

The Illegal Cigarette Trade

Klaus von Lampe

Introduction

The smuggling and illegal distribution of cigarettes is a global phenomenon in a dual sense. It can be observed in some form or other on every continent, and there are some schemes that span the globe, connecting distant places such as a clandestine factory in China producing counterfeit cigarettes with a street corner in London where these cigarettes are eventually sold to consumers.

Cigarettes are essentially a legal good. What makes the trade in cigarettes illegal is the evasion of excise and customs duties. Excise duties are taxes levied on certain goods produced or sold within the country. Customs duties are charged on goods imported from another country. Cigarettes are among the highest taxed commodities and provide a significant source of revenue for governments. While the level of taxation varies across jurisdictions, in many countries taxes account for as much as 70 to 80 percent of the price smokers have to pay for a pack at a legal retail outlet store. Through a number of different schemes, suppliers and customers circumvent the taxation of cigarettes. As a result, cigarettes are being made available at a cost below legal retail prices, providing both lucrative profits for suppliers and significant savings for consumers, while causing substantial losses of revenue to governments, estimated at around forty billion USD globally in 2007, and at the same time undermining public health policies that aim to discourage smokers through high tobacco taxation (Joossens et al., 2009). The illegal cigarette trade shows similarities but also some notable differences to other illegal markets. Illegal markets are characterized by the exchange of goods or services in violation of the law. Some goods are illegal under all circumstances, such as child pornography, some goods are illegal when they are handled without official permission or license, such as arms and pharmaceutical drugs, and some goods, such as cigarettes and gasoline, are illegal when duties are not paid. The peculiarity of the latter category is that, parallel to the black market, the same commodity is widely available through legal channels. In most countries, the legal market for cigarettes is much larger than the illegal market. It has been estimated that the global illicit cigarette trade accounted for 11.6 percent (or 657 billion cigarettes) of all cigarettes sold worldwide in 2007 (Joossens et al., 2009). In some countries like Libya and Guinea-Bissau, however, allegedly most (around 80 percent) of the cigarettes are sold illegally (United Nations Office on Drugs and Crime, 2009). One consequence of the parallel existence of legal and illegal market seems to be that there is no stigma of illegality attached to the commodity as such and perhaps for that reason the cigarette black market has a higher chance of social acceptance than other illegal markets. Another characteristic of the cigarette black market is the uniformity of the commodity. While there are special kinds of cigarettes deviating from the norm, most cigarettes are similar in shape, size, consistency, and weight, and they are usually packed in packs of twenty sticks and cartons of ten packs (two hundred sticks). This means that the handling of cigarettes poses the same challenges for illegal traders irrespective of place and time. Yet, there are significant variations in the manifestation of the cigarette black market internationally and nationally, and there are, as indicated, differences in the schemes used for procurement and distribution of illegal cigarettes that deserve closer examination.

The anatomy of the illegal cigarette trade

The term “illegal cigarette trade” as understood here is broader than the often-used term “cigarette smuggling” and encompasses three levels: the procurement level, an intermediate level where cigarettes are moved in the direction of the consumer, and the level of retail distribution.

Procurement Schemes

Cigarettes are procured for distribution on the black market in different ways, with different degrees of illegality and different levels of complicity of those involved. Three main schemes can be distinguished: bootlegging, large-scale smuggling, and counterfeiting.

Bootlegging

Bootlegging involves the purchase of cigarettes in low-tax countries for resale in high-tax countries, taking advantage of cross-border differentials in legal retail prices. In these cases taxes on cigarettes are paid, though not in the country of consumption (see, e.g., Hornsby & Hobbs, 2007).

Large-Scale Smuggling

Large-scale smuggling takes advantage of the temporary suspension of customs duties, excise, and other taxes on goods destined for export to a third country. Cigarettes destined for markets abroad are not subject to taxation in the country of origin, or any transit country along the way for that matter, as long as certain procedures for storage and transport are followed. These untaxed cigarettes either never leave the country and are directly diverted to the black market, or, far more commonly, they are properly exported and disappear on the black market abroad or are illegally re-imported (see, e.g., Joossens & Raw, 2008).

Counterfeiting

While in cases of both bootlegging and large-scale smuggling, cigarettes are procured from originally legitimate sources, counterfeiting involves the production of fake brand cigarettes, including packaging and, on occasion, fiscal marks made by unauthorized manufacturers. In addition to tax evasion, the trade in counterfeit cigarettes constitutes a violation of brand property rights. Most counterfeit cigarettes are said to be produced in illegal factories and tend to differ in every respect from their legal counterparts, including tobacco, paper, filter tips, and packaging. China, also the largest manufacturer of legal cigarettes, is believed to be the main source of counterfeit cigarettes (Shen, Antonopoulos & von Lampe, 2010).

Other Sources of Black Market Cigarettes

Since 2004, a new phenomenon has begun to shape the cigarette black markets across Europe: cigarettes legally manufactured in Kaliningrad, Russia, and other locations in Eastern Europe under the brand name ‘Jin Ling’. These cigarettes appear to be readily available to smugglers and, indeed, appear to be primarily distributed through black market channels (Candea et al., 2008). Another facet of the cigarette black market that should not be entirely ignored, although it will probably never reach the significance of the previously described schemes, is the selling of stolen cigarettes.

Smuggling and Wholesale Distribution Schemes

The second major element of the illegal cigarette trade, following the initial procurement of cigarettes for the black market, comprises the smuggling of cigarettes, or their clandestine transport across borders without paying taxes and customs duties. However, the border

crossing is only a small part of the overall handling of cigarettes between procurement and retail selling. In fact, there are schemes where the crossing of international borders is not required and all illicit activities take place within one country. In the United States, for example, cigarettes are brought from states with low taxes to states with high taxes. Another pattern pertains to cigarettes destined for export. These untaxed cigarettes may be diverted to the black market without ever leaving the country.

The cigarettes that are procured for illegal distribution may go through similar and, at times, identical channels on the lower levels of the black market, as is true for the illegal cross-border transport of cigarettes. Smuggling modes, it seems, vary not so much according to the source of the cigarettes but rather with the size of the consignments that are being moved. Large loads of about one million sticks and more are typically transported while concealed in or behind legal goods under the guise of legal cross-border commerce. The smuggling of smaller loads is typically embedded in the flow of noncommercial cross-border traffic, although smuggling across unregulated land and sea borders has also been reported. Common methods include the use of hidden compartments in cars and vans, for example, in the form of false bottoms or modified gas tanks. Another method, connected especially to the illicit sale of cigarettes over the Internet, is the use of parcel post services. Cigarettes may be passed on directly to consumers. However, in most cases there seems to be a separate pattern of activities linking procurement and retail distribution. On this intermediate level cigarettes may be stored, reconfigured, and typically broken up into a number of smaller consignments which are then passed on to buyers positioned further down in the distribution chain.

Retail distribution schemes

A variety of patterns have also emerged by which contraband cigarettes are sold to consumers. These patterns can be grouped into three broad categories by the type of setting: public places, semipublic places, and private settings.

At public places like street corners or flea markets, the opportunity to purchase illegal cigarettes is advertised by vendors to passers-by. In semipublic places like bars and kiosks, the illegal cigarettes can be purchased under the counter as an alternative to legal cigarettes. Sometimes, consumers are defrauded when counterfeit (or stolen) cigarettes are sold as legitimate merchandise. Finally, illegal cigarettes may be passed on to consumers in private settings through social network relations.

Interestingly, the dominant distribution scheme varies geographically within and across countries. One striking example is Germany where street vending of illegal cigarettes has been widespread in the Eastern parts of the country but virtually absent elsewhere (von Lampe, 2006).

Who is involved in the illegal cigarette trade?

Criminal Groups and Terrorist Groups

One of the reasons why the illegal cigarette trade provides an interesting object of study is the diversity of the players involved in illicit activities. Three aspects have received particular attention: the level of involvement of criminal groups, and the involvement of terrorist groups, and the complicity of the tobacco industry. It has often been alleged that the illegal cigarette trade is the domain of well-organized criminal groups who have previously been active in other areas of crime like drug trafficking. However, research in Europe has found that the illegal cigarette trade is primarily run not by known criminals but by individuals without a previous criminal record (see, e.g., Van Duyne, 2003). Likewise, the involvement of terrorist groups who trade in illegal cigarettes to raise funds (see Shelley & Melzer, 2008) seems to be the exception rather than the rule.

The Tobacco Industry

The involvement of tobacco manufacturers in the illegal cigarette trade appears to have been a more common occurrence in the past. There are several well-documented cases of complicity between major tobacco companies and cigarette smugglers (e.g., Joossens & Raw, 2008). In other cases, tobacco companies have at least turned a blind eye to the fact that their cigarettes are being funneled into illicit channels, typically through small countries with no significant domestic cigarette market. More recently, however, tobacco companies, under pressure from governments, have significantly reduced or entirely ceased their exports to such countries. This has apparently resulted in a sharp decline in the availability of major brands on the black market (Joossens & Raw, 2008). In fact, the emergence of counterfeit cigarettes and the brand “Jin Ling” may well be connected to stricter sales policies adopted by the large tobacco companies in the early 2000s.

Countermeasures

There is a heated debate over the best approaches to tackle the illegal trade in cigarettes. While antismoking lobbyists place the major blame on the tobacco industry, the tobacco industry itself argues that the high taxation of tobacco products more or less automatically creates a black market. From the available evidence it seems that, although there would not be an illegal cigarette trade without excise and customs duties, high taxes do not automatically lead to the emergence of a black market of significant size. Black markets for cigarettes are not necessarily most prevalent in high-tax countries and least prevalent in low-tax countries (Joossens & Raw, 2002: 5-6). Likewise, there are substantial regional variations in black market prevalence within particular countries despite uniform tax rates nationwide (von Lampe, 2006). It appears to be at least as important that supply of and demand for untaxed cigarettes are linked up in an efficient way and that illegal transactions can take place in a relatively non-hostile environment. This, in turn, depends on the strength or weakness of law enforcement and civil society in a community. In this context it should be noted that through a number of countermeasures, mirroring efforts against drug trafficking, the illegal cigarette trade has become more risky in recent years. Most notably, through the introduction of stationary and mobile scanners and the use of tobacco sniffing dogs the control of international cargo has been made substantially more effective.

The illegal cigarette trade is essentially a form of tax evasion. Different schemes have developed to circumvent taxation to supply cigarettes to consumers below legal retail prices. Cigarettes are either diverted from legal channels, or they are produced specifically for distribution on the black market.

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