

# The cigarette black market in Germany and in the United Kingdom

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## Abstract

<i>Purpose of this paper</i>	The research aims at providing a comprehensive assessment of the cigarette black market in Germany and the United Kingdom within the framework of the study of organized crime.
<i>Design/methodology/approach</i>	The particular approach upon which this paper is based is a systematic, cross-national review of open sources, including media reports and government documents. The information gleaned from these sources is transferred into a classificatory scheme derived from the analysis of organized crime.
<i>Findings</i>	While similarities exist regarding the inner workings of the cigarette black market, interesting variations between the two countries emerge, including an asynchronicity of the developmental process and differences in modus operandi. In addition to cross-national differences, striking regional variations in the prevalence and character of black market activity exist within each country. This leads to the conclusion that a multitude of factors have to be considered to account for the overall dynamics and specific manifestations of the cigarette black market.
<i>Research limitations/implications</i>	In future research the database needs to be broadened beyond open sources.
<i>Practical implications</i>	Policy decisions with the aim to curb the cigarette black market have to take the apparent complexity of causal and intervening factors into account. The level of taxation is just one of several factors.
<i>What is original/value of paper</i>	No comparative analysis of the cigarette black markets in Germany and the United Kingdom has previously been available.
<i>Keywords:</i>	cigarette smuggling, organized crime, Germany, United Kingdom

# The Cigarette Black Market in Germany and in the United Kingdom

Klaus von Lampe

## **INTRODUCTION**

The smuggling and illegal distribution of cigarettes is a global phenomenon that has varied greatly in shape and volume across time and space.<sup>1</sup> In the European Union it has a long tradition in some Member States while being a more recent problem in others. Italy and Spain have been associated with a large scale cigarette black market for several decades. Since the 1990s, Germany and the United Kingdom appear to have emerged as the major retail markets for contraband cigarettes within the EU.<sup>2</sup>

The existence of the illicit trade in high-excise goods in general and cigarettes in particular is commonly explained by the high tax burden relative to the underlying value of the goods. On the black market, cigarettes from tax-free or low-tax sources are supplied at a price below legal retail prices, providing significant savings on the consumer side and lucrative profits for suppliers. Correspondingly, the illicit cigarette trade has received increasing political attention in the light of substantial losses of revenue and growing concerns that the cigarette black market is linked to “organized crime”.<sup>3</sup>

The purpose of this paper is to assess the situation in Germany and the United Kingdom in systematic and in comparative terms, drawing on a review of open sources. The focus will be on the volume and structure of the black market.

## **OVERVIEW**

The cigarette black market can be roughly divided into two levels: procurement and distribution. Cigarettes have to be procured avoiding taxation before they are marketed for consumption.

Currently, there appear to be three main schemes by which cigarettes are supplied to the black market: bootlegging, large-scale smuggling and counterfeiting.

Bootlegging involves the purchase of cigarettes in low-tax jurisdictions for resale in high-tax jurisdictions.<sup>4</sup>

Large-scale smuggling takes advantage of the ‘in transit’ system which allows cigarettes to be sold and shipped for export to non-EU countries with taxes suspended.<sup>5</sup> These untaxed cigarettes either never leave the EU or, far more commonly in recent years, are properly exported, but only to be illegally re-imported.

Counterfeiting involves the production of fake brand cigarettes, including packaging and sometimes also fiscal marks, by unauthorized manufacturers.<sup>6</sup>

Once contraband cigarettes have reached destination countries like Germany and the United Kingdom, they are either sold openly or through clandestine distribution networks.

## **MARKET VOLUME ESTIMATES**

### **The scope of the black market in the UK**

For obvious reasons it is difficult to determine the overall scope of the cigarette black market. However, some attempts have been made of which the approach taken by customs in the United Kingdom appears to be the most ambitious one. HM Customs and Excise estimate the scale of excise duty fraud for cigarettes using a combination of consumer survey data, statistics on legal sales of cigarettes, and surveys on cross-border shopping and smuggling.

According to these estimates the illicit share of the overall cigarette market in the UK has varied between 21 % in 2000-2001 and 15 % in 2003-2004. The estimates for the share of legal cross-border shopping range from 6 % in 2000-2001 to 9 % in 2003-2004, resulting in estimates of the non-UK duty paid sector of between 24 and 28 %.<sup>7</sup>

The tobacco manufacturers have tried to assess the penetration of non-UK duty paid cigarettes using regular cigarette pack collections and face-to-face consumer interviews. According to the Tobacco Manufacturer's Association, these surveys permit an assessment of the non-UK duty paid share of the overall cigarette market and the ratio between genuine and counterfeit cigarettes, but provide no basis for determining whether or not genuine non-UK duty paid cigarettes stem from legal cross-border shopping or from bootlegging. For 2003, the tobacco manufacturers estimated that 28 % of the cigarettes consumed in the UK were non-UK duty paid.<sup>8</sup>

Within the estimated illicit market share of 15 percent in 2003-2004, HM Customs and Excise assume that large-scale smuggling dominates. This assumption is based on seizure data, according to which large-scale smuggling accounts for the vast majority (between 70 and 80 %) of seizures.<sup>9</sup> The tobacco manufacturers argue that customs underestimate the scale of cross-channel smuggling and shopping because of a focus on extra-EU container traffic, and that, drawing on pack surveys, around 60 % of non-UK duty paid cigarettes come from markets inside the EU.<sup>10</sup>

Customs estimates are also higher than those of the tobacco manufacturers in the case of counterfeit cigarettes. In 2004 it was tentatively assumed by customs that around a quarter of the smuggled cigarette market is counterfeit, which would translate to about 3-4 % of the overall cigarette market. In contrast, the pack surveys conducted by the Tobacco Manufacturer's Association found 2.3 % of all reviewed packs to be counterfeit.<sup>11</sup>

### **The scope of the black market in Germany**

In Germany, no similarly sophisticated methodologies have been employed to estimate the size of the cigarette black market. German customs have placed the main emphasis on the amounts of seized contraband cigarettes, but more to measure trends over time than to determine the volume of the illicit market in absolute terms. Market volume estimates are only sporadically made public, according to which in 2004 one out of six cigarettes smoked in Germany has been smuggled.<sup>12</sup>

In the same year, 2004, the Association of the Cigarette Industry (VdC) has begun to commission pack surveys. Like the surveys conducted in the UK, these provide no breakdown between illicit sales and legal cross-border shopping. The findings suggest that 9.5 % of the cigarettes consumed in Germany are non-duty-paid.<sup>13</sup>

### **BOOTLEGGING**

The three main channels for contraband cigarettes, bootlegging, large-scale smuggling and counterfeiting, follow essentially the same logic in Germany and the United Kingdom. There are, however, some country-specific differences, especially as they pertain to bootlegging.

### **The legal framework**

In Germany, small-scale smuggling has been a problem along the Polish and Czech borders every since the fall of the Iron Curtain, while in the United Kingdom, cross-channel smuggling and - to a lesser degree - smuggling by air passengers have received increasing attention since the mid 1990s. It is important to note that the legal framework in both cases is markedly different. Whereas strict customs and tax allowances apply for travellers at the

German-Polish and German-Czech borders, cross-channel travellers may bring any amount of cigarettes to the UK as long as these cigarettes are for their own personal use.

This difference continues to exist even after the EU enlargement in May 2004, because as a transitional measure under Art 24 of the Act of Accession, the previous quantitative limits of 200 cigarettes remain in effect for travellers from Poland and the Czech Republic until at the latest the end of 2008 and 2007, respectively.<sup>14</sup>

In contrast, cross-channel travellers and air passengers coming to the United Kingdom from other old Member States have been able to profit, since its introduction on 1 January 1993, from the Single European Market. Under Article 8 of directive 92/12/EEC, products purchased and transported within the EU by private individuals for their own use are subject to excise duty only in the Member State in which they are acquired. Whether or not cigarettes are transported for private use is determined by a set of criteria, including the quantities involved. In this respect, Member States may lay down guide levels, solely as a form of evidence that may not be lower than 800 cigarettes (Article 9 of directive 92/12/EEC). In the United Kingdom this level has been raised to 3,200 cigarettes in October 2002. Thus, there is a difference of 3,000 sticks or 15 cartons in the amounts of cigarettes that may be legally brought into the country between the situation at the British Channel and along Germany's eastern border.<sup>15</sup>

### **The bootlegging situation in Germany**

As far as can be seen there are no systematic analyses available on the modus operandi and structure of bootlegging. In Germany, a sketchy picture does emerge from a review of customs service press releases and media reports. These indicate a broad spectrum of traditional smuggling schemes, ranging from contraband cigarettes being hidden in hand luggage or clothes of travellers, to the use of secret compartments in cars, vans, busses and trucks, to the transport of contraband cigarettes across water borders on boats.<sup>16</sup>

While these methods have consistently been used in bootlegging, German customs believe that in recent years they have also been adopted by large-scale smugglers who had previously transported contraband cigarettes in bulk shipments concealed in container trucks.<sup>17</sup>

### **The bootlegging situation in the UK**

In the United Kingdom, bootlegging has most closely been linked to the so called "white van trade". This term refers to the smuggling of duty paid goods in light vehicles through the channel ferry ports and the channel tunnel by small-scale operators who exploit cross-channel tax differentials, especially with regard to Belgium and Luxembourg. The goods are bought ostensibly for personal use and are sold on in the UK without payment of UK duty.<sup>18</sup> Customs believe that since 2000 a zero-tolerance approach combined with higher fare prices has led to a sharp decline in the "white van trade", arguing that the likelihood of vans being stopped, seized, and destroyed, and rising costs have made bootlegging in vans uneconomical.<sup>19</sup>

Another manifestation of bootlegging involves EU duty-paid cigarettes which, according to HM Customs and Excise, are brought into the UK by large gangs of air passengers working as "runners" for organised groups. Fairly large amounts can be smuggled in this way. In one operation on Christmas Day of 2004, customs officers were deployed to a provincial airport and seized over two million cigarettes from 21 passengers coming back on a low cost flight, which amounts to about 100,000 cigarettes for each passenger.<sup>20</sup> Customs assume that smuggling gangs may have moved into air smuggling that previously have been involved in cross-channel smuggling.<sup>21</sup>

## **LARGE-SCALE SMUGGLING**

In contrast to bootlegging, large-scale smuggling typically involves more countries than simply a source country and a destination country. Moreover, Germany and the United

Kingdom are apparently linked to the same smuggling channels, with Germany being at the same time a destination country and a transshipment centre for contraband cigarettes going to the United Kingdom. About 50 % of the cigarettes seized in Germany during the last few years had been destined for marketing in the UK.<sup>22</sup>

Large-scale smuggling takes advantage of the 'in transit' system which allows cigarettes destined for export to non-EU countries to be purchased and shipped duty unpaid. According to a Council of the European Union report,<sup>23</sup> intermediary companies residing in non-EU countries buy cigarettes and give instructions to ship them to customs warehouses in, for instance, Antwerp and Rotterdam or to customs free zones in Switzerland. From there the cigarettes are on paper transferred to other companies and shipped by selected haulers to warehouses in countries outside the EU from where they are smuggled back into the EU. Several trade routes have been identified of which those involving the Baltic States and other Eastern European countries seem to have been the most important ones for Germany and the United Kingdom.<sup>24</sup>

The actual smuggling takes place in principally two forms: the shipments either pass through customs inspections, or customs inspections are evaded. In the first case, the shipments are accompanied by customs forms which are either forgeries or false declarations. In the latter case, which appears to be far more characteristic of the situation in Italy and Spain than for Germany or the United Kingdom, the cigarettes enter the EU outside regular channels, typically by sea.<sup>25</sup>

Large-scale smuggling in Germany and the United Kingdom is characterized by concealed shipments of between one and eight million cigarettes which are hidden inside or behind legal freight, including furniture, food, and timber.<sup>26</sup> The concealment can take on quite sophisticated forms. In one case, discovered at Manchester Airport in 2003, cigarettes were being smuggled inside cans labelled as peas or beans. The tins contained two packets of cigarettes and a quantity of sand to make up the proper weight.<sup>27</sup>

Large-scale smuggling may involve storage and reloading within the EU. In several cases, contraband cigarettes have been seized, for example, in warehouses in Germany and the Benelux countries where they awaited shipment to the United Kingdom or distribution to domestic illegal whole-sale dealers.<sup>28</sup>

## **COUNTERFEITING**

Counterfeiting involves the production of fake brand cigarettes, typically also including packaging and fiscal marks, by unauthorized manufacturers. The production of counterfeit cigarettes varies in the level of sophistication. According to an HM Treasury report,<sup>29</sup> factories for counterfeit cigarettes could be anything from underground boltholes where the cigarettes are packed by hand to more sophisticated production lines with large-scale facilities.

Production also varies in the quality of the raw products and of the packaging. The packaging generally seems to be of high quality. Customs and tobacco manufacturers alike have stressed that in recent years the packaging has been produced in a way that it is difficult to distinguish counterfeit from genuine cigarette packs.<sup>30</sup> In one case, counterfeiters even used genuine packs that were obtained from the supplier of the legal tobacco manufacturer whose cigarettes were copied.<sup>31</sup>

In contrast, the tobacco used in the production of counterfeit cigarettes is regarded to be of questionable quality. Not only are counterfeit cigarettes said to contain on average higher concentrations of poisonous and carcinogenic substances like lead and cadmium.<sup>32</sup> The tobacco at times may also be contaminated with sand and other packing material such as bits of plastic.<sup>33</sup> Still, by and large, counterfeit production requires the same raw materials as those used in the legal production of cigarettes, including tobacco, paper and filter tow for the cigarettes, and paper or cardboard and foil for the packaging.<sup>34</sup>

Depending on the location of the counterfeit production, either the raw tobacco or the manufactured cigarettes have to be smuggled into the EU. Most counterfeit cigarettes are believed to be produced in China, other countries in Southeast Asia, and countries in Eastern Europe, but production facilities have also been discovered in final destination countries, including Germany and the United Kingdom.<sup>35</sup>

## **RETAIL**

Similar to bootlegging, the retail sale of contraband cigarettes is embedded in a complex framework of social, economic, and legal conditions that are far from being uniform across Europe.

### **The retail sale of contraband cigarettes in Germany**

The retail distribution of contraband cigarettes in Germany is commonly associated with the street selling by Vietnamese vendors in the eastern parts of the country. Vendors operate at fixed locations, typically outside a supermarket or a train or metro station. The transactions either take place on the spot, or orders are taken for home deliveries. Another form of open selling of contraband cigarettes, which has also been observed in West Germany, is the sale on flea markets. Some legal outlets allegedly sell contraband cigarettes too. Finally, informal distribution channels exist embedded in social network ties between friends, relatives, work mates and members in athletic clubs.<sup>36</sup>

### **The retail sale of contraband cigarettes in the UK**

The retail market in the UK appears to be somewhat different from Germany as street selling never seems to have been a widespread phenomenon. Street selling similar to the situation in East Germany is apparently confined to a few places, namely Holloway Road in London.<sup>37</sup> In contrast, other forms of open selling appear to be more widespread in the UK than in Germany, such as car boot sales and flea markets. Pubs and private homes are also said to serve as important outlets for contraband cigarettes.<sup>38</sup> Overall, diverse patterns have emerged that, according to HM Customs and Excise, range “from the pub hawker selling from plastic bags, to more elaborate house or warehouse-based set-ups”.<sup>39</sup> In contrast, it is believed that contraband cigarettes have largely been kept out of legal retail channels since the introduction of fiscal marks on cigarette and hand rolling tobacco packets in July 2001.<sup>40</sup> Social networks are also important distribution channels in the UK. HM Customs and Excise research found that about one third of contraband cigarettes are bought from friends.<sup>41</sup>

### **Regional Differences in the Black Markets in Germany**

Interestingly, there is evidence that the retail markets in Germany and in the United Kingdom, respectively, are not evenly distributed across the country.<sup>42</sup>

For Germany it has already been noted that the phenomenon of widespread street selling has been confined to the territory of the former German Democratic Republic with East Berlin constituting the largest local black market.<sup>43</sup> In the western parts of Germany, the problem is believed to be most prominent in the Ruhr region.<sup>44</sup>

Pack surveys conducted in 2004 confirm these regional concentrations with regard to non-German duty paid cigarettes, however, the differences within West Germany are not as significant as those between East and West Germany, and between the border regions along the Polish and Czech borders and the rest of the country.<sup>45</sup>

### **Regional Differences in the Black Markets in the UK**

In the United Kingdom, shortly after the introduction of the single market, surveys of tobacco retailers found that losses in legal sales increased with the proximity to the channel. But they

also found that awareness of smuggled products was highest in two northern cities, Newcastle and Liverpool, which was interpreted as a possible indication of organized bootlegging.<sup>46</sup> More recently, pack surveys conducted in 2003 and 2004 consistently found higher shares of non-UK duty paid cigarettes in the northern parts of England and in Wales compared to the South East and South West. These same surveys also identify the North of England as the black market hotspot.<sup>47</sup> On the other hand, London and the West of Scotland, which have been named as national hotspots by some observers,<sup>48</sup> do not rank prominently in these surveys.

Interestingly, differences do not only show on the national level but also on the local level. In a 2001 survey among smokers in London on the availability of smuggled cigarettes a large variation was found between the boroughs.<sup>49</sup>

### **Internet sales**

The internet has been used for retail selling since the 1990s. This involves the sale of duty-paid cigarettes from low-tax countries and the sale of contraband and counterfeit cigarettes. Offers are made on special sites or in online auctions.<sup>50</sup>

Internet sales that circumvent taxes in the consumer country are illegal even within the EU. Art. 8 of directive 92/12/EEC<sup>51</sup> provides that products purchased within the EU by private individuals for their own use are exclusively subject to excise duty in the Member State in which they are acquired, but only if the purchaser transports the products him- or herself. This is not the case when cigarettes are ordered over the internet and shipped to the consumer by the online seller.<sup>52</sup> Customs have been successful in intercepting fairly large amounts of cigarettes sent by mail. HM Customs and Excise have published a figure of 13 million cigarettes for the year 2002-2003.<sup>53</sup>

## **PERSONS AND GROUPS INVOLVED IN THE CIGARETTE BLACK MARKET**

### **Personal characteristics**

Little systematic information is available on the individuals engaged in the various black market activities. In the United Kingdom, the focus is on the consumer population rather than on the suppliers of contraband cigarettes. Not too surprisingly, demand for contraband cigarettes is seen to come primarily from the lower social strata, given higher smoking prevalence and a presumably stronger economic motivation to buy cheap cigarettes.<sup>54</sup> Very much in contrast to Germany, there is no connection made between the illegal cigarette market and certain ethnic groups.

In Germany, black market participants have primarily been characterized in terms of ethnicity. In media reports and official statements the nationality of offenders is regularly emphasized, and in general descriptions it is a recurrent theme to stress that the supply of contraband cigarettes is largely in the hands of Eastern Europeans, mostly from Poland, and that the open retail market in East Germany is dominated by Vietnamese.<sup>55</sup>

### **Offender groups**

Official and media accounts are ripe with rhetoric that denotes the organizational structure of the cigarette black market using terms familiar from other discussions of organized crime. In the broadest sense, the cigarette black market is said to be in the hands of or “undertaken by organised crime” and controlled by what is variously termed the “cigarette mafia” or the “nicotine mafia”.<sup>56</sup> Particular collectivities of offenders are typically classified as “groups”, “gangs”, “syndicates” or “networks” without any clarification about the intended meaning of these terms. For example, law enforcement in the United Kingdom give the number of

“gangs” that have been disrupted in a given period of time, 259 in four years as of 2004, without any further details on their nature.<sup>57</sup>

At times, a spectrum of organizational structuring is implied in statements about “large scale organised smuggling gangs” who are said to supply most of the illicit market, and “lower-level smuggling gangs” believed to be engaged in bootlegging,<sup>58</sup> or in statements about smuggling groups resembling “tightly controlled ‘mafia’-style organisations, in which there are clear chains of command and communication” and “loose networks of criminals”.<sup>59</sup> Notorious criminal organizations are also frequently mentioned in the context of the cigarette black market, including the Italian Mafia and Camorra and paramilitary groups, namely republican and loyalist groups in Northern Ireland. However, it is not always clear to what extent members of these groups or groups as a whole are engaged in cigarette smuggling or simply impose underworld taxes on otherwise independent illegal entrepreneurs.<sup>60</sup>

There are no scientific studies that would shed light on the current organizational structure of the cigarette black market in Germany and United Kingdom. One study examining groups disrupted in Berlin in the early 1990s found that the black market seemed to have been characterized by low-density networks comprising small, simply structured enterprises and individual entrepreneurs who perform relatively simple tasks. More cohesive groups, to the extent they became visible, generally displayed little vertical or horizontal differentiation.<sup>61</sup> It is a matter of further research to determine whether organizational structures have remained fluid or consolidated over time.

## **CAUSAL AND FACILITATING FACTORS**

The activities, actors and structures making up the cigarette black market can be located in a specific context of conducive and facilitating factors.

### **Tax levels and price discrepancies**

The factor most often cited as key to understanding the phenomenon of the cigarette black market is the level of taxation and the resulting price discrepancies between duty paid and duty non-paid cigarettes on one hand, and between high tax and low tax countries on the other. High price differentials between duty paid and duty non-paid prices are believed to provide an incentive for large-scale smuggling, involving cigarettes officially destined for markets outside the EU, and for counterfeit cigarettes. Price differentials between high-tax and low-tax countries are viewed as the root cause of bootlegging.<sup>62</sup> However, the assumed causal links are not necessarily taking effect as certain low-tax countries have experienced high levels of smuggling while certain high-tax countries have not been confronted with similar problems.<sup>63</sup> Likewise, cross-national price differentials cannot explain the unequal geographical distribution of black market activity that can be observed in both Germany and the United Kingdom. Moreover, price discrepancies are not only created by tax differences but also by different net-prices, as becomes evident when comparing cross-national tax levels and price levels (figures 1a and 1b).

Figure 1a: Cross-National Differences in Excise Levels within the EU

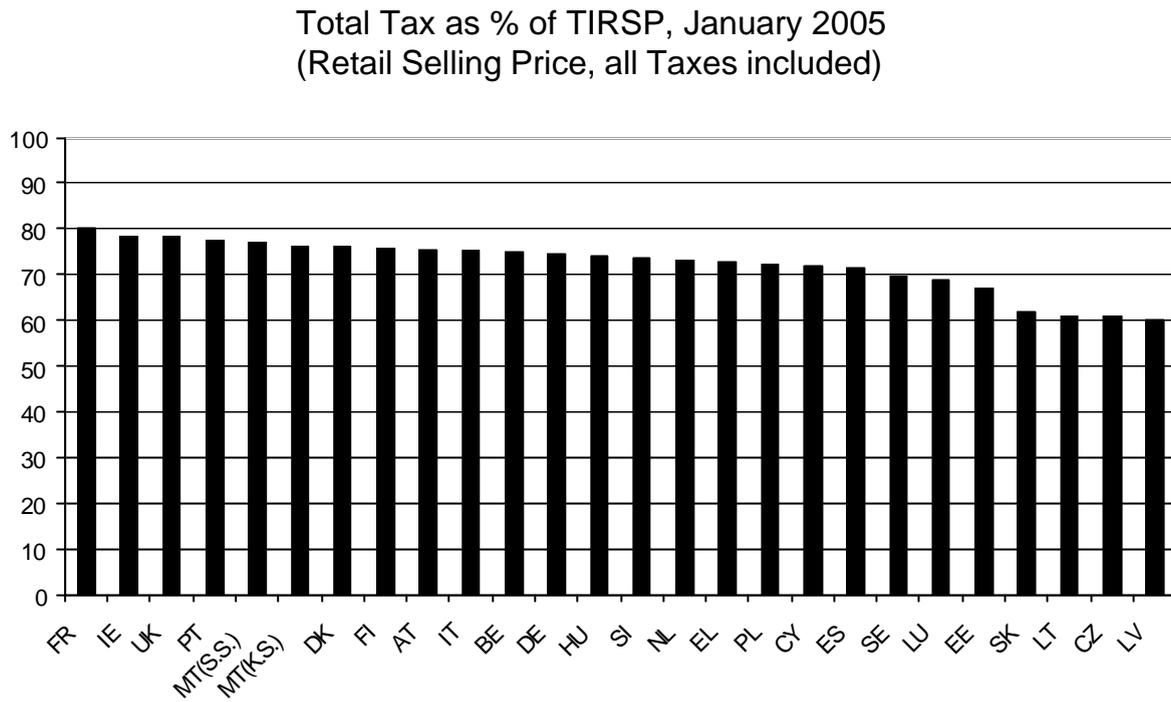
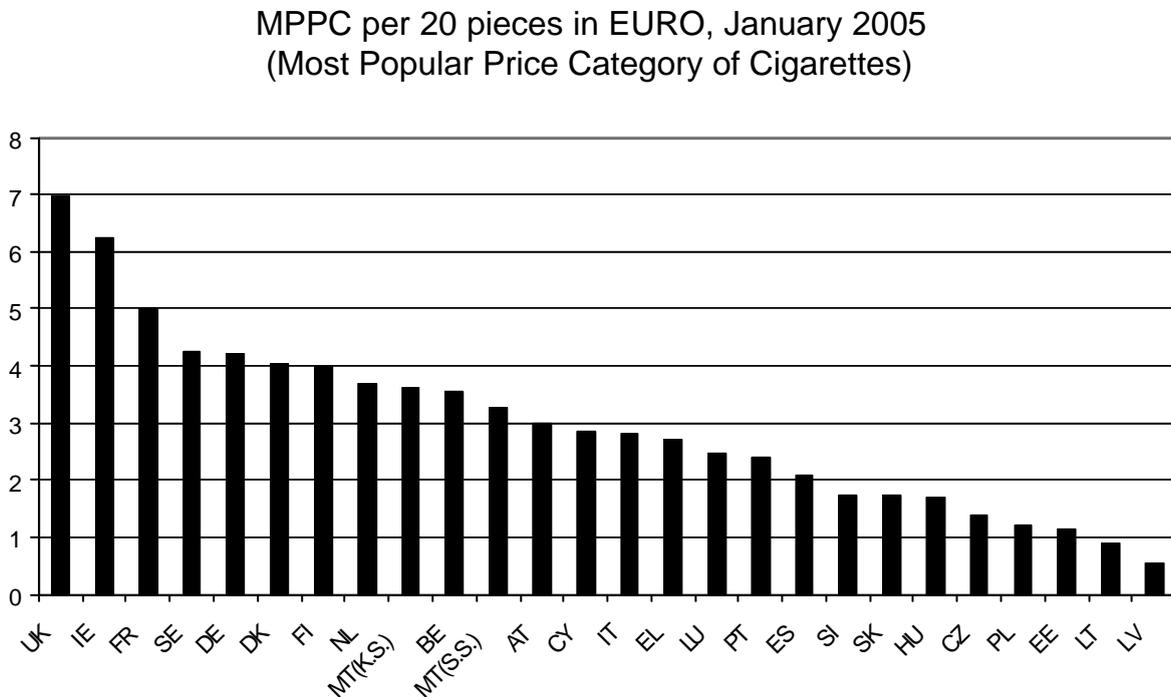


Figure 1b: Cross-National Differences in Legal Retail Prices within the EU



Source: European Commission (2005) *Excise Duty Tables, Part III - Manufactured Tobacco*, European Commission, Brussels.

### **Social Deprivation and Legitimacy Deficits**

Apart from cigarette price discrepancies, social deprivation is believed to contribute to the emergence and growth of the cigarette black market by providing an added incentive for consumers to purchase contraband cigarettes.<sup>64</sup> Legitimacy deficits of the political system in general and the tax system in particular have also been considered conducive factors.<sup>65</sup> A study of smokers in deprived areas of Edinburgh, for example, found that most respondents felt that tax on cigarettes is excessive, especially compared with the price of cigarettes abroad, and that smuggling was a legitimate response.<sup>66</sup>

### **THE ROLE OF THE TOBACCO INDUSTRY**

Next to price differentials, the aspect most often cited in efforts to explain the cigarette black market is the alleged role of the tobacco industry. It has been argued by some that a cigarette black market of any significance is immanently linked to large-scale smuggling and that large-scale smuggling would not be possible without at least the tacit connivance of cigarette manufacturers.<sup>67</sup>

### **Evidence linking tobacco manufacturers to smuggling**

While collusion between cigarette manufacturers and smugglers have been established - based on guilty pleas and internal tobacco industry documents - in other regions of the world, namely in North and South America, there seems to be no similarly strong evidence of any such link in Germany or the United Kingdom.<sup>68</sup>

The EU had filed a law suit against major cigarette manufacturers before a US court, arguing that they “have controlled, directed, encouraged, supported, and facilitated the activities of smugglers”, but this case pertained to the black markets in Spain and Italy, and, above all, has been dismissed on procedural grounds.<sup>69</sup> One of the defendants, Philip Morris, later - in 2004 - agreed to pay \$ 1.25bn to the EU to avoid further law suits.<sup>70</sup>

The only case, as far as can be seen, where criminal investigations have been launched anywhere in the EU against the management of a tobacco manufacturer on the grounds that they conspired with smugglers, the Reemtsma case in Germany, ended with the charges being dropped against three former managers after they agreed to pay 1.5 million Euro in fines.<sup>71</sup>

The absence of court approved evidence notwithstanding, a number of issues have been raised in support of allegations that cigarette manufacturers bear some responsibility for the black market in Germany and the United Kingdom. These issues include

- the predominance of certain brands on the black market;
- the supply of large quantities of cigarettes to certain smaller countries in excess of the domestic demand;
- a perceived reluctance on the part of the tobacco industry to cooperate with authorities; and
- the presumed objective interest cigarette manufacturers have that their products are sold on the black market.

### **The Example of Imperial Tobacco**

An illustration of these allegations is provided by the example of the British tobacco manufacturer Imperial Tobacco.

According to HM Customs and Excise estimates, in 2001 the Imperial Tobacco brands “Superkings” and “Regal” accounted for 5.3 and 3.9 % of the legal UK cigarette market, but held shares of 30.1 and 20.1 %, respectively, of the illegal UK cigarette market.<sup>72</sup> Similarly, the two brands were the ones most often seized in the UK (24 and 25 % of cigarette seizures) and among the most often confiscated in Europe.<sup>73</sup> At the same time, Imperial Tobacco had exported large quantities of “Superkings” and “Regal” to small countries with no apparent domestic market of matching size and demand. Two thirds of the exports of “Regal” and

“Superkings”, totalling some three billion cigarettes, were allegedly sent to just five locations, namely Latvia, Kaliningrad, Afghanistan, Moldova and Andorra.<sup>74</sup> HM Customs and Excise believed that 65 % of Imperial exports were smuggled back into the country, compared with a rate for all cigarettes of only 16 %.<sup>75</sup>

Critics of the tobacco industry have charged that these figures are best explained by complicity between Imperial Tobacco and smugglers, implying that cigarettes had consciously been supplied to the black market in the UK in a similar fashion as alleged of other tobacco companies with regard to other regional black markets.<sup>76</sup> For example, in its complaint against US tobacco manufacturers, the EU alleges that cigarettes were supplied to smugglers, or distributors who sold to smugglers, using various means to conceal these relationships and to help facilitate the smuggling activities, including knowingly affixing improper tax stamps to their cigarettes or wilfully turning a blind eye to the issue of counterfeit stamps.<sup>77</sup>

HM Customs and Excise, in public statements, have not gone as far in their judgement with regard to Imperial Tobacco, but noted a certain lack of commitment to help reduce the return of exported cigarettes. In a memorandum submitted to a House of Commons committee, customs stated that the “dialogue with Imperial has been less co-operative than with other manufacturers”.<sup>78</sup>

Imperial Tobacco, in turn, has denied any form of complicity with smugglers or even an objective interest in the black market, arguing that profits from sales to the UK market are much higher than profits from sales to non-EU countries. The company insisted that the discrepancy between legal and illegal market shares were related to regional variations in the popularity of its brands, specifically “Regal”, which, it said, was a popular brand in regions identified as smuggling hot spots. Shipments to small countries were explained with their role as hub markets, in the case of Latvia, for example, as a hub for other Eastern European countries.<sup>79</sup>

Still, Imperial Tobacco chose to cease trade with 30 distributors between 1999 and 2002 and to significantly decrease or to completely stop export of “Regal” and “Superkings” to certain formerly important destination countries.<sup>80</sup>

Since then, the share of Imperial brands on the black market in the UK has significantly decreased. In 2003-04, “Superkings” accounted for 9 % of seized genuine UK brand cigarettes while the share of “Regal” was ‘negligible’. In the meantime, June 2003, Imperial Tobacco had signed a Memorandum of Understanding with customs, following similar MoUs customs signed with the other two major British manufacturers, Gallaher (April 2002) and British American Tobacco (October 2002). These agreements formalize customs-industry cooperation and aim to ensure that cigarettes are only supplied to markets with a legitimate demand, that supply routes are identified, and that no sales are made when the final destination is in doubt.<sup>81</sup>

### **Recent Trends in the Role of the Tobacco Industry**

HM Customs and Excise believe that in recent years, due to improved industry cooperation, the availability of genuine brand cigarettes has been greatly reduced and that therefore UK manufactured cigarettes on the black market have increasingly been replaced by counterfeit product.<sup>82</sup>

A similar trend may have emerged in Germany where Reemtsma’s “West” has apparently lost its position as market leader in the contraband cigarette market while at the same time becoming a popular brand to be counterfeit.<sup>83</sup>

These recent developments may be regarded as evidence that cigarette manufacturers are indeed in a position to control the supply to the black market to some extent. On the other hand, it is peculiar to note that Gallaher, the British company which was the first to sign a Memorandum of Understanding with customs and which has been characterized by customs

in 2002 as “certainly one of the most compliant companies”,<sup>84</sup> in 2003-04 accounted for 21 % of all cigarettes seized in the UK while the share of Imperial products dropped to a share of 3 %.<sup>85</sup> In a House of Commons hearing, a Gallaher representative explained that they had problems with one particular supplier who initially had given no reason for concern and that they had suspended the contract.<sup>86</sup>

While there are no sufficient insights into the Gallaher distribution system to pass a judgement on the question of responsibility, it is noteworthy that the diversion of cigarettes to the black market does not seem to coincide with any complaints by customs about a lack of cooperation. This in turn would suggest that diversion of untaxed cigarettes is possible against the will of a manufacturer at least for a certain period of time.

## **COUNTERMEASURES**

Closer cooperation with the tobacco industry is one element in the overall strategy of customs agencies to curb the cigarette black market.<sup>87</sup> Other measures, adopted on the national and international levels, include restrictions on the transport of duty-non-paid cigarettes within the European transit system in the mid 1990s, and increased resources for customs in the form of staff and equipment, namely x-ray-scanners and tobacco sniffing dogs, for the quicker and more extensive control of cross-border traffic.

These measures are partly credited with an overall reduction of the black market and partly they seem to have had a displacement effect. For example, the introduction of a guarantee covering 100 % of potential liability for each cigarette shipment was followed by a shift from fraudulently diverting cigarettes from within the transit system to the legal export and consequent illegal re-import of untaxed cigarettes.<sup>88</sup> Likewise, as noted above, the boom of counterfeit cigarettes has been linked to the reduced availability of genuine cigarettes to smugglers,<sup>89</sup> and the deployment of scanners and detector dogs has allegedly forced smugglers to divide shipments into smaller consignments or to seek out new routes to reduce the risk of confiscation.<sup>90</sup>

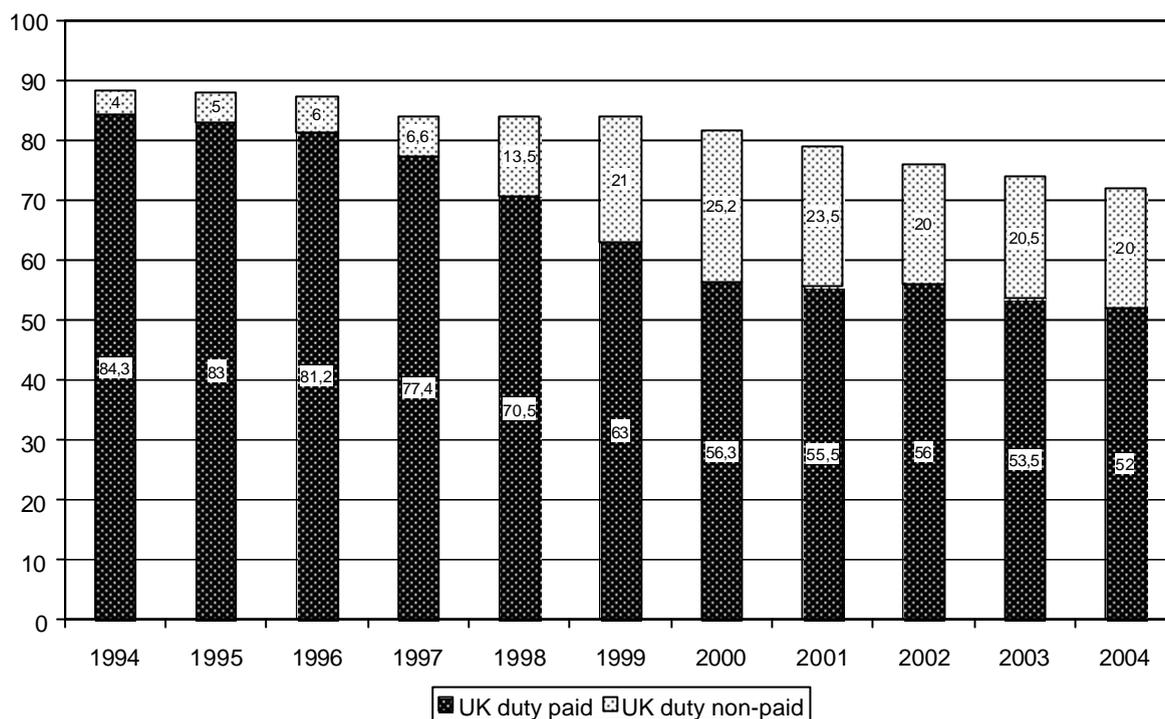
Finally, as indicated, an aggressive policy is credited for curbing the so-called “white-van trade” in the UK, while also invoking criticism in the public and by the EU Commission for being overly harsh.<sup>91</sup>

## **RECENT TRENDS**

The shifts in the respective prominence of bootlegging, large-scale smuggling and counterfeiting, as well as the changes in trafficking routes and in smuggling methods are evidence of the dynamics of the cigarette black market.

As of 2005 the situation in the United Kingdom seems to be further improving with an overall decrease in black market volume not being set off by the current wave of counterfeit cigarettes (figure 2). The overall amounts of seized cigarettes have decreased from 2.8bn in 2000-01 to 1.8bn in 2003-2004, while in the same time period a three-fold increase occurred in the volume of seized counterfeit cigarettes. In 2003-04, 54 % of cigarettes seized by customs were counterfeit.<sup>92</sup> One can speculate whether the spread of counterfeits carries with it the potential for a collapse of the black market, given the presumably not unlimited willingness of consumers to trade off cost savings for quality.

Figure 2: TMA estimates of cigarette consumption in the UK 1994-2004 (billion)

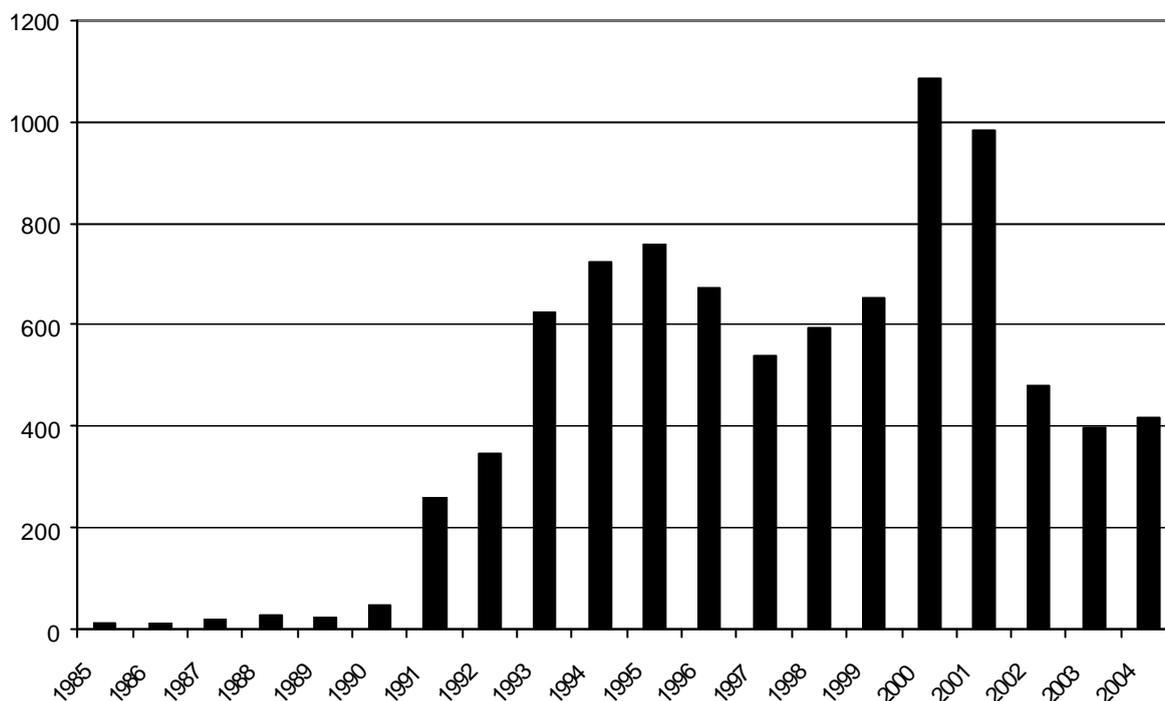


Non-UK Duty Paid = smuggling, legal cross border and duty free shopping

Source: Tobacco Manufacturer's Association at [www.the-tma.org.uk](http://www.the-tma.org.uk)

A similar development with regard to the share of counterfeit cigarettes has taken place in Germany. Three times more counterfeit cigarettes were seized in 2004 compared to 2003, amounting to 165 million out of a total of 418 million.<sup>93</sup> At the same time, Germany may be faced with an unprecedented crisis. While the black market in East Germany has become less visible - Vietnamese street vendors seem to have all but disappeared outside the greater Berlin area -, and the number of seized cigarettes has been below the level of previous years in 2003 and 2004, a reversal of this downward trend may be taking place (figure 3). An increase in cigarette smuggling had been foreseen as a consequence of the EU-enlargement in May 2004 and the removal of controls at the German-Polish and German-Czech borders, combined with a series of tobacco tax increases. And indeed, in the first half of 2005 customs reportedly have seized more cigarettes than during the entire year 2004.<sup>94</sup>

Figure 3: Contraband cigarettes seized by German customs 1985-2004 (million)



Source: Zoll (various publications)

## CONCLUSION

The cigarette black market is a significant crime problem in Germany and the United Kingdom that has not yet been the object of a comprehensive analysis. From the review of open source data emerges a complex picture that shows interesting variations between the two countries, including an asynchronicity of the developmental process and differences in modus operandi, for example regarding the relative importance of street selling. But significant differences also exist within each country. In Germany as well as in the UK regional concentrations of black market activity have become apparent. Before this background simple explanations have to be rejected. It seems that a multitude of factors have to be considered to account for the overall dynamics and specific manifestations of the cigarette black market.

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- <sup>10</sup> House of Commons, ref. 8 above, Ev. 76, 77, 120.
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- <sup>13</sup> Verband der Cigarettenindustrie (2005) *Bericht zur VdC-Studie Sammlung weggeworfener Cigarettenpackungen' (EDP-Studie)*, VdC, Berlin.
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- <sup>30</sup> *Ibid.*, p. 41; House of Commons, ref. 8 above, Ev. 40, 50; RILO, ref. 2 above, p. 21.
- <sup>31</sup> *Hannoversche Allgemeine Zeitung online*, 'Zigaretten gefälscht in illegaler Fabrik', 1 March 2004.
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<sup>38</sup> House of Commons, ref. 8 above, Ev. 33, 50, 73; Wiltshire, S., Bancroft, A., Amos, A., Parry, O., (2001) 'They're doing people a service - qualitative study of smoking, smuggling, and social deprivation', *British Medical Journal*, Vol. 323, p. 204.

<sup>39</sup> Retrieved from the HM Customs and Excise website on 27 May 2005 at: [http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?\\_nfpb=true&\\_pageLabel=pageLibrary\\_ShowContent&propertyType=document&featurearticle=true&id=HMCE\\_CL\\_001317](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&propertyType=document&featurearticle=true&id=HMCE_CL_001317).

<sup>40</sup> HM Customs and Excise, ref. 21 above, p. 15.

<sup>41</sup> HM Treasury, ref. 6 above, p. 33. See also Al Yafai, F., 'Six months for police sergeant who sold smuggled tobacco to officers', *Guardian*, 1 April 2005.

<sup>42</sup> A similar phenomenon has been observed in Italy (see European Parliament, Committee of Inquiry into the Community Transit System Hearing XIV, 18 November 1996: Part II).

<sup>43</sup> Von Lampe, K., ref. 35 above. See also Nibbrig, H., 'Zigarettenmafia greift Berlin an', *Berliner Morgenpost*, 2 March 2004.

<sup>44</sup> Bundesministerium der Finanzen, ref. 35 above, p. 60. See also Zimmermann, H., ref. 35 above; *Rhein-Sieg-Anzeiger*, 'Raum Köln ist Hochburg der Zigaretenschmuggler', 1 August 1998; *Westdeutsche Allgemeine Zeitung online*, 'Essener Zoll stoppt Millionenschmuggel', 15 January 2004.

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<sup>46</sup> Pieda plc (1994) *The Economic Impact of Cross-Border Shopping and Bootlegging on the Independent Tobacco Retailing Sector*, Pieda plc, Edinburgh, p. 6.

<sup>47</sup> House of Commons, ref. 8 above, Ev. 126.

<sup>48</sup> House of Commons, ref. 18 above, Q 183, 184, 278.

<sup>49</sup> Williams, B. and Williams, J. (2002) *Tobacco in London: Attitudes to smoking in the capital*, SmokeFree London, London, p. 13.

<sup>50</sup> High Level Group on Fraud in the Tobacco and Alcohol Sectors (1998) *Report to Directors General for Customs and Indirect Taxation*, at [http://europa.eu.int/comm/taxation\\_customs/resources/documents/taxation/excise\\_duties/circulation\\_control/studies\\_reports/Tobacco\\_and\\_alcohol\\_fraud\\_report\\_en.pdf](http://europa.eu.int/comm/taxation_customs/resources/documents/taxation/excise_duties/circulation_control/studies_reports/Tobacco_and_alcohol_fraud_report_en.pdf), p. 19; Joossens, L. (1999) *Smuggling and cross-border shopping of tobacco products in the European Union*, Health Education Authority, London, p. 5. See also Van der Graaf, C., 'Goedkope Roemeense sigaretten via internet', *NRC Handelsblad*, 10 January 2004; Schauka, F., 'Glimmstängel per Mausklick', *Märkische Allgemeine*, 16 December 2004.

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<sup>52</sup> See the judgement of the Court of Justice of the European Communities in the "Man in Black" case (OJ C 209 of 4.7.1998, pp. 2-3).

<sup>53</sup> House of Commons, ref. 8 above, Ev. 81.

<sup>54</sup> Pieda plc, ref. 45 above; Wiltshire et al., ref. 37 above.

<sup>55</sup> Bundeskriminalamt (2004) *Organised Crime Situation Report 2003 Federal Republic of Germany: Summary*, Bundeskriminalamt, Wiesbaden, Germany; Bundesministerium der Finanzen, ref. 35 above.

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<sup>57</sup> HM Customs and Excise (2004) *Measuring and Tackling Indirect Tax Losses - 2004: An Update on the Government's Strategic Approach*, HMCE, London.

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<sup>59</sup> HM Treasury, ref. 6 above, p. 24.

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<sup>60</sup> Coker, D. (2003) 'Smoking May not Only be Hazardous to Your Health, but also to World Political Stability: The European Union's Fight Against Cigarette Smuggling Rings that Benefit Terrorism', *European Journal of Crime, Criminal Law and Criminal Justice*, Vol. 11, pp. 350-376; Northern Ireland Organised Crime Task Force (2004) *Confronting the Threat: Serious and Organised Crime in Northern Ireland, Threat Assessment & Strategy 2004*, Northern Ireland Office, Belfast.

<sup>61</sup> Von Lampe, K. (2003) 'Organising the nicotine racket: Patterns of cooperation in the cigarette black market in Germany', in: P. van Duyne, K. von Lampe, J. Newell (eds), *Criminal Finances and Organising Crime in Europe*, Wolf Legal Publishers, Nijmegen, the Netherlands. See also Van Duyne, P., ref. 23 above.

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<sup>63</sup> Joossens, L. and Raw, M. (2002) *Turning Off The Tap: An update on cigarette smuggling in the UK and Sweden, with recommendations to control smuggling*, Cancer Research UK, London, p. 5-6.

<sup>64</sup> Von Lampe, K., ref. 36 above, p. 149; Wiltshire et al., ref. 37 above, p. 204.

<sup>65</sup> High Level Group, ref. 50 above, p. 19; Von Lampe, K., ref. 36 above, p. 149.

<sup>66</sup> Wiltshire et al., ref. 37 above, p. 205.

<sup>67</sup> Dantine, M. (2001) 'Contrebande de cigarettes: un exemple moderne de délinquance d'entreprise', *Revue Internationale de Criminologie et de Police Technique et Scientifique*, Vol. 54, pp. 3-25; Joossens, L. and Raw, M., ref. 63 above.

<sup>68</sup> Aguinaga Bialous, S., Shatenstein, S. (2002) *Profits Over People: Tobacco Industry Activities to Market Cigarettes and Undermine Public Health in Latin America and the Caribbean*, Pan American Health Organization, Washington D.C, pp. 77-88; Beare, M. (2003) 'Organized Corporate Criminality: Corporate Complicity in Tobacco Smuggling', in: M. Beare (ed), *Critical Reflections on Transnational Organized Crime, Money Laundering, and Corruption*, University of Toronto Press, Toronto, pp. 183-206.

<sup>69</sup> European Community, Complaint before the U.S. District Court, Eastern District of New York, 3 November 2000, p. 19. Interestingly, the one case of supply to a smuggling group in the United Kingdom mentioned in the complaint involves cigarettes that were in turn smuggled into other Member States (p. 76).

<sup>70</sup> Black, I., 'Tobacco firm pays to curb smuggling: \$ 1.25bn deal with EU to end row over black market cigarettes', *The Guardian*, 10 July 2004.

<sup>71</sup> *Die Welt*, 'Verfahren gegen Ex-Manager eingestellt', 24 June 2005.

<sup>72</sup> House of Commons, ref. 18 above, p. 9.

<sup>73</sup> *Ibid.*, Appendix 3; RILO, ref. 2 above, p. 10.

<sup>74</sup> House of Commons, rev. 18 above, p. 10.

<sup>75</sup> *Ibid.*, p. 8.

<sup>76</sup> Joossens and Raw, ref. 63 above, pp. 2-3.

<sup>77</sup> European Community, Complaint before the U.S. District Court, Eastern District of New York, 3 November 2000, p. 73.

<sup>78</sup> House of Commons, ref. 18 above, Appendix 3. See also the statement by Customs chairman Richard Broadbent (*ibid.*, Q 282) and a later statement by the acting director of strategy for HMCE, Mike Wells, in House of Commons, ref. 8 above, Ev. 4.

<sup>79</sup> House of Commons, ref. 18 above, Q 292, 377, 474.

<sup>80</sup> *Ibid.*, Q 310, Appendix 3.

<sup>81</sup> House of Commons, ref. 8 above, 11, Ev. 106.

<sup>82</sup> *Ibid.*, Ev. 5; HM Customs and Excise, ref. 7 above, 18.

<sup>83</sup> The first production facility for counterfeit cigarettes discovered in Germany produced fake "West" (*Hannoversche Allgemeine Zeitung online*, 'Zigaretten gefälscht in illegaler Fabrik', 1 March 2004), and a large-scale counterfeiting operation busted in February 2005 produced "West" among other prominent brands: "Marlboro", "Prince Denmark", "Regal", "Benson & Hedges", and "Superkings" (Zollfahndungsamt Hamburg and Staatsanwaltschaft Rostock, 'Fürst des internationalen Zigarettenschmuggels festgenommen', press release, 28 February 2005).

<sup>84</sup> House of Commons, ref. 18 above, Q 118.

<sup>85</sup> House of Commons, ref. 8 above, Ev. 129.

<sup>86</sup> *Ibid.*, Ev. 30.

<sup>87</sup> In Germany, MoUs have not been signed by individual tobacco companies but by the association of tobacco manufacturers (VdC) as early as 1994. However, the main pressure to implement tighter controls on distribution channels seems to have come not from this customs-industry agreement but from the criminal investigations against the Reemtsma management.

<sup>88</sup> European Parliament (1997) *Committee of Inquiry into the Community Transit System, Report on the Community Transit System*, European Parliament, Strasbourg.

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<sup>91</sup> Osborn, A., and Elliott, L., 'Anti-smuggling regime under EU fire', *Guardian*, 19 September 2002; *The Economist*, 'Anything to declare?', 21 September 2002, pp. 36-37.

<sup>92</sup> House of Commons, ref. 8 above, p. 17.

<sup>93</sup> Bundesministerium m der Finanzen, 'Zoll legt überzeugende Jahresbilanz 2004 vor', press release, 1 April 2005.

<sup>94</sup> Ulrich, A., 'Drehen im Untergrund', *Der Spiegel*, 27/2005, pp. 56-57.