: Authors' Compilations

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

5.2 Recommendations

5.2.1 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. Relevant agencies that should be prioritized for collaboration include the Anti-Counterfeit Agency, KRA Customs Department, 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). Collaborations of relevant agencies is also vital for addressing challenges of corruption, which is an incentive for illicit trade. Interagency collaboration should be enhanced to facilitate track and trace of previous proceeds of illicit trade to ensure that fines imposed takes into account both seizures and past benefits of illegal trade.
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 centre of their operations beyond Nairobi, Mombasa and Kisumu. Best practice reveal 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 achievements 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 need for obligation on different agencies mandated to curb illicit trade to compile data to facilitate trend analysis of illicit trade. 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.
6. As indicated in the study, the Tobacco Act provides that the health Cabinet Secretary in consultation with other stakeholder ministries may formulate multidisciplinary policy framework to ensure that the objectives of the Tobacco Control Act are achieved. In this regards therefore, the ministry of health should spearhead establishment of a consortium for effective interagency approach to combat illicit trade in tobacco products. Best practice illustrates the importance and effectiveness of an interagency approach to combat this vice.
7. Regionally, East African Community (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.
8. 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.

5.2.2 Areas for Further Research

1. A key challenge in illicit trade research is lack of comprehensive data due to 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 should be undertaken. Such initiatives should however be cognisant of immense financial resources requirements which is a major deterrent factor.
2. 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
(i) 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, Kenya Anti-Counterfeit Agency and the Kenya Bureau of Standards.
(ii) 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 Department of weights and Measures.
(iii) 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, Kenya anti-counterfeit agency, KRA customs department, and Kenya Bureau of Standard.

(iv) 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.
(v) To review international best practices in combating illicit trade in tobacco products.	Desktop review of selected countries' policy, practices and regulatory measures.	Relevant laws and literature for new zealand; Australia, and South Africa.
(vi) To evaluate regional collaborative efforts to combat illicit tobacco trade and ascertain their effectiveness		EAC laws and regulations; Key informant interviews.

Annex 2: List of Key Informants

i. Kenya Revenue Authority (KRA) Customs Department;

ii. Anti-counterfeit Agency (ACA);

iii. Kenya Bureau of Standards (KEBS);

iv. Tobacco Control Board;

v. Tobacco manufacturing companies: British American Tobacco (BAT) Kenya and Mastermind Tobacco; and

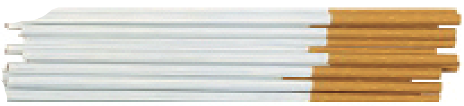
vi. Kenya Association of Manufactures (KAM).

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
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

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 of 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
Pipes  Pipes are usually made of materials such as briar, slate or day; tobacco is placed in the bowl and the smoke inhaled through the	**Dry Snuff**  Powdered tobacco that is inhaled through the nose or taken orally.

Kreteks  Are clove -flavored cigarettes that may contain exotic flavorings 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. Flavored 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. The participants were drawn from both public and private sector stakeholders including National Authority for Campaign against Alcohol and Drug Abuse (NACADA); 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 (KEBS); Tobacco Control Board; Kenya Tobacco Control Alliance (KETCA); Kenya Industrial Property Institute (KIPI); Parliamentary Budget Office; Kenya Revenue Authority; Ethics and Anti-Corruption Commission (EACC); The National Commission for Science , Technology and Innovation(NACOSTI); 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 (BAT).

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 findings of the study and engage the 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 through pulling of resources;
5. Kenya has many laws that deal with illicit trade, but implementation remains a key issue. Therefore, there is need to address implementation of the laws that deal with illicit;
6. Public sensitization of the presence of counterfeit tobacco products is essential for consumers;
7. Improved coordination amongst oversight authorizes;
8. Undertaking a study with a wider scope which reviews 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

Year	Description	Excise Chargeable		
2003 & 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.	**Category**	**Retail selling Price per mille**	**Excise Rate per mille Ksh.**
		A	Up to Ksh. 1,500	450
		B	Ksh. 1,501-2,500	650
		C	ksh. 2,501-3,500	900
		D	More than Ksh. 3,500	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 & Star, Comet, Rocker, Polo	450
		B	Supermatch, Kings, Supermatch, Menthol, Safari Kings, Ralli, Horseman menthol, Horseman,Kings, Safari,Super, Safari Menthol, Champion, Crown Board	650
		C	Sportsman King Size, Sweet Menthol	900

				1,400
		D	Embassy King Size, Embassy Lights, Embassy Superlights Embassy menthol, Sportsman Light, Benson & Hedges Lights, Benson & Hedges Special Filter, & all other cigarette brands	
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 mile**	**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. 2,500-3,500 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. 2,500-3,500 More than Ksh. 3,500	500 800 1,200 2,000

		Category	Retail Selling Price per mile	Excise Rate per mille Ksh.
2008 **2009** **&** **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 become 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 as follows:	**A**	Plain cigarettes with RSP of up to - Shs.2,500 per mille	
		B	Soft-cup cigarettes of 72mm or less, or soft cap cigarettes of 72 mm or less with RSP 2,501-3,500 per mille	1,000
		C	Soft-cap cigarettes of 72 mm or less, or soft cap cigarettes of more than 72 mm with RSP of 3,501 to Ksh. 4500 per mille	1,500
			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[1]. The Finance Act No. of 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: Republic of Kenya (2011); Republic of Kenya (2008b)

[65] Two reasons were given by Finance Minister 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 (Republic of Kenya, 2011).

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