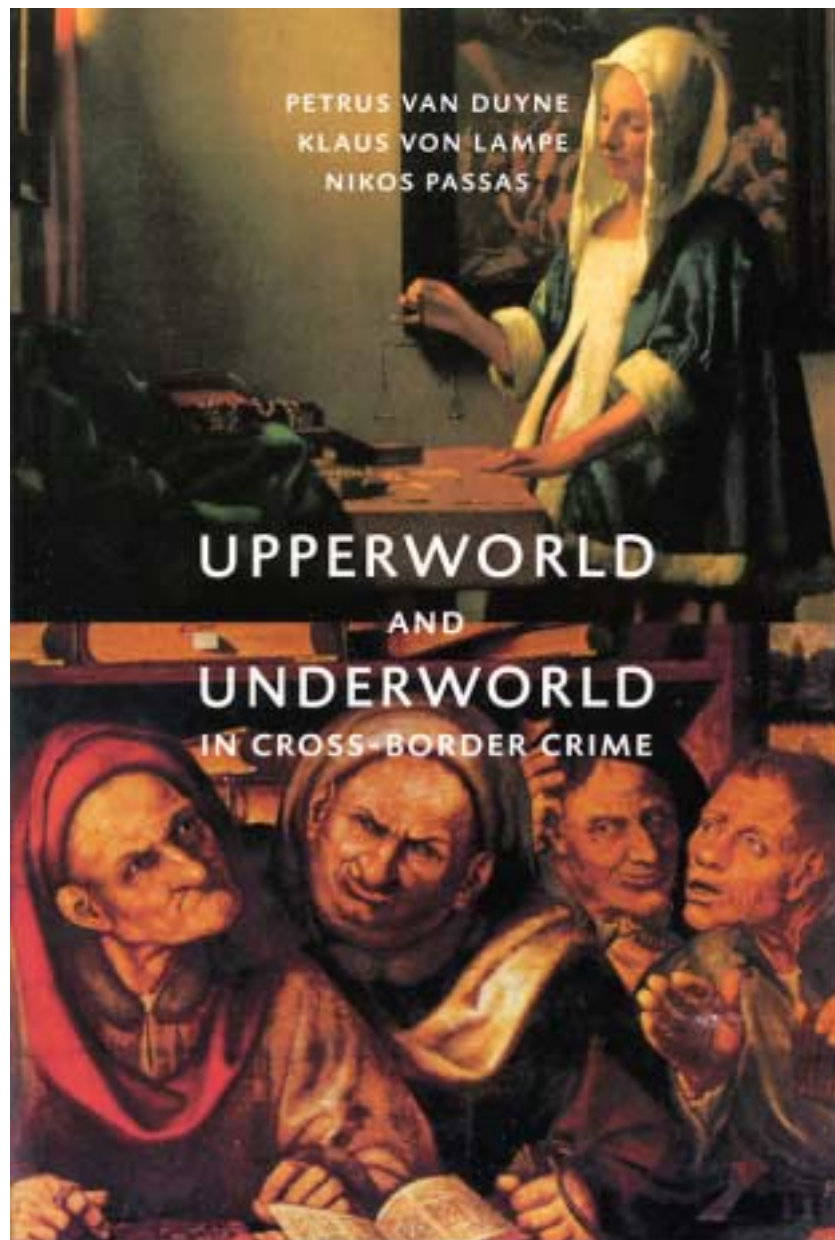


## **The Trafficking in Untaxed Cigarettes in Germany: A Case Study of the Social Embeddedness of Illegal Markets**

by Klaus von Lampe

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# The Trafficking in Untaxed Cigarettes in Germany

## A Case Study of the Social Embeddedness of Illegal Markets

*Klaus von Lampe*<sup>1</sup>

### Introduction

In April 1991 the Berlin based daily newspaper '*die tageszeitung*' felt it needed to do something about its readers' foreign-language skills. In order to buy a carton of cigarettes on Kantstrasse, a major street in the Western part of Berlin, the proper thing to say, the newspaper advised, was the Polish phrase '*Ile kosztuje karton Marlboro?*', how much is a carton of Marlboros.<sup>2</sup> Since the visa obligation had been lifted for Polish citizens travelling to the then capitalist enclave of West Berlin in January of 1989, smokers could choose between the highly taxed cigarettes sold in tobacco stores and supermarkets, and cheap contraband cigarettes from Poland sold by illicit street dealers. In the turbulent times after the German re-unification, however, a crash-course in Polish was soon outdated. In West Berlin, under pressure from a law-and-order-seeking public, the authorities cracked down on the Polish dominated street sale of untaxed cigarettes. Meanwhile in East Berlin and other cities in the former German Democratic Republic (GDR), an illegal market for cigarettes of even greater proportions had emerged. It was not just the continuation of the previous Polish street trade as tourists from Poland and other Eastern European countries were increasingly replaced by vendors of a completely different nationality: Vietnamese. Male and female Vietnamese offering near metro stations and supermarkets contraband cigarettes became common a common

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<sup>2</sup> Slaska, E., and A. Böhm, Guten Tag - Dzień Dobry - Dschijn dobri, in: *die Tageszeitung*, 8 April 1991.

sight. For a while they even managed to establish themselves as quasi-legitimate business people. For example, at *Frankfurter Allee*, one of East Berlin's main traffic junctions, peddlers from Vietnam could be found selling untaxed cigarettes from long rows of make-shift stalls.

Today, although fewer vendors sell fewer cigarettes at fewer locations than during the early 1990s, the street sale of untaxed cigarettes has proven to be not just a temporary phenomenon in East Germany. At the same time, it seems that an increasing number of contraband cigarettes are being distributed to consumers through more clandestine channels in both the Eastern and Western parts of the country. In the end, the illegal cigarette market appears to have gone through significant changes in volume, geographical expansion and structure.

This paper will describe this development by outlining its basic characteristics and will explore the conditions that have contributed to its emergence and continued existence. Data were obtained from various sources, including media reports, government documents, interviews conducted with law enforcement officials, informants, and a representative of the German association of cigarette manufacturers.

## **Basic Parameters of the Illegal Cigarette Market**

Regardless of the specific conditions prevailing in Germany, the illegal cigarette market has a greater chance of being tolerated than other illegal markets, namely the drug market. Unlike illicit drugs, such as heroin or cocaine, the cigarettes that are sold on the black market are legal products. Though there have been confiscations of counterfeited cigarettes presumably stemming from Chinese product pirates, these cigarettes were not destined for Germany but for other, more profitable retail markets such as Great Britain, which imposes a much higher excise rate than most other EU Member States. In the Berlin area, the largest regional market for untaxed cigarettes in Germany, only a handful of cartons of counterfeit merchandise has been seized so far.

Just like the contraband cigarettes sold in Germany come from legal manufacturers, the consumption of these cigarettes in itself is neither illegal nor even deviant. Importing, distributing and acquiring cigarettes in violation of tax laws does constitute a criminal offence or at least a summary offence. But unlike injecting heroin or sniffing cocaine, smoking cigarettes is more or

less socially accepted, though, of course, there is some controversy over the extent to which smoking should be tolerated with regard to the inherent health risks. In sum, only part of the process that leads from the production to the eventual consumption of cigarettes is potentially subjected to definitions of illegality.

While the black market for cigarettes provides a link between two sets of legal activities (producing and consuming cigarettes) and for this reason alone seems to be less prone to stigmatisation and intense prosecution than other crimes, involvement in the black market for cigarettes appears to be regarded as a lesser crime also because it is in essence a variety of tax evasion, i.e. an offence which is widely seen as trivial.

The basis for the smuggling and illegal distribution of cigarettes is, quite obviously, the tax burden imposed on cigarettes. In Germany, some 70 percent of the retail price consists of excise and value added tax. This is less than, for example, in Great Britain or Denmark, but significantly more than in countries like Poland and the Czech Republic (Körner, 1996). The state imposed 'price wedge' (Van Duyne, 1996) as well as the tax rate differences between various countries provide wide profit margins, which are a stimulus for those who are capable of circumventing tax regulations. In Germany, the cigarette 'bootleggers' use three major channels through which they supply the black market:

- Cigarettes from a legitimate plant in a low-tax country such as Poland are legally purchased and then smuggled into Germany. With this method, differences in retail prices between high-tax and low-tax countries are exploited. It has been characteristic of the early phases of the black market and is still being used today by amateur smugglers.
- Cigarettes legally produced in Germany for export to non-EU countries are diverted to the black market before they cross the border. This method takes advantage of the fact that in the EU export goods are exempt from taxation. Since 1993 a series of restrictions on the shipping of cigarettes has apparently made this method more costly and therefore less frequent, including an increase in guarantees demanded from manufacturers or

dispatching agent to cover potential losses in tax revenue, and a more cautious sales policy adopted by the tobacco industry.<sup>3</sup>

- In recent years, it seems that the supply for the black market in Germany has increasingly come from cigarettes which are legally exported to non-EU countries only to be smuggled back. This category also encompasses untaxed cigarettes delivered to Russian army facilities before their closure in 1994. Allegedly, members of the Russian forces in Germany systematically sold cigarettes to black marketeers.<sup>4</sup> The advantage of actually exporting the cigarettes is avoiding the risks of having to bribe customs officials or to use false documents pretending that the goods have actually left the country.

Once the cigarettes are funnelled into the black market, they are supplied to consumers through a longer or shorter chain of distributors, depending on the size of the original shipment. For example, the Polish tourists travelling to West Berlin in 1989 functioned as both smugglers and vendors of the small amounts of cigarettes they brought with them. Later on, a division of labour emerged between smugglers from Eastern Europe and Vietnamese vendors. The longest distribution chain can be observed in the case of container-size contraband shipments. They are divided up and passed down a pyramid of wholesale and intermediate distributors until they reach the broad base of retail dealers.

The retail market in Germany is split into the visible street market and a hidden market. While the street market consists of vendors who offer their merchandise to the general public, the clandestine market largely relies on pre-existing social networks for transactions to take place, for example, at the workplace or among friends and family (Gosztonyi, 1994).

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<sup>3</sup> Restrictive measures include the introduction of a special carnet "TOBACCO-ALCOHOL" within the TIR system in 1993, the complete exclusion of cigarettes from the TIR system in 1994, and the exclusion of cigarettes from the comprehensive guarantee procedure within the Community Transit System in 1996 (see Committee of Inquiry, 1997).

<sup>4</sup> Reinhard, M., Berlin ist der Stützpunkt der Russen-Mafia in Deutschland, in: *Der Tagesspiegel*, 21 January 1993.

## **Historic Trends**

West Germany had known a small-scale clandestine market for contraband cigarettes that were procured from low-tax countries like Luxemburg and from Eastern European valuta stores. But it was only in the course of the political changes taking place in the late 1980s and early 1990s that a black market of any significance came into being. It was during these years that the street sale of untaxed cigarettes first emerged and it seems fair to say that it was only then that a broad demand for untaxed cigarettes developed.

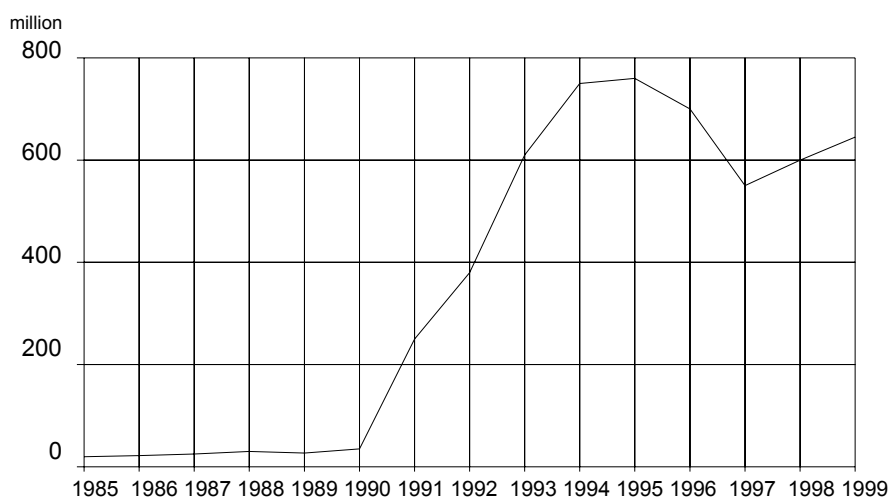
The black market for cigarettes as we know it today originated in the late 1980s, when the Iron Curtain began to corrode and travel from Soviet Bloc countries to the West became more and more common. Travellers could take advantage of the lower prices charged in valuta stores and regular stores for products such as cigarettes, which are easy to carry and could be sold for high profits. These opportunities were first exploited on a large scale by Polish citizens travelling to West-Berlin after the visa-obligation was lifted in January of 1989. Within weeks, thousands of Polish tourists gathered in shopping malls and at improvised market places to offer a whole variety of merchandise, including Polish and Western made cigarettes (Irek, 1998). Soon, especially after the economic and currency union between East and West Germany in June of 1990, four months prior to re-unification, the open sale of untaxed cigarettes spread to other places in the Eastern parts of Germany. Within a year the selling of contraband cigarettes had developed into a well established business.

The statistics on the seizure of contraband cigarettes indicate how quickly the black market expanded during this period, particularly in 1991 and 1992 (Tab. 1). While the number of cigarettes confiscated by the West-German customs service had not exceeded 20 million per year until 1987, it was well over 20 million in 1988 and 1989. For 1990 no accurate figures are available, but apparently some 50 million cigarettes were seized in West and East Germany combined. Then, in 1991, the first year after German unification, a fivefold increase occurred with a total of 260 million contraband cigarettes being confiscated by the customs service, followed by 350 million seized in 1992 and 624 million seized in 1993.<sup>5</sup>

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<sup>5</sup> Figures were obtained from various publications of the Bundesfinanzministerium and the Zollkriminalamt.

Table 1

**Seizures of Contraband Cigarettes in Germany, 1985-1999\****(source: Zollkriminalamt)*

\* 1986-1989: West Germany, 1990: East and West Germany combined (incomplete statistics), 1991-1998: Germany

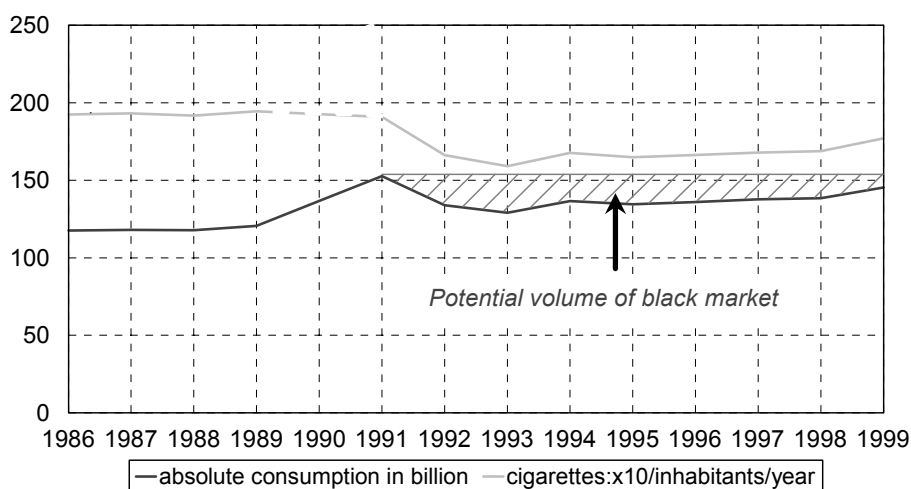
Of course, these figures are no accurate representation of the overall volume of the black market. To a considerable extent they simply reflect different levels of intensity of law enforcement. Still, a trend becomes discernable that also appears in other statistics, such as those on the legal consumption of cigarettes (Tab. 2). These figures not only indicate a shift from the legal to the illegal cigarette market in the early 1990s. They may also provide the basis for a rough estimate of the volume of the illicit cigarette market.

In the 1980s, the per-capita consumption of cigarettes had reached a level of about 1,900 per year in both West and East Germany. Accordingly, when the 16 Million East Germans joined the 61 million inhabitants of the Federal Republic of Germany the number of tax paid cigarettes rose by some 30 billion from 120 billion in 1989 to 152 billion in 1991. However, in 1992, the second year after the unification, the per-capita consumption of taxed cigarettes

dropped sharply to about 1,600 and the overall volume of taxed cigarettes decreased to about 134 billion.<sup>6</sup>

**Table 2**

**Legal Consumption of Cigarettes 1986-1999\* in Germany**  
(source: Statistisches Bundesamt)



\* No numbers available for 1990

This drop in the legal sales of cigarettes coincided with a seven percent increase in the average price of taxed cigarettes due to an increase in the tobacco tax which took effect in March of 1992. Therefore, some of the reduction in tax paid cigarette sales will have to be attributed to normal consumer reactions to price increases, like abstaining and switching to lesser taxed tobacco products (Körner, 1996). Yet, it seems fair to say that the sharp decline in legal sales between 1991 and 1992 reflects to a large part not a shift away from cigarette smoking, but a shift away from the legal cigarette market. This assumption is supported by household surveys conducted by the German Bureau of Statistics, which indicate that the actual consumption of cigarettes decreased only slightly, if at all, in 1992 (Fiebiger, 1992, 1993).

<sup>6</sup> See statistical yearbooks of the GDR and the FRG.



## The Volume of the Illegal Cigarette Market

Assuming that the actual consumption has not significantly dropped below the 1991 level of some 1,900 cigarettes per capita or some 150 billion cigarettes overall, it is possible to give a rough estimate of the volume of illicit consumption by comparing these figures with the respective figures for the following years. Between 1992 and 1998, legal sales fell short of the 1991 level by amounts of between 14 and 22 billion cigarettes annually. Percentage wise this implies that untaxed cigarettes have accounted for between 9 and 15 percent of the overall consumption. However, according to estimates by the German association of cigarette manufacturers, VdC, over half of the untaxed cigarettes smoked in Germany each year stem from across-the-border purchases within or slightly exceeding the permitted limits, while less than half are brought into the country by outright smugglers. Taking these estimates into account, contraband cigarettes sold on the black market would have held a share of only between about 4 and 7 percent of the overall cigarette market in Germany, which would still represent a share of a remarkable size. But the true dimension of the problem does not become apparent unless the unequal geographical expansion of the black market is taken into consideration.

## The geographical concentration in East Germany

One of the most striking characteristics of the illegal cigarette market in Germany is its concentration in the territory of the former GDR. The most obvious aspect in this regard is the fact that the street selling of contraband cigarettes is an almost exclusively East German phenomenon. Another indicator are the statistics on the seizure of contraband cigarettes, which consistently show higher amounts for East Germany than for West Germany, although since 1997 a trend towards greater approximation can be observed. For example, in 1995 the most successful year for the customs service, 583 million cigarettes were seized in East Germany, more than three times the amount of 175 million confiscated in West Germany.<sup>7</sup> This leads to the conclusion that more than just a few percent of the cigarettes consumed in East Germany come from illicit sources.

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<sup>7</sup> The amounts confiscated in East and West Germany from 1991 until 1998 are as follows, 1991: 180/80 million, 1992: 285/62, 1993: 522/102, 1994: 600/125, 1995: 583/175, 1996: 498/176, 1997: 293/247, 1998: 343/252; 1999: 339/314 (source: Zollkriminalamt).

The fact that the illegal cigarette market is unequally distributed across Germany provides a quasi-experimental set-up for exploring the factors most conducive to its emergence and continued existence. Actually, there are a number of aspects that may explain why the black market for cigarettes is more prevalent in the East than in the West.

On the *supply side*, one obvious aspect is the proximity to Poland and other Eastern European countries from where most of the smuggled shipments originate. On the *demand side*, differences in the social and economic conditions between East and West Germany have to be taken into account. The average household income is significantly lower and the unemployment rate significantly higher in East Germany than in West Germany. Therefore, East Germans have stronger incentives to purchase cheap contraband cigarettes. This assumption is supported by surveys that show a clear correlation between income levels and the willingness to procure cigarettes from illicit sources (MSI Market Services, 1997). Another reason could be that West Germans are less willing to engage openly in illegal activities, like the purchase of untaxed cigarettes, whereas East Germans may be more defiant of prohibitive laws. This may either be an after-effect of the shadow economy prevalent under communist rule, or a sign of opposition against a legal system that has been rigorously transferred from West Germany.

Also conducive to the emergence and proliferation of the illegal cigarette market is the relative weakness of the police and customs service in East Germany as a consequence of the general restructuring of government agencies following the collapse of the communist regime and the re-unification of Germany. Even in Berlin, where authorities could rely on the well established public-service apparatus of former West-Berlin, the customs service never had more than about 60 officers at its disposal to combat the trafficking of untaxed cigarettes taking place on a regular basis at up to 1,200 different locations.

Finally, one exceptional quality of the conditions in East Germany is the existence of a marginalised Vietnamese community. Of course, this is not to argue that there is some ethnic trait making Vietnamese particularly suitable to the illicit cigarette market. Nevertheless, the street vending of contraband cigarettes, initially the domain of tourists from Poland and other Eastern European countries, was largely taken over by members of East Germany's Vietnamese community in 1991 and 1992. Since this take-over coincided with the rapid expansion of the black market, it is plausible to assume that there is a causal relation between these two phenomena. Therefore, one of the reasons why a visible black market has not emerged in West Germany, may be because it has no similar Vietnamese community. Though there are also Vietnamese

living in West Germany, they are mostly well-integrated former boat-people with no particular incentives to engage in illegal activities. In contrast, the former migrant workers who make up the Vietnamese community in East Germany suffer from social deprivation and from seclusion from their host society.

## The Vietnamese involvement

The dominant role of the Vietnamese in the contraband cigarette street market is likely to conjure up images of an ethnic mafia taking over an illicit market by force, violence and corruption. Such stereotypical notions are without foundation. There is no indication whatsoever that Vietnamese street sellers used violence in the process of asserting themselves against non-Vietnamese competitors. On the contrary, it is likely that the Vietnamese were welcome to take over the most exposed and riskiest positions in the market hierarchy and that the Eastern European market participants gladly confined themselves to the less conspicuous roles of smuggler and wholesale distributor (see Gosztanyi, 1994; Irek, 1998). Likewise, there is no evidence that Vietnamese obtained a competitive advantage by corrupting officials. Only isolated incidents of rudimentary forms of police corruption have been reported. In one case, frustrated police officers gave up chasing fleeing street peddlers if they dropped their merchandise. The officers then kept the cigarettes for their private use or to sell them on their own account.<sup>8</sup>

A more convincing explanation for the success of Vietnamese street vendors than mafia imagery seems to be that they were simply better prepared for this business than any other social group. The Vietnamese who entered the street market for cigarettes in the early 1990s had come to the GDR from the Northern and central regions of Vietnam as temporary workers some five years before. By the time the communist regime collapsed in 1989, some 60,000 Vietnamese lived in East Germany. They were among the first ones to become unemployed as factories had to rationalise or close down completely, causing many to return to Vietnam. However, about 20,000 stayed behind in search of new sources of income. Since Vietnamese had been wheeling and dealing in textiles and other rare products on the fringe of legality under communist rule, it seems like an obvious choice that many of them began to follow the example of Eastern European tourists selling untaxed cigarettes.

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<sup>8</sup> Polizisten korrupt, Richter schockiert, in: *Der Tagesspiegel*, 14 May 1994.

As it turned out, the Vietnamese street vendors not only had the necessary skills to succeed in the cigarette business. For various reasons, they also proved particularly resistant to law enforcement.

Similar to other marginalised ethnic minorities, the Vietnamese in East Germany have –voluntarily or involuntarily– conserved their culture and language and remained mainly isolated. Consequently, the allegiance to the norms and values of the host country tends to be weaker than the internal solidarity within their own community. These conditions hamper investigations in many ways, as the willingness to co-operate with the authorities is limited and qualified interpreters are required to overcome the language barrier. Another specific problem arises from the absence of standardised rules for the registration of Vietnamese names, which do not follow the pattern of first name and last name. This has reportedly led to instances where peddlers were arrested several times without being identified as one and the same person. Finally, even if criminal charges are pressed, street vendors stand a good chance of receiving a sentence that allows them to return to their business right after each arrest. Though sentencing has reportedly become more severe since the mid 1990s, illegal vendors in Berlin still only face a suspended sentence of three months with probation after the third arrest and a suspended sentence of six months with probation after one prior conviction.

While every vendor –regardless of his or her ethnic background– could benefit from such leniency, Vietnamese have an additional advantage over other foreigners insofar as they run a lower risk of deportation. This is due to the requirement that Vietnam, like apparently no other country in the world, requires an entry-visa, even for its own citizens. Among several criteria, the visa is denied unless the applicant states that he or she wishes to return to Vietnam voluntarily. Few Vietnamese do.

The problem is aggravated by the fact that in the street sale of contraband cigarettes former guest workers, who received the status of legal residents in 1993, have increasingly been replaced by newly arriving illegal immigrants from Vietnam. These illegal immigrants are likely to use false documents and they seem even less inclined to co-operate with the authorities.

In 1995, a treaty between Germany and Vietnam went into effect which aimed at facilitating the extradition of Vietnamese involved in the illegal cigarette business. The Vietnamese government agreed to grant re-entry to 40,000 of its citizens from Germany until the year 2000. During the first three years, however, the execution of the treaty passed off slowly. Instead of 20,000

only about 5,000 Vietnamese returned to Vietnam under the provisions of the treaty.<sup>9</sup>

Even if an illegal cigarette vendor has successfully been extradited, law-enforcement officials claim that this has no lasting effect insofar as he or she is immediately replaced by a new immigrant from Vietnam. Vendors who in recent years have been apprehended for the first time usually had just arrived in Germany a few days earlier. Reportedly, alien smugglers have made a profitable business from recruiting prospective vendors, who are charged several thousand dollars they either have to pay in advance or work off by selling cigarettes.<sup>10</sup>

### The Special Case of West Berlin

The relative immunity from law enforcement displayed by the Vietnamese street peddlers and the list of other conditions favourable to the black market in East Germany explain a great deal. However, they cannot explain why the street selling of cigarettes has not extended into West Berlin. In fact, in West Berlin the same conditions exist, for example, the proximity to Poland and a high rate of unemployment. Still, ever since the authorities in West Berlin successfully curbed the wheeling and dealing by Polish tourists in the early 1990s, the Western part of the city has remained largely unaffected by illegal street traders.

It is interesting to observe that Vietnamese vendors of untaxed cigarettes did briefly appear in various places in West Berlin, but failed to achieve continuity. At the same time in East Berlin they succeeded in establishing the central position in the open cigarette market. This points to conditions unique to East Germany as a society in transition, i.e. conditions which are rooted in the process of transformation from a communist system to a free-market economy and which exist neither in West Berlin, nor in the Western parts of Germany.

In the early 1990s, street sellers of cigarettes, particularly if they were Vietnamese, were perceived as an alien element in West Berlin. Whenever Vietnamese peddlers made inroads into West Berlin they were immediately

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<sup>9</sup> Mai, M., Statt Vietnam Ausreise nach Tschechien, in: *die Tageszeitung*, 22 September 1998.

<sup>10</sup> For a more comprehensive description of Vietnamese street vendors and the associated phenomenon of Vietnamese extortion gangs, see Habenicht (1995), Laudan (1999), Lehmann (1998) and Niggel (1994).

reported to the police or customs service. The agencies were pressed, especially by legal cigarette dealers, to take immediate action. In contrast, despite the fact that illegal cigarette sellers had previously been just as unknown in the East, it was only one of many new worrying phenomena characterising the period of transition. Compared to the rise of widespread unemployment and social deprivation and the occurrence of more serious forms of crime, the emergence of an illicit market for cigarettes appeared as one of the minor problems.

### **Impulses for action**

A certain degree of indifference towards the illegal cigarette market in East Germany has not only been shared by East Germans, but also by the federal government and the Berlin administration, both of which have been dominated by Westerners. The common indifference is reflected in the history of countermeasures adopted to curb the street sale of cigarettes in East Germany.

The first major step was taken by the federal government in late September of 1991 with the creation of a special unit of some 50 customs officers charged with intensifying the control of smuggling routes and trading locations. Until then it had been rather restrained in its comments about the estimated several hundred million Deutsche Marks in lost tax revenues. Reportedly, the special unit was established only after a tobacco company had brought complaints before the minister of Finance, asserting unfair competition against the background of a black market in which none of its products held a significant share.<sup>11</sup>

On the state level, most notably in Berlin, the impulse to take decisive action against the black market was even less directly connected with the harm associated with the trafficking in untaxed cigarettes. Rather, it was an outbreak of violence within the Vietnamese community that led to a concerted effort of customs service and police. Until then—with the exception of West Berlin—the police had only reluctantly become involved in the fight against the illicit cigarette market. It considered violations of tax regulations the exclusive competence of the customs service. This attitude changed with the escalation of violent conflicts between Vietnamese extortion gangs, which had emerged shortly after Vietnamese vendors took over the street sale of contraband cigarettes.

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<sup>11</sup> Sommerfeld, F., Zigarettenhandel - die polnische Mafia sahnt ab, in: Berliner Zeitung, 16 June 1992.

The trafficking in untaxed cigarettes is a profitable business down to the street level. Profit margins for street vendors, according to various sources, range between 2 and 20 Deutsche Marks per carton of 200 cigarettes. One peddler interviewed by a journalist in 1995 reported that at lucrative spots up to 600 cartons could be sold in a single day for a profit of 2 to 4 Marks each, while less attractive locations were allegedly still good for selling 10 to 20, sometimes 100 cartons a day.<sup>12</sup> In some cases this would amount to monthly earnings well above the average legal income in Germany. The profitability of the business combined with its visibility and illegality make street sellers of untaxed cigarettes a likely target of predatory criminals. In fact, early on Vietnamese peddlers have been victimised in two distinct ways. On the one hand, they were harassed and assaulted by right-wing extremist juveniles, on the other hand they increasingly became victims of Vietnamese extortionists, who organised along lines of regional affiliation.

The activities of these extortion gangs are purely predatory in nature. They exact protection payments from vendors without interfering with the sale of cigarettes as such. This finding corresponds with general assumptions about the respective functional autonomy of violence oriented criminal groups and illegal enterprises (Block, 1980; Schelling, 1971; Skaperdas & Syropoulos, 1995). Likewise, it is not surprising that these extortion gangs soon engaged in a bloody conflict over spheres of influence, as continuous extortion, by necessity, requires the establishment of a monopoly of power in a specific territory (Schelling, 1971).

In Berlin, this conflict culminated in a virtual gangland war in late 1995 and early 1996 with shoot-outs taking place on busy streets during business hours, such that passers-by were at risk of being hit by stray bullets. It was only at this point that a massive and concerted attack against the illegal cigarette business was launched. For the first time, police gave full support to the customs service in cracking down on the open market. As a consequence the number of vending locations and dealers and the volume of the street sale dropped significantly. According to one series of surveys, the volume of the open market decreased by about 40 percent between September of 1995 and September of 1996 (MSI Market Services, 1998). The remaining street dealers were forced to change their modus operandi to adjust to increased law-enforcement pressure.

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<sup>12</sup> Smoltczyk, A., Der neue Ho-Chi-Minh-Pfad, in: *Wochenpost*, 6 May 1995.

## **The structure of the cigarette street sale**

The structure of the visible retail market for untaxed cigarettes had long been characterised by individual entrepreneurs who either smuggled the cigarettes into Germany by themselves or bought them from smugglers and illegal distributors. A change occurred only after increased law-enforcement pressure forced vendors into more complex enterprise structures comprising a division of labour. In order to safeguard against raids, look-outs were positioned around vending locations. To minimise losses from confiscations, the contraband cigarettes were kept separate from the vendor. This required stock-keepers for guarding the merchandise and to hand out cigarettes once the vendor had come to an agreement with a buyer. Likewise, to avoid the forfeiture of monies, cash had to be kept separate from the cigarettes which required the position of cashier.

It is not clear how durable the co-operation of a given team of street sellers tends to be and to what extent the positions are part of a hierarchical structure. In any case, the differentiation of roles is a remarkable response to an increasingly hostile environment, making the organisation of the street sale more complex and sophisticated. Usually, the reverse is true for criminal enterprises as fewer participants mean less risk of detection and betrayal (Southerland & Potter, 1993). In the case of street vending operations these considerations probably do not apply for the simple reason that all participants are by nature visible to outsiders.

## **The structure of the clandestine retail market**

Parallel to the structural changes in the street sale of cigarettes, more clandestine forms of distribution have apparently spread in East Germany and also in the Western parts of the country. According to surveys conducted among East German Smokers, purchases in Poland and the Czech Republic as well as at the workplace and in bars and restaurants have become significantly more important since 1995 (MSI Market Services, 1998).

In West Germany, a similar development can be observed. The seizures of contraband cigarettes have increased, especially since 1997, and anecdotal evidence point at the extension of clandestine distribution networks into West Germany, either from East Germany or from countries like Poland and Lithuania.

One reason for the apparent shift towards clandestine forms of distribution is that street vendors have adopted more discrete methods like home deliveries.



Another reason is the fact that the trafficking of untaxed cigarettes has attracted entrepreneurs, who have avoided public exposure from the beginning. Some of these entrepreneurs are members of pre-existing criminal networks, who find the cigarette business a profitable and relatively safe alternative to other illegal activities such as fencing stolen goods. Some distributors of untaxed cigarettes have no prior criminal record. They operate within social networks that are otherwise not entangled in illegal activities.

The structure of the clandestine retail market, by nature, is less transparent than the structure of the visible street market. However, individual entrepreneurs seem to be most common, while there are no reports of more complex enterprises similar to those currently characterising the street sale of contraband cigarettes.

### **The structure of the wholesale distribution**

In contrast to the sales outlets, the upper levels of the business, the smuggling and wholesale distribution of untaxed cigarettes, have not only become much more sophisticated over the years. They also show clear signs of a concentration process. However, at present there is no evidence of the exercise of market power.

Following the initial phase of the open market for untaxed cigarettes in East Germany, a specialisation between smugglers, primarily from Eastern Europe, on the one hand, and vendors, mostly Vietnamese, on the other could be observed. Along with this division of labour the smuggling of cigarettes took on new proportions. While individuals have continued to bring small amounts of cigarettes across the border, reports on the confiscation of contraband cigarettes indicate that soon the major supply for the German consumer market came from bulk shipments. These range from the size of a full car trunk, about 50,000 cigarettes, to containers with several millions of cigarettes, being brought into the country in all imaginable forms of disguise.

Parallel to the extended use of traditional smuggling methods more elaborate schemes to put large quantities of untaxed cigarettes on the black market evolved. Dummy corporations were set up to purchase legally tax-free cigarettes per truck loads from companies in Germany and other Western countries, including the U.S., supposedly to be exported to Eastern Europe. Before the cargo reached the border, however, it was unloaded and sold to illegal wholesale dealers. The trucks were then either supplied with false documents or customs officials were bribed to issue genuine documents in order to maintain the impression that the cigarettes had actually been exported. In one of the few

discovered cases, Polish smugglers reportedly had paid two German customs officers 10,000 Deutsche Marks each per truck for confirming the proper crossing of the border.<sup>13</sup> In recent years wholesale operators seem to have turned to exporting bulk shipments of legally purchased cigarettes to Eastern Europe, most notably Poland and Lithuania, only to smuggle them back into Germany later with false customs declarations. The chance of discovery is rather small in view of the enormous volume of cross-border traffic and the limited capacity of the customs service to conduct thorough searches.

The legal procurement of large quantities of untaxed cigarettes is apparently linked to a concentration process on the upper levels of the black market. While it is the cheapest and potentially most profitable way to obtain untaxed cigarettes, it is open only to a few more or less sophisticated and well funded operators. A carton of 200 cigarettes designated for export to a non-EU country costs between 6 and 9 Deutsche Marks and can be resold to illegal wholesale dealers for between 12 and 25 Deutsche Marks. A truck load of cigarettes, including the service of drivers, carriers, forgers and various small time accomplices, according to one estimate, costs about 500,000 DM and produces net profits of close to 1.5 million Deutsche Marks.<sup>14</sup>

In Berlin, during the mid 1990s the wholesale market was reportedly divided between three so-called cigarette syndicates. From the information provided to journalists by a high level insider<sup>15</sup> one can surmise that this oligopoly had come into being only because of the economies of scale involved and not through deliberate efforts to restrict access to the market. No indications exist of any violent competition or, reversely, of any cartel agreements. From the data collected for this paper, only one reported incident of violence could be interpreted as related to a dispute directly connected with the black market for cigarettes. In 1996, a group of five Poles assaulted four Vietnamese in an apartment in the East German town of Guben and took away money and passports. In the press this event was ascribed to 'gang wars over illegal trade deals at the German-Polish border'.<sup>16</sup>

In the last years, the concentration process seems to have trickled down to the level of Vietnamese wholesale dealers. In an interview given to a TV-reporter in 1999, a Vietnamese informant claimed that in Berlin there are three

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<sup>13</sup> Plarre, P., Lukratives Geschäft mit illegalen Fluppen, in: *die Tageszeitung*, 23 February 1993. On corruption in the German customs service, see also Bruhn (2000).

<sup>14</sup> Wittmann, K., Perfekt, blitzschnell und dreist, in: *Die Zeit*, 3 May 1996.

<sup>15</sup> Nie Fragen gestellt, in: *Der Spiegel* 27/1997, p. 25-26.

<sup>16</sup> Von Polen überfallen, in: *die tageszeitung*, 23 July 1996.

groups of former street vendors, who are capable of purchasing bulk loads from smugglers to the amount of several hundred thousand contraband cigarettes. They in turn supply groups of intermediate dealers with up to 100,000 cigarettes at a time who then sell smaller amounts to street vendors.<sup>17</sup>

The fact that the concentration process has extended from the top level can be interpreted as a natural development. It seems unlikely that truckloads of untaxed cigarettes would be sold directly to great numbers of vendors. For practical reasons and to reduce the risk of detection, top level operators will be inclined to deal with as few customers as possible.

## Conclusion

Despite the incompleteness of the available data and the sketchiness of the above description, some cautious remarks can be made concerning the nature of the illegal cigarette market in Germany.

The first observation that has to be made is that the trafficking in untaxed cigarettes is a classic example of the provision of an illegal good to a demanding public. The criminal activities involved are characterised by the absence of direct victims, by continuity, and, with regard to the street sale, by a high visibility to outsiders. In contrast to other illegal markets, however, which come into being by means of morally induced prohibitions of goods and services, the illegal market for cigarettes deals with a substantially legal commodity and promotes an activity –the smoking of cigarettes– which is neither illegal nor even deviant.

A combination of social, economic, political, legal and cultural factors has contributed to the emergence and continued existence of a large scale black market in Germany, which is centred around the street sale of untaxed cigarettes in East Germany.

In each phase of the historical process, market participants have taken advantage of pre-existing circumstances and have adopted to changes, rather than having attempted to alter the conditions. The assumption that the provision of illegal goods and services on a continuous basis requires systematic corruption is not supported. Likewise, the black market for cigarettes does not fit the stereotype of violent competition and a tendency towards monopolisation. While the upper and intermediate levels are characterised by an oligopolistic market structure, this concentration merely reflects economies of scale in the bulk procurement of untaxed cigarettes. There are

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<sup>17</sup> Althammer, R., Ein mörderisches Geschäft, B1, 15 October 1999, 20.15-20.45 h.

no indications that entrepreneurs strive for a monopoly to secure monopoly profits, neither by use of force, nor by any other means. This calls into question the widespread notion that the maximisation of profits through attempts at cartelisation or monopolisation is a defining characteristic of organised crime.

Finally, there is no evidence of the emergence of an illegal power structure overarching the illicit cigarette business. Such a monopoly of power could either evolve in response to a demand for non-violent dispute settlement mechanisms (Reuter, 1984), or in an effort to internalise the external costs of the use of violence (Hellman, 1980; Luksetich & White, 1982). As indicated, both factors do not seem to be relevant for the illegal cigarette market.

The extortion of street vendors is a different issue. Rivalling extortion gangs have used violence to exact 'protection' payments and to enlarge their respective areas of influence by eliminating competitors. But they have refrained from any direct involvement in the day-to-day routines of the cigarette business.

In the light of a continuously high level of law-enforcement pressure and the progressing consolidation of government structures in East Germany, it is unlikely that the visible black market will regain the proportions it had reached in the early to mid 1990s. At the same time, the clandestine distribution of cigarettes may well continue to expand in East and West Germany as long as tobacco taxes remain high and no efficient means are found to prevent legally manufactured cigarettes from entering the black market.

More research is needed to explore the basic conditions and inner workings of the illegal cigarette market. Some of the aspects that require further investigation are, for example, the role of the legal tobacco industry, the relation between the legal and illegal cigarette market with regard to pricing and brand popularity and the involvement of legal businesses in the illegal distribution of cigarettes. In addition, insight must be obtained into the structure of illegal businesses involved in the black market, the norms and values regulating transactions between market participants, the overlap with other areas of crime, and the position of Germany within the broader context of cigarette smuggling in Europe and around the world.

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