

AN OVERVIEW OF THE TOBACCO BLACK MARKET IN EUROPE

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Abstract: *Cigarette smuggling is a global phenomenon and so well-organized that it poses a serious threat to public health and national economies. The aim of the article is to highlight the main definitions and classifications between illegal tobacco trade and cigarette smuggling and also to describe the general situation of Europe. Based on data retrieved from International Tobacco Trade and UNODC, the paper is focused on the price differences, source countries, supply and demand and on the analysis of reports and articles. Furthermore the main findings emphasize the role of high taxation and corruption which have affected the European economies.*

Keywords: tobacco, illegal cigarettes, smuggling, counterfeiting, underground economy.
JEL Classification: E26, O17

INTRODUCTION

Tobacco has a true long history, from its first native forms in the early Americas to the well-known widespread trade through Europe and further to Asia. Introduced by Spanish to Europeans, tobacco showed at the end, how quickly can be sold, action initiated at that time by the French ambassador in Lisbon, Jean Nicot. Historical events that followed after this peak point, led to a big profitable business of our days which unfortunately turned tobacco and cigarettes into one of the most popularized topics, especially regarding health problems and illegal trade.

Recognized as a symbol of modern society, the simple cigarette has transformed into a very common product of both legal and illegal base. Although the international tobacco industry became a profitable business with a large portfolio of clients all over the world, the total production continues to be associated and also interferes with the evasion of excise and customs duties. According to Illicit Tobacco Trade 2008 Report, hundreds of billions of cigarettes are "vanishing" each year from legal trade channels into an underworld market and the counterfeiting of cigarettes is growing steadily, all at an enormous cost to public health and nations' economies (ITT, 2008 Report, p. 2).

Illicit tobacco trade is a much broader concept than smuggling. For instance, the ITT 2012 Report showed that smuggling is conducted for one or both of the following reasons: to avoid

excise taxes and to evade rules prohibiting the sale of such goods. Moreover, some well-known economists such as David Merriman defined the action of smuggling as the evasion of excise taxes on goods by circumvention of border controls (Merriman, 2002). The illicit tobacco trade process works on three major pillars such as smuggling, counterfeiting and the category of tax evaded products (ITIC, 2010). These three important pillars are very connected and interrelated in the production and sale mechanism, a true important fact which describes that this industry may also have ramifications in the global underground economy. Also this process does not define one particular country or region, it simply covering all the world nation's economies, the high and low income countries together.

However, in finding a more specific definition for the illegal tobacco trade, definitely cannot be removed the nature of the product. Being a highly taxed product in many countries, it is understandable that it has been created a distribution niche of cheaper and poorer quality cigarettes. Sometimes with the help of the international tobacco companies, the cigarette black market turned into a real business same as drug trafficking, which reached a high level in terms of total sales of cigarettes, involving in the whole mechanism a more efficient transport and processing.

Considering the general overview regarding the illegal tobacco trade, which has emerged in a surprisingly way, this paper focuses on smuggling of cigarettes in Europe. Labelled as an outlaw trade, the black market tobacco is covering all the states, whether it is United Kingdom, China, or Brazil, this illicit trade has become a real problem for all the world governments especially regarding the stability of their budgets. For many years, EU was the main destination for illicit tobacco products, although transit routes were often via South America. Even an expert of Philip Morris International, Timothy Lindon said in 2011, that the illegal cigarette market in the EU is at this time more larger than the legal cigarette markets of France, Ireland and Finland combined, and also many European countries are determined by two distinct cigarette markets, one legal regulated market which is declining, and an illegal unregulated market that is growing (PMI, 2011).

Europol data points out that these types of cigarettes are manufactured elsewhere, particularly in China and the Far East, in the Middle East and the CIS countries (UNODC, 2011). Recent studies like Action on Smoking and Health 2011, estimated that 11,6% of all internationally traded cigarettes are smuggled, equivalent to 667 billion cigarettes a year, causing losses to government revenue worldwide of US\$40,5 billion. For European Union particularly, it is estimated that the illicit tobacco trade is costing the governments about €10 billion a year in lost revenue (UNODC, 2011).

International tobacco industry with the big 4 tobacco manufacturers, Philip Morris International, Japan Tobacco International, British American Tobacco and Imperial Tobacco Limited, represents the legal face of this successful business, being extremely involved on the market. The ugly truth that affects these multinational companies is the fact that smuggling makes top international brands available at affordable prices to low-income consumers. Although there are many cigarettes brands that continue to be smuggled, such as Marlboro, State Express, 555, Benson & Hedges, Camel or Winston, there is evidence indicating that the international tobacco industry has instigated cigarette smuggling and has participated directly in these activities, while at the same time carrying out costly lobbying campaigns to pressure governments against tax increases and to promote their own interests (Armendares and Shigematsu, 2006).

Roughly cigarette smuggling is labelled as a serious threat of our modern era because: smuggling makes cigarettes available cheaply, fact which leads to increasing consumption; about third of annual global exports go to the contraband market, representing an enormous impact on general consumption (Joossens and Raw, 1998); cigarettes are considered a part of the highest taxed commodities which provide a significant source of revenue for governments, smuggling involving in this way the stability of government budgets (Klaus von Lampe, 2011); is a significant source of income for all levels of organized crime, income that is very often reinvested to support other criminal activities; affects seriously the consumers health, for example World Health Organization (WHO) statistics revealed that tobacco caused 100-million deaths worldwide in the 20th Century.

1. ILLICIT TOBACCO TRADE- DEFINITION AND CLASSIFICATION

In this era of Internet purchases and globalised exchanges, the idea of prohibiting the sale of a product such as tobacco, with a history going back thousands of years may simply appear unreal (Petkantchin, 2012, p.1). Even in this context, the economics and tobacco are definitely linked. Based on the economic nature, illicit trade can be seen as a simple outcome of classic *demand* and *supply* (Joossens and Raw, 2011). First, *demand* derives from the need of smokers for cheaper products while on the other side, *supply* continues to highlight the situation of legal and illegal tobacco manufacturers, which are looking to increase their sales, profits and market share or even to penetrate new markets that are very often facilitated by corruption or by the presence of criminal organization and poor government policies (Joossens and Raw, 2011). Also many experts suggested through their own research that the world cigarette production is very close to the world consumption only because cigarettes do not keep for very long. Thus global imports should be equal

or close to global exports, but the real economic world is quite different, because generally imports are lower than exports to a serious degree that cannot be explained.

According to *Illicit Tobacco Trade 2008 Report*, illicit tobacco trade is a much broader concept than the often-used "cigarette smuggling". Generally, this term refers to a prohibited practice or activity that involves production, shipping, distribution, receipt, purchase or sale of products*. Moreover this illicit trade is characterized by:

a) *Large-scale smuggling* - takes advantage of the temporary suspension of customs duties, excise and other taxes on goods destined for export to a third country (Klaus von Lampe, 2011). These untaxed cigarettes don't leave the country and are directly diverted to the black market, or, far more commonly, they are properly exported and disappear on the black market abroad or are illegally re-imported (Klaus von Lampe, 2011). Moreover, the ITT 2008 Report shows that the large-scale smuggling very often involves criminal organizations.

b) *Bootlegging* - a practice which involves the purchase of cigarettes in low-tax countries for resale in high-tax countries, a form of smuggling carried out by individuals or small groups (Klaus von Lampe, 2011). The main differences in these cases are given by the nature of the paid taxes which are made not in the country of consumption (Hornsby and Hobbs, 2007).

c) *Counterfeiting* - the fastest-growing category of illicit tobacco trade, counterfeiting constitutes a violation of brand property rights and involves the production of fake brand cigarettes, including packing and on occasion, fiscal marks made by unauthorized manufacturers (Klaus von Lampe, 2011, p.149). A strong example is given by China, the largest manufacturer of legal cigarettes and also the main source of counterfeit cigarettes (Antonopoulos and Klaus von Lampe, 2010).

Illicit trade in tobacco products has ramified detrimental consequences and above all, smuggling continue to be caused by large price differences between cigarettes in different countries, the evasion of border controls, distribution infrastructure (e.g. street vendors), trade restriction, geographic proximity, overproduction, unemployment or low-wage legal employment, frequencies of international travel, moral suasion or by the demand to finance other illegal activities.

2. SOURCE COUNTRIES

The illegal tobacco industry is a global black market defined by complex distribution systems and smuggling routes that are very hard to track. Described as a underground industry, the illegal

* see *Illicit Tobacco Trade 2008 Report* available on http://tobaccofreecenter.org/files/pdfs/en/ILL_overview_en.pdf

tobacco trade starts from Fujian and Guangdong provinces with the Chinese counterfeiters that are very well-known due to their capacity to mimic Marlboro to perfection, to Kaliningrad and with Russian-owned factories that produce popular brands exclusively to be smuggled into Western Europe, to Indian reservations in New York, to South America's notorious Tri-border (Argentina, Brazil and Paraguay) and furthermore to illegal reservation from Pakistan and African countries (see Figure 1).

Generally there are three types of countries in this whole process: source countries of illicit cigarettes, countries that are mainly transit routes and the third type, are the final destination countries, where the illegal products are consumed. Despite this, some researcher suggest that in this classification can be introduced another type of countries, mixed countries which can be found in more than one of these categories.

The source countries are viewed generally through the Asian gate. Countries like China, Vietnam or North Korea are the main suppliers of counterfeiting cigarettes for the European and U.S.A countries. For the Middle East, Egypt is recognized as a central key regarding cigarettes contraband. In Africa, Zimbabwe plays an important role in the contraband process which is detected mainly in East and Southern Africa while in Latin America; Paraguay continues to be a real source of illicit cigarettes which are especially transported in Brazil. In addition other popular sources of counterfeit cigarettes include Iran, United Arab Emirates, Romania, Russia and Ukraine, known as Europe suppliers.

Figure 1 - The Global Trade in Smuggled Cigarettes for 2010



Source: Guevara (2010) *Follow the Money: Who Benefits from Booming Trade in Smuggled Tobacco?* retrieved from www.unfreemedia.com/un/2010/05/follow-the-money-who-benefits-from-booming-trade-in-smuggled-tobacco.html

According to *Illicit Tobacco Trade 2008 Report*, to move cigarettes from legal trade channels into the black market, a smuggling route can cover thousands of miles. One pathway for smuggling American cigarette brands into Italy began with container loads exported to Antwerp, Belgium under the transit system of temporary suspension of taxes on goods headed for a third country. Next cigarettes were rapidly exported and imported again through many locations, ultimately transferring them to illegal channels in a city known for lax surveillance, such as Bar or Zelenika in Montenegro. Finally speedboats ferried cases of the cigarettes by night across the Adriatic to Italy where they were sold in the streets of Naples and Bari*.

3. TRENDS IN SMOKING IN EUROPE

Europe is for sure among the top global consumer of tobacco. A report released by Philip Morris International showed that Europeans smoked more than 65 billion illicit cigarettes in 2011 (Nielsen, 2012). Moreover, in Europe approximately 30% of adults smoke regularly and some 1.3 millions deaths per year are caused by smoking, losing 20 years of life each on average. Deaths from smoking are highest in Eastern Europe and at current rates, 20% of all deaths in 2020 will be from smoking[†]. Some 550 000 people in the European Union die from their smoking habit (WHO Europe, 2002).

Despite health problems that tobacco causes, there are no signs of smoking decreasing in Europe. Although there are serious consequences, both in health and economic sector, Europe continues to be determined by wide differences regarding price and tax between countries, an important example being in the image of Spain and UK.

4. CIGARETTE SMUGGLING IN EUROPE

The dynamics of illicit tobacco trade have evolved remarkable in the past years. From a market characterized by a large -scale cigarette smuggling in the nineties and at the beginning of this millennium, Europe showed in the last few years a slight decrease regarding large-scale smuggling in favour of counterfeiting and the development of new cigarette brands. The market itself is determined by variety: there is an explosive growth of "illicit white" or so called "cheap

* see *Illicit Tobacco Trade 2008 Report* available on http://tobaccofreecenter.org/files/pdfs/en/ILL_overview_en.pdf

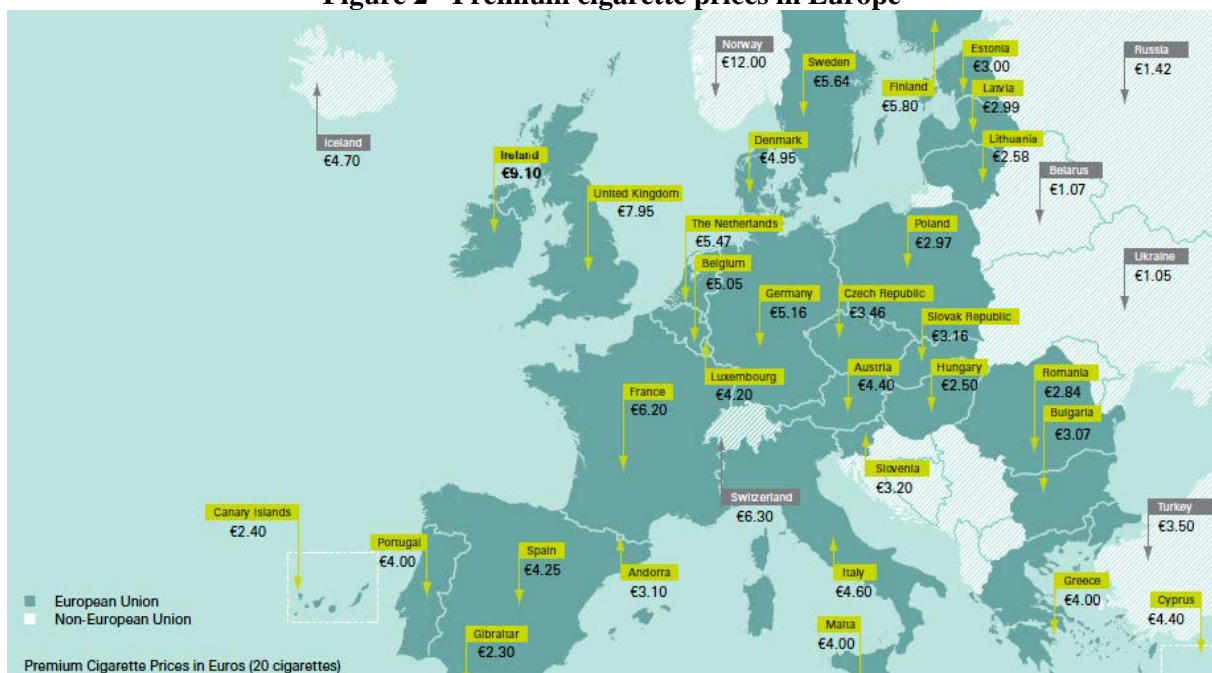
[†] See *Economic Aspects of Smoking in Europe* p.17 available on http://www.nuigalway.ie/hbsc/documents/economic_aspects_of_smoking_final_report.pdf

whites" a special type of cigarette at very low-cost made for smuggling while on the other side is the high-presence of internet sites who sell and ship cigarettes in small quantities by the post to evade taxation. Despite this, can be mentioned an expansion in distribution networks. Generally smuggled tobacco is transported in containers (by sea, rail or road), postal routes and even with tourists or carried abroad through unusual ways as tunnels between countries, like that one discovered between Slovakia and Ukraine in 2012* .

4.1 Cigarette prices in Europe

The wide range of economic situations makes Europe a continent with a wide range of prices. Figure 2 shows that generally in the eastern European countries like Belarus, Ukraine or Russia a pack of Marlboro for example can be bought for around one euro while in the top most expensive are situated by far the western countries like Ireland and Norway where a pack of cigarettes cost ten times as much (see Figure 2).

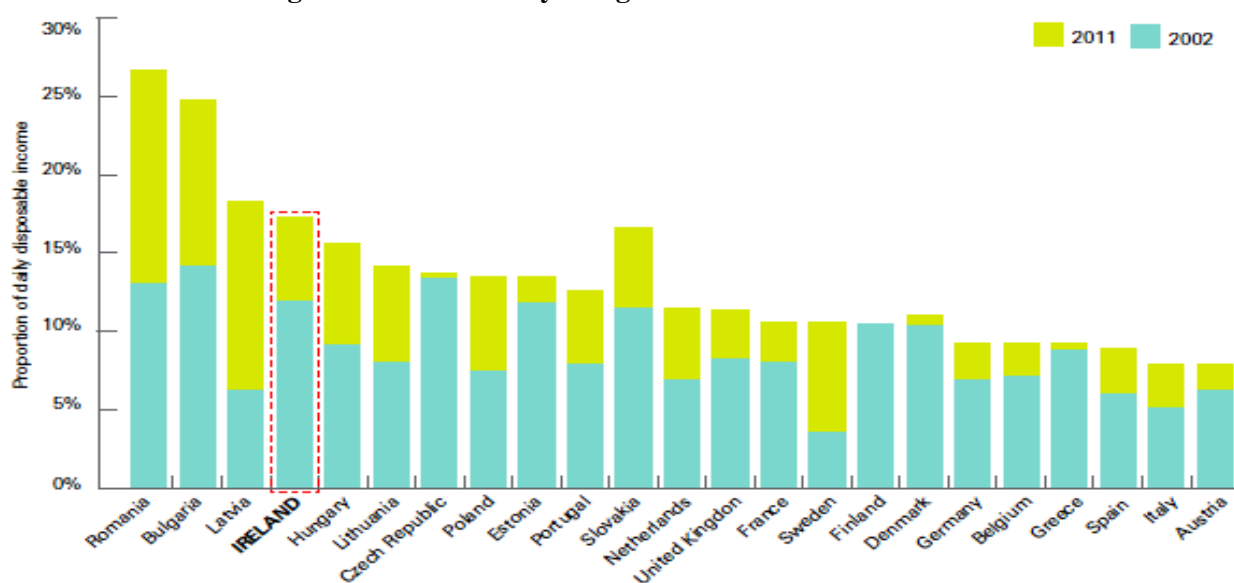
Figure 2 - Premium cigarette prices in Europe



Source: JTI, January 2012

* e.g. see *Tunnel vision*, accessed on July 2012 at <http://www.economist.com/blogs/easternapproaches/2012/07/slovakias-borders>

Figure 3 - Affordability of cigarettes in the EU in 2002 and 2011



Source: JTI, 2011 Report and Oxford Economics/EC

According to KPMG, total cigarette consumption in the EU was 685 billion units and contraband trade accounted for 8,9% of total consumption in 2009 (Joossens, 2011, pp.1-2). Also according to JTI 2011 Report, cigarettes in Ireland are the fourth least affordable in the EU being ranked after Romania, Bulgaria and Latvia (see Figure 3).

In the same context, Table 1 shows the price and tax burden of a pack of 20 cigarettes in eight of the 27 EU Members states, representing the four most and least expensive jurisdictions. As the table indicates, smugglers can make profit on the territory of Estonia.

Table 1- The price and tax burden of 20 cigarettes in the premium cigarette price category in eight of the 27 EU Member States

Country	RRP per 20 cigarettes			Tax burden per 20 cigarettes			Tax incidence
	GBP	EUR	USD	GBP	EUR	USD	
Ireland	7,41	9,27	11,62	5,82	7,28	9,13	79%
UK	6,95	8,69	10,89	5,40	6,75	8,47	78%
Sweden	5,71	7,14	8,95	3,95	4,94	6,19	69%
France	5,12	6,40	8,03	4,09	5,12	6,41	80%
Bulgaria	2,65	3,31	4,15	2,08	2,60	3,26	79%
Lithuania	2,41	3,01	3,77	1,78	2,23	2,79	74%
Hungary	2,40	3,00	3,76	1,88	2,35	2,95	78%
Estonia	2,38	2,97	3,73	1,85	2,31	2,90	78%

Source: ITT, 2012, FATF Guidance.

Characterized very often due to cheap price (sometimes less than £ 3.50 for a pack of 20) unpopular foreign names such as Raquel and Jin Ling, no picture health warning or unusual

packaging and taste, smuggled tobacco is generally easy to detect. An underground market like this generates a considerable profit margin for illicit traders.

For example, organized smugglers can buy a container of Jin Ling cigarettes in Russia (on which they pay no taxes) for US\$100 000. The value of such container in the EU is on average US\$2 million, an enormous profit margin. In the UK the potential profit is as much as three time higher (Joossens and Raw, 2011).

For several decades the European Community was flooded by smuggled tobacco. With time, more exactly from 1994 onwards, cigarettes smuggling became more prolific, both outside and inside the EU territory. Austin Rowan the Head of Operations in the Task Group Cigarettes in the European Commission's Anti-Fraud Office (OLAF) reported that in the early days the mostly affected countries were Italy and Spain - Marlboro being the main brand placed onto the Italian contraband market, Winston onto the Spanish contraband market. Also he points out that it is very interesting how the smugglers operate, because both Italy and Spain with the exception of Luxembourg had the lowest taxes on cigarettes in the EU for many years.

Several studies reported that the Nordic countries have the highest cigarette prices in the world (between US\$4 and \$6 a pack) but a low level of smuggling, as street selling is not acceptable in northern Europe. In countries such as Spain and Italy prices are low, but the level of smuggling is high, as street selling is culturally acceptable. In Spain 40% of contraband cigarettes are sold on the streets and 23% in the bars (Joossens, 1999, p. 9).

4.2 The Eastern border - a gate to West for smuggled cigarettes?

EU agreement regarding the tax increase on cigarettes has led also to an increase in consumption of illicit cigarettes in all the Member States. Also according to Michaletos, inside the European Union, tobacco smuggling has increase more than 100 percent since the introduction of the Schengen control-free zone. Furthermore the proliferation of inter-European tourism and the multitude of air transportation and truck companies, along with the existence of duty free zones in non-EU states across the borders of Schengen agreement countries, have fuelled the issue and provided golden opportunities to the smugglers.

The main gates that facilitated the illicit tobacco transportation are in particular Moldova, Ukraine, Belarus and Russia. All these illegal cigarettes that enter the EU via Eastern border are destined generally for the illegal markets in Western Europe, like Germany or the United Kingdom, especially because of the higher prices they can be sold for. Although the smugglers take into their

account European countries with high taxes, a significant portion of the smuggled cigarettes is targeted on the local market. Moreover, many researchers reported that smuggling of cigarettes and tobacco products is very prominent in the regional triangle between Netherlands, Belgium and the United Kingdom particularly for the main reasons of high taxes practice and the potential for large profit.

With time, some international investigations detected that an important part of European countries are actually flooded by smuggled Russian cigarettes that worth millions of dollar per year, the main smuggled pack of cigarettes being Jing Ling which resembles very much with the Camel pack of cigarettes.

5. ILLEGAL CIGARETTE TRADE AND CRIMINAL ORGANIZATIONS

Illegal cigarette trade it was always an interesting topic, not only to its mechanism terms but also to its variety of groups involved in this underground activity. According to Klaus von Lampe 2011, there are three major aspects that describe the nature of illegal tobacco trade: the interest of criminal groups, the source funding nature for terrorist groups and the complicity for bigger profits and sale of the tobacco companies.

The latest studies on this topics revealed that this activity it is not run primarily by criminal groups but by common individuals. Despite criminal groups, Louise Shelley, a transnational crime expert at George Mason University and an adviser to the World Economic Forum on illicit trade reported that terrorist financing through cigarette smuggling is "huge". Also, extremist groups like Hezbollah, al-Qaeda or Real Irish Republican Army (IRA) and the Kurdistan Workers` Party (PKK) are involved in smuggling cigarettes (Willson, 2009) even on the European territory.

Along time tobacco manufacturers blamed smuggling on organized crime, but some investigations proved that some tobacco companies like BAT, Philip Morris and R.J. Reynolds have had their own connections to crime groups.

CONCLUSIONS

Labelled as a global problem which needs global solutions, illicit tobacco trade contributes to a major harm to public health and economies worldwide. Despite the general view, tobacco smuggling is particularly a significant political issue different from country to country.

Reviewed literature points out that it is very difficult to estimate the real size of illegal tobacco all over the world, practically it is impossible. Moreover the lack of experience showed in this domain is a handicap to future research. Part of the underground economy the illicit tobacco trade and cigarette smuggling involves also criminal and terrorist groups and even tobacco companies for higher profits.

For Europe, this issue continues to be a serious concern. First because undermines the effectiveness of tax policies and second because increases the availability of cheap cigarettes on the market. Recent case studies showed that the most involved countries, both indirect and direct are United Kingdom, Spain, Norway, Sweden, Ukraine, Russia, Belgium or Romania.

This work provides a general description of the changing nature of illicit tobacco trade all over the world, with greater focus to Europe. Also points out the form of classic demand and supply: demand by smokers for cheaper cigarettes and supply by legal and illegal tobacco companies which primarily are looking for more profit and more sales.

Countries should be encouraged to develop and to implement strong measures such as national taxation and other best practice tobacco policies to curb the illicit trade (e.g. raise public awareness of smuggling; increase the penalties for those convicted of smuggling and so on). Also there is a strong need for international cooperation, partnerships among the ministries of health, ministries of finance and law enforcement agencies and civil society for an effective control of tobacco products and illegal trade.

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