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## **1. SUPPLY CHAIN TRACKING AND VERIFICATION (SCTV)**

The objective of this document is to outline the position on supply chain tracking and verification systems and BAT views on application and implementation. This is in light of the recent development with regards to Track and Trace discussions in Botswana.

In principle, BAT is not opposed to supply chain tracking and verification systems such as Digital Tax Verification, Product Authentication, or a Track and Trace system, as they are a vital part in combating the illicit trade. However, practicality and careful implementation are key to a sound application of tracking and verification systems, especially in areas where production is based in another country and thus trade gaps can manifest.

### **Definitions**

Supply chain tracking and verification systems is a term used to describe several different approaches to controlling, supply chains. In this document we mean it to address the tobacco supply chain specifically. Each approach seeks to address a different illicit trade challenge. They vary in scope, cost and complexity. For the purposes of this document we will define three diverse types of SCTV:

#### **1. Digital Tax Verification**

This is a cost effective technological solution that supports the reporting, calculation and collection of excise revenues from tobacco products. It is best suited to markets where the illicit trade is characterised by tax evasion activities of local producers. This includes under-declaration of production levels to avoid attracting excise thereon.

#### **2. Track and Trace**

Track and Trace is a supply chain verification tool used primarily to combat illicit markets characterised by smuggled/contraband cigarettes. The basic premise to understand where the products would have been diverted from legitimate supply chains in order to identify those illegally acquiring and selling these goods. It is highly dependent on international (regional) buy in and support as the system only works if all neighbouring countries recognise and utilise the system. Most of the world's largest tobacco producers have already implemented track and trace technology

#### **3. Product/Digital Authentication**

Product authentication is a tool used to identify fake products. It is therefore suited to markets where illicit trade is characterised by counterfeit or fake products. It generally uses advanced marking system integrated into packaging which can be scanned by law enforcement to test its authenticity. The system is dependent on very robust security systems and constantly evolving security measures to ensure the markers cannot be duplicated. However, these are usually counterfeited and sold on the black market to illicit producers.

### **Botswana Market**

The Botswana tobacco market is characterised by the retail of manufactured tobacco products that are imported from South Africa, and nearby countries. Over 90% of the tobacco products found in Botswana are of this type. Thus, in order to ensure that the correct quantities of product are entering the country legally, strong controls between neighbouring countries and at the boarder are needed to accurately account for the in country sales and reconciled tax payments due. As it stands, this process has largely

been successful, however with increasing revenue leakages evident, an illicit economy of smuggled product can be seen manifesting.

Estimated at 400 million sticks, Botswana is not a high tobacco consumption country, with much of the consumption within the Premium segment, which accounts for 95% of tobacco sales. As such outside of tax induced price increases, general market prices for tobacco products are relatively high (Value for Money / Low Priced volume accounts for less than 1%). However, with a tax levy in place and increasing excise duties, the increasing prices and low affordability of consumers is generating a vacuum for illicit activity to occur, in the form of contraband products entering the market from neighbouring countries. To put it in greater focus, compared to neighbouring countries, the consumption levy is the singular differentiator that is driving price gaps in the market, and encouraging illicit trade.

### **Recommendation**

Whilst we support the initiative taken by the Botswana Unified Revenue Service in looking to address shortcomings between supply chain and reconciliation of tax payments, we believe that further consideration on its application needs to be considered. Because of the nature of the product manufacturing stemming from SADC members, more engagements between Botswana and its regional body members needs to happen, to align the process of implementing a supply chain tracking and verification system. A stand-alone Botswana solution may exacerbate the illicit issues further, without proper enforcement support from regional countries.

In addition, there is further analysis and engagements that need to take place in order to find the best solution, and its practical application. Paper based models, such as printed tax stamps on products, have been found to be problematic due to counterfeiting of stamps or parallel production of tax stamps in various countries both within East and West Africa, as well as globally. Digital solutions are best placed to offer a solution but do require a significant initial investment from both the revenue authority and the manufacturers in technical development, training, and deployment. As such, a thorough engagement and analysis process on the cost implications, technical requirements that agree with all parties, and the best solution that can be regionally agreed upon is needed.

To this extent, the following steps are recommended to the BURS:

1. Delay the implementation of the Botswana specific solution and engage on a regional solution. In the long run, this will prove more effective than a country specific issue.
2. Delay the implementation of the supply chain tracking and verification system, whilst a thorough analysis of the differing options is conducted to understand technical requirements in consultation with industries. Engagement with manufacturers is key to a successful system to avoid creating loop holes in the system. Tobacco industry has a wealth of experience globally on different systems and would be happy to assist in this process.
3. Consider the removal of tax levies, that are creating price gaps between Botswana and neighbouring countries. Various examples, globally have shown that levies that are not in line with regional policies and are country specific, have led to an increase in contraband. Careful management of market prices is key in managing consumption and retailer behaviour. Levies in Botswana need to be reconsidered in this light.

## 2. CASE STUDY ON THE PROCESS AND IMPLEMENTATION OF TRACK AND TRACE SYSTEM: EUROPEAN UNION

As can be seen with the below European Union case study, before the official announcement on the date of implementation, the process of engaging both manufacturers and member states was open and transparent, as well as inclusive as to understand the implications and selection of various track and trace systems. Regional integration is a key insight to acknowledging and understanding the movement of goods, and how a track and trace system must be applied in instances where the manufacturers are based out of country.

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### Systems for tobacco traceability and security features

#### Fighting illicit trade in tobacco products

Articles 15 and 16 of the Tobacco Products Directive 2014/40/EU (TPD) provide for EU-wide **systems of traceability and security features for tobacco products to address the issue of illicit trade.**

### Traceability system

The traceability system aims to:

- Contribute to reducing the circulation of non-compliant tobacco products
- Reduce artificially cheap supplies of illegal tobacco products
- Protect public health, State budgets, and legal economic operators.

Under the traceability system:

- All unit packets of tobacco products will be required to be marked with a unique identifier
- Relevant economic operators involved in tobacco trade will be required to record the movements of these packets throughout the supply chain and transmit the related information to an independent provider (data storage contracts to be approved by the Commission)
- The data will then be made accessible to the authorities of EU countries and to the Commission for enforcement purposes.

In this way, it will be possible to track and trace the movement of legal tobacco products to allow public authorities to determine when a product was diverted into the illicit market.

### Security features system

Under the security features system, all unit packets of tobacco products placed on the EU market will be required to:

- Carry a tamper-proof security feature composed of visible and invisible elements, enabling authorities and consumers to verify their authenticity.

The systems of traceability and security features must be in place by:

- 20 May 2019 for cigarettes and roll-your-own tobacco
- 20 May 2024 for all other tobacco products.

This will provide manufacturers of other tobacco products (which are often small and medium enterprises (SMEs)) with a longer period to adapt to and benefit from the experience gained before the systems become applicable to them.

## Relevant legislative acts

Articles 15 and 16 of the TPD require the Commission to adopt implementing and delegated acts to lay down the technical details necessary for the systems of traceability and security features for tobacco products to become fully operational. These acts were **adopted on 15 December 2017** and published in the [Official Journal of the EU of 16 April 2018](#).

The acts are published on the following pages:

1. Commission Implementing Regulation (EU) 2018/574 on technical standards for the establishment and operation of a traceability system for tobacco products (incl. Annex I and II): **7**
2. Commission Delegated Regulation (EU) 2018/573 on key elements of data storage contracts to be concluded as part of a traceability system for tobacco products: **1**
3. Commission Implementing Decision (EU) 2018/576 on technical standards for security features applied to tobacco products: **57**

[Timeline](#) of actions required before 20 May 2019 under Commission Implementing Regulation (EU) 2018/574 and Commission Delegated Regulation (EU) 2018/573.

[Impact Assessment](#) accompanying Commission Implementing Regulation (EU) 2018/574 on technical standards for the establishment and operation of a traceability system for tobacco products and Commission Implementing Decision (EU) 2018/576 on technical standards for security features applied to tobacco products.

[Executive summary](#) of Impact Assessment

[Annexes](#) accompanying Impact Assessment

[Q&A: EU systems for traceability and security features of tobacco products](#)

[Stakeholder manual](#)

## Implementation Analysis

The following document serves as the Final Report to the European Commission's Consumers, Health, Food and Agriculture Executive Agency (Chafea) in response to the request for service Chafea/2015/health/40 for the implementation of Framework Contract FWC DIGIT/R2/PO/2013/004 ABC III Lot 2, concerning the implementation analysis regarding the technical specifications and other key elements for a future EU system for traceability and security features in the field of tobacco products.

The present document is the main report of the [study carried out](#), and is complemented by:

- [Annex I – Evaluation of Policy Options](#)
- [Annex II – Technical Specifications of the Tracking and Tracing System and the Security Features](#)
- [Annex III – Model Contract](#)
- [Résumé exécutif](#)

The content of the implementation analysis represents the views of the contractor and is its sole responsibility; it can in no way be taken to reflect the views of the European Commission and/or Chafea or any other body of the European Union. The European Commission and/or Chafea do not guarantee the accuracy of the data included in this report, nor do they accept responsibility for any use made by third parties thereof.

The implementation analysis is an external document and insofar it may assist the interested parties in familiarising themselves with concepts and potential solutions relating to the systems of traceability and security features, this analysis cannot and does not supersede any applicable provisions set out in Articles 15 and 16 of the TPD and the relevant supporting acts: Commission Implementing Regulation (EU) 2018/574, Commission Delegated Regulation (EU) 2018/573 and Commission Implementing Decision (EU) 2018/576.

# Notification of proposed primary data storage providers and draft data storage contracts

Pursuant to Article 15(8) of the TPD, manufacturers and importers of tobacco products must conclude data storage contracts with an independent third party.

According to Part A of Annex I (paragraph 1) to the **Commission Implementing Regulation (EU) 2018/574 on technical standards for the establishment and operation of a traceability system for tobacco products**, each manufacturer and importer is required to submit, no later than two months following the entry into force of **Commission Delegated Regulation (EU) 2018/573 on key elements of data storage contracts to be concluded as part of a traceability system for tobacco products**:

1. the **identity** of the third party that it proposes to appoint to operate a primary repository ("the proposed provider");
2. a **draft data storage contract** containing the key elements laid down in Delegated Regulation (EU) 2018/573

for approval by the Commission.

As set out in Part A of Annex I (paragraph 2) of **Implementing Regulation (EU) 2018/574**, this notification must be accompanied by:

1. a **written declaration of technical and operational expertise**, referred to in Article 4 of *Delegated Regulation (EU) 2018/573*;
2. a **written declaration of legal and financial independence**, referred to in Article 8 of *Delegated Regulation (EU) 2018/573*;
3. a **table** setting out correspondence between the contractual clauses and the requirements laid down in *Delegated Regulation (EU) 2018/573*.

**Note:** In the case of data storage contracts between the storage provider and several inter-linked parties (e.g. a parent company and its subsidiaries, or a company marketing a product under its brand and its contractor which actually manufactures that product), whenever possible, submitting parties are asked to notify such a contract jointly, i.e. to avoid multiple notifications of the same contract.

## Procedure for notification

Submitting parties are requested to send the required documentation to the following email address: [SANTE-TT-SW@ec.europa.eu](mailto:SANTE-TT-SW@ec.europa.eu)

You should expect to receive an email acknowledging the receipt of your documents. Should you fail to receive such an email within 5 working days, please contact the secretariat of SANTE B2 Tobacco Control at the following numbers: +32 229-96269, or +32 229-92406.

Submitting parties are asked:

1. To use the following **templates** for the purpose of their submissions:
  - [written declaration of technical and operational expertise](#)
  - [written declaration\(s\) of legal and financial independence](#) (including of potential subcontractors)
  - [table](#) setting out correspondence between the contractual clauses and the requirements laid down in Delegated Regulation (EU) 2018/573.
2. To submit the data storage contract in the **MS Word format**.
3. To include, in the body of the cover email, an email address and telephone number of one contact person for the submitting party.

NOTE: See the list of all [notified and approved providers of primary repositories](#).

# Regional workshops and webinars

From January to April 2018, the European Commission organised a series of regional workshops and webinars to support the technical roll-out of the systems for tobacco traceability and security features.

## **Webinar series (16, 17, and 23 April)**

- [Summary record](#)
- [Presentation \(webinar for economic operators\)](#)
- [Presentation \(webinar for solution providers\)](#)
- [List of questions \(16 April, 1st webinar\)](#)
- [List of questions \(16 April, 2nd webinar\)](#)
- [List of questions \(17 April, 3rd webinar\)](#)
- [List of questions \(23 April, 4th webinar\)](#)
- [List of questions \(23 April, 5th webinar\)](#)

## **Workshop No 4 (Bulgaria, Greece, Cyprus, Malta, Croatia, Slovenia, Italy, Finland) – 19 April 2018, Rome**

- [List of participants](#)
- [Presentation](#)
- [Summary record](#)

## **Workshop No 3 (Spain, Belgium, Portugal, Germany, France and Luxembourg) – 15 March 2018, Madrid**

- [List of participants](#)
- [Presentation](#)
- [Summary record](#)

## **Workshop No 2 (Austria, Czech Republic, Slovakia, Poland, Hungary, Lithuania, Romania) – 15 February 2018, Bucharest**

- [List of participants](#)
- [Presentation](#)
- [Summary record](#)

## **Workshop No 1 (Denmark, Estonia, Ireland, Latvia, Sweden and UK) – 25 January 2018, Stockholm**

- [List of participants](#)
  - [Presentation](#)
  - [Summary record](#)
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### 3. FACTORY COSTS ASSOCIATED WITH IMPLEMENTATION OF A TRACK AND TRACE SYSTEM

Manufacturer costs incurred:

- IT system upgrades that link the track and trace system with BURS: £600,000 (BWP 8,166,000) per factory
- Machine upgrades per production line to put stamps on ID markers: £200,000 (BWP 2,772,000) per production line
- Additional bespoke upgrade required for unique box formats: £50,000 (BWP 680,500)

Estimated costs for a medium sized enterprise:

- Upgrade of IT infrastructure: £600,000 (BWP 8,166,000)
- 8 production line upgrades: £1,200,000 (BWP 16,332,000)
- 2 unique pack formats (box of 30's)/ Soft pack line upgrades: £100,000 (BWP 1,361,000)

Further costs down the value chain that are not accounted for:

- Logistics company IT technical infrastructure upgrades
- Ongoing cost of changes to pack necessary due to implementation.
- Boarder post IT infrastructure upgrades
- BURS in market devices to read unique identifiers
- IT Infrastructure / Consulting fees
- Factory efficiency losses arising from stamp application and resultant stoppages.

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Comments on costing:

This is still in factory costs. The implications of which are a rise in market price due to the production cost base, that will be factored into the product cost price. Together with levies, this will increase price. Such market activity is what has given rise to illicit trading as the cost of compliance outweighs the benefits trading illicitly.

For manufacturers who are tax paying manufacturers, the cost of doing business and the market opportunities to continue to invest in building the market in Botswana, could be in danger as costs rise. The impact of a potential illicit economy and reducing levels of protection for manufacturers are warning signs for the business.

The rise in consumer prices will make legal product difficult to afford, leading to volume loss. For Botswana the implications of this would be:

- Reduced revenue from levies due to tax base erosion from volume loss
- Job losses within the distribution and retail parts of the value chain
- Tax base erosion from increase illicit trade by tax dodger manufacturers (case in point South African issue)




Case study lessons on Track and Trace and paper tax stamps (Summary of global experiences):

#### **4. UNDERSTANDING THE COST OF PAPER TAX STAMPS: WHY THEY ARE NOT EFFECTIVE**

1. Paper-based tax stamps are out-dated and failing to protect government revenues
  - a. Paper stamps can and have been easily counterfeited within as little as three weeks following their introduction. This is despite the inclusion of supposedly 'secure' holograms, colour-shifting inks, UV fibres and other features.
  - b. Paper stamps have a supply chain of their own. They can and have been lost and stolen in the period between production and delivery to manufacturers. Genuine paper stamps have been found affixed to counterfeit product, meaning the information they provide relates to the stamp itself, rather than the product.
  - c. Paper stamps require secure logistical management and control. This makes them difficult and expensive to handle, especially if they carry a pre-paid tax value.
  - d. In short, paper-based tax stamps are out-dated and provide a false sense of security.
2. Economic analysis offers no evidence that tax stamps are effective at reducing illicit consumption or increasing revenues
  - a. A third-party analysis by Oxford Economics (an internationally-recognised economic think tank based in the UK) across six countries which use tax stamps (Brazil, Greece, Malaysia, Morocco, Turkey and Ukraine) found that there is no evidence that they have been effective at reducing illicit consumption or raising tax revenues.
  - b. An independent analysis by the US state of Indiana Department of Revenue of the effectiveness of the California tax stamp also found no evidence that it helped protect or increase tax revenues. Indiana subsequently decided not to introduce a tax stamp as a result of the conclusions of this report.
2. Paper tax stamps do not provide track and trace capability
  - a. Paper tax stamps do not enable users to interrogate the whereabouts of tobacco products as they move forward through the supply-chain (i.e. tracking from point of manufacture through to point of sale), nor do they enable users to re-create the route or movement taken by tobacco products through their supply-chain (i.e. tracing backwards to identify the point of diversion). In short, they cannot track and trace tobacco products.



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- b. A WHO-commissioned expert report, authored by IBM, concluded that even the most ‘sophisticated’ paper stamps do not meet the tracking and tracing requirements of the FCTC Protocol on illicit trade.
  - c. Commenting on the tax stamps used in Brazil and Turkey in particular (which are provided by Sicpa), the report states: “...in order to meet the requirements of an international track-and-trace regime for tobacco products, the following issues characterizing the current system would need to be dealt with:
    - international serialization standards are not used;
    - international data exchange standards are not used;
    - events are not tracked along the supply chain; and
    - aggregation does not take place (only cigarette packs are marked).”

### 3. Paper tax stamps are expensive

- a. As experience from many countries shows, the costs of implementing, running and administering paper tax stamp systems are high for all parties involved, including government, manufacturers, distributors and importers.
- b. The alcohol and beer industries in many countries have raised significant concerns about the costs of paper tax stamps. In Morocco, for example, one of the largest alcoholic beverage manufacturers (Societe des Brasseries du Maroc) suspended production in 2010 in protest at the high cost of the paper stamp being imposed by the government (and provided by Sicpa).

### 4. Paper tax stamps have a negative impact on manufacturing efficiency

- a. Paper tax stamps can have a significant impact on manufacturer’s speeds of production and the handling processes for distributors and importers.
- b. Tax stamp suppliers will typically require manufacturers and distributors to equip their factories with proprietary stamp application machines, which can cost upwards of **US\$125,000 (BWP 1,701,250) per production line.**

Manufacturers often face on-going production delays and technical problems (such as production line stoppages and machine jams) caused by tax stamps. Readability issues can also occur for tax stamps which need to be ‘activated’ on production lines, causing stoppages, requiring the attendance of engineers and increasing product rejects. Appendix 1 below illustrates the average cost of tax stamps across various geographies, including the cost of digital stamps as per the EU experience.



**Appendix 1**

Country	Region	Tax Stamps Cost per thousand (USD)	Tax Stamps Cost per thousand Stamps (BWP)	Tax Stamps Cost per Stamp (BWP)
<b>Paper Based Tax Stamps</b>				
Malawi	SADC	\$6.00	P60.77	P0.06
Mozambique	SADC	\$8.90	P90.14	P0.09
Zambia	SADC	\$3.30	P33.42	P0.03
<b>SADC Regional Average</b>		<b>\$6.07</b>	<b>P61.45</b>	<b>P0.06</b>
DRC	COMESA	\$25.00	P253.21	P0.25
Kenya	COMESA	\$27.60	P279.54	P0.28
Mauritius	COMESA	\$14.10	P142.81	P0.14
Rwanda	COMESA	\$9.70	P98.25	P0.10
Uganda	COMESA	\$1.30	P13.17	P0.01
<b>COMESA Regional Average</b>		<b>\$15.54</b>	<b>P157.40</b>	<b>P0.16</b>
EuroZone (lowest)	EURO	\$1.34	P13.61	P0.01
EuroZone (Highest)	EURO	\$6.72	P68.04	P0.07
<b>EuroZone Regional Average</b>		<b>\$4.03</b>	<b>P40.83</b>	<b>P0.04</b>
<b>Digital Tax Stamps</b>				
<b>Cost of Digital Stamp</b>	<b>EURO</b>	<b>\$0.47</b>	<b>P4.81</b>	<b>P0.01</b>