

THE LINK BETWEEN ILLICIT TOBACCO TRADE AND ORGANISED CRIME

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- Introductory remarks -

Introduction: Organised crime as a global economic power

- Hand in hand with the globalisation of the economy, the liberalisation of trade markets as well as the opening of the internal borders of the EU, **organised crime** has become a **transnational phenomenon**.
- Benefitting from **access to new markets** with different legal and cultural conditions, organised crime has expanded its engagement in illicit trade significantly. Organised crime groups engaging in illicit trade have become very professional in exploiting the different legal frameworks and tax regulations in various countries to their advantage.
- Additionally, due to the new dimensions the world wide web brings to our daily life and consumption behaviour and the increasing **shift of trade markets to the virtual space, national borders do not constitute an obstacle to illicit trade** anymore. The internet allows offenders to communicate and coordinate anonymously and across borders.
- These advantageous conditions have led to estimations by the OECD that international organised crime annually generates around 870 billion US-Dollar, which accounts for **1.5 percent of the global GDP** (gross domestic product). In Germany, for instance, the proportion of lawsuits prosecuting organised crime with international links is as high as 80 percent for around 18 years – with fluctuations of around 4 percent.

The characteristics of illicit trade

- According to the most recent EU Serious and Organised Crime Assessment (SOCTA) published by Europol in 2017, more than 5,000 organised crime groups (OCGs) are under surveillance in the EU. They are characterised by **profit orientation, multi-nationality, mobility, high flexibility, poly-criminality** (meaning engagement in different markets reaching from meth-smuggling over trading fake handbags to money laundering), **transborder-working methods** and coordination via the **internet**. The trend for flexibility and internationalisation can be demonstrated by a criminal network that spans over Great Britain, Germany and the Netherlands over to Pakistan, which changed its key business from drug trafficking to tobacco smuggling.

- This example indicates a trend in illicit trade that I intend to discuss in detail in this speech. The OECD presumes that, in 2016, 2.5 percent of the global trade volume traced back to product piracy - making it a major part of international illicit trade. The combination of **high profits** in the realm of illicit trade with counterfeited and contraband goods and the **low risk of criminal liability** made it **one of the main sources of revenue for OCGs**. In addition, fake products enjoy a much higher **social acceptance** and their purchase is often considered as a **trivial offence**.
- In the past, the main focus of law enforcement authorities was put on drug trafficking, arms smuggling and human trafficking, which were perceived to pose a more immediate threat. This focus allowed the OCGs to gain expertise in much more profitable criminal activities with considerably lower risks. Already in 2013, the **profit of counterfeited products exceeded the profit of drug businesses by far**: on EU level, organised crime earned around 28 billion Euro with drug dealing, which, of course, is still a high number. However, with **counterfeited products** OCGs were able to acquire **42.7 billion Euro**.
- This demonstrates that, while looking for more profitable sources of income, **organised crime expands into new markets that are less controlled, have a low risk of detection and where punishment and prosecution pressure are lower**. The profit margins of illicit trade with counterfeited Nike sneakers, Louis Vuitton handbags, medical products, potency pills and cigarettes are far above those of trade with cocaine, heroin and ecstasy. The **markets are huge** and the **products enjoy a great demand**. Additionally, the **sanctions** for trademark violations are comparatively **low**. In Germany, for instance, the possession or purchase of counterfeited products is not liable to prosecution. **EU law** even explicitly **excludes an intervention of customs authorities** when fake products are discovered in the luggage of travellers – in case the goods are carried along without commercial intentions.
- All these determinants make **counterfeited medical products, sneakers and cigarettes “the new cocaine”**. These goods are an extremely attractive source of income for organised crime – which eventually allows OCGs to continue and expand their criminal activities as long as there is no major **change of priorities on the agenda of politics and law enforcement authorities**.

Illicit trade of tobacco products (ITTP)

- Cigarettes are a case in point of the before-mentioned determinants that changed illicit trade over years. With **low production costs**, illicit cigarettes are lightweight and **easy to transport**, yet retain a **high sales value** and consistent **consumer demand**. Moreover, the **differentiating prices** of cigarette packages globally and even inside the EU are beneficial to tobacco smugglers. The tendency of policy-makers and security authorities to **focus on other forms of organised crime** such as drug trafficking **allowed the**

illicit cigarette trade to operate under the radar of law enforcement. These conditions present OCGs significant opportunities and make the global trade in illicit cigarettes one of the world's foremost criminal enterprises. According to the latest SOCTA, out of 40 million seized counterfeited goods with a value of 642 million Euro, **cigarettes accounted for the mostly seized product with a share of 27 percent.**

- Despite a notable decrease in consumption of contraband and counterfeit of tobacco products in 2016, it continues to constitute a **substantial source of income for OCGs** across Europe. In 2016, **9 percent of total consumption** continues to be **counterfeit and contraband**, while illicit consumption deprived governments of €10.2 billion in tax. Activity on this scale is representative for major organised crime on international level conducted by agile groups to feed sustained consumer demand.
- With a **profit margin of up to 900 percent**, the **revenues of ITTP are reinvested** in more severe criminal activities such as human trafficking, arms smuggling and even terrorist activities. According to the latest SOCTA, more than **45 percent of OCGs are engaged in several markets (poly-criminality)**. The so-called Vietnamese markets in the Czech Republic are an example for the phenomenon of poly-criminality. According to an Interpol report, most of the cigarettes smuggled to Germany are purchased there. A couple of years ago, the dealers started to sell Crystal Meth – using the same network they had established for ITTP.
- One important phenomenon of “modern” ITTP in the EU are the so-called **illicit whites**, which account for **over a third** (33.9 percent in 2016) of the distributed cigarettes with unpaid tax. Only ten years ago, their market share was almost zero. Illicit whites are cigarettes that are **legally produced in their country of origin**, but with the **only purpose to contraband them to other countries**. In the target markets, they are sold duty-free because of non-existing legal distribution channels for these products. Due to the comprehensive controls of the "Tobacco Big Four", illicit whites can be considered synonymous with smaller, outside the EU produced brands.
- The existence of this phenomenon proves best that ITTP is not a petty crime, but rather in the hands of **well-structured and multi-national OCGs**. Illicit whites are **produced on industrial scale** in large production sites, connected to **sophisticated logistics and distribution channels**.
- While the legislator was able to fight contraband of legal cigarettes with legal provisions for supply chain security and track-and-trace systems, **illicit whites evade any regulations**. The challenge of the fight against illicit whites is their *raison d'être* – namely illicit trade. These cigarettes are manufactured outside legal frameworks and do not enter regulated markets. This means, that they are **not subject to production standards, consumer protection regulations or tobacco regulations**.
- While original products are included in EU legislation, i. e. the TPD, and can be traced back in case of being seized as contraband goods, these traditional means to fight the illicit trade of tobacco products are not useful to fight the

trade with illicit whites. Additionally, the **globalisation of organised crime** generating 1.5 percent of the global GDP and the “**professionalisation**” of OCGs with regards to **large-scale counterfeit and contraband** of various goods, in particular **cigarettes**, demonstrate that ITTP is no trivial offence but rather an **international threat to public security**. For this reason, an emphasis needs to be put on the **fight against structures of organised crime and deterrence**.

Measures to fight ITTP as a source of income for OCGs

Although the extent of illicit tobacco smuggling and the enormous damage it causes are proven, there is a **major awareness and prosecution deficit**. Taking into consideration the results of the research I have conducted over the past years, there are several measures that need to be implemented:

1. *Raising awareness*: First of all, criminal offences in the context of intellectual property crime and excise fraud are still considered as a petty crime.
 - Hence, we must raise awareness among political decision makers, law enforcement authorities and the society that **excise fraud, counterfeiting and contraband play a significant role in terms of financing and expanding structures of organised crime**. The fight against illicit trade of tobacco products must be included in the priority catalogues of international crime prevention and repression.
2. *Improve mechanisms of deterrence*: The wrong perception of counterfeit and contraband as a trivial offence is also grounded in the fact that the purchase or possession of counterfeit products is not liable to prosecution.
 - In this point, even a small sanction such as an administrative offence could have a preventive effect. Therefore, the existing **legislation** should be **evaluated to improve mechanisms of deterrence**.
3. *Counteract system of “low risk high profit”*: Illicit trade of cigarettes is such an attractive field of engagement for OCGs due to the high profit margin.
 - With the consequent **confiscation of the revenues**, ITTP would become **less profitable** and, consequently, less attractive.
4. *More personnel and (technical) resources*: Due to the **lack of resources** available to law enforcement authorities, **only 2 to 5 percent of imported goods are controlled in the EU**. As a result, the detection risk is very low. Additionally, controls focus largely on traditional trade routes. By contrast, virtual marketplaces are barely observed, although it is well known that the **trading venues have massively expanded from the offline to the online market**. For example, **SOCTA 2017** classified the **online trade in illicit and counterfeit goods** under the category of cross-cutting priority crime threats and named it one of the **fastest-growing main business areas of organised**

crime. However, increased use of resources by law enforcement authorities is not evident.

- Consequently, **law enforcement authorities** need to be better equipped in terms of **personnel and (technical) resources**. It needs to be ensured that the **control volume and thus the seizure rate increases** as well as that the **controls can be extended to the new, virtual sales markets**.
5. *Enhance cooperation and information exchange:* There is still a lack of institutionalised forms of cooperation and information exchange, especially between police and customs authorities. As a result, **data on people, trade routes, networks and markets for illegal goods** are collected and saved in various places - but usually **remain disconnected**. Regulatory obstacles to the exchange of data and information make it more difficult to systematically exploit the information and thus to identify internationally operating networks.
- It needs to be ensured that the **customs and law enforcement authorities on national and international level cooperate closely** for the prosecution and detection of illegal trading activities. Similarly, the **exchange of information and data must be legally enabled**.
6. *Improve Public Private Partnerships:* So far, there is very few institutionalised cooperation between the public security authorities and the affected brand owners. Again, this leads to the result that data on people, trade routes, networks and markets of illegal goods are collected and saved in different places – but usually remain disconnected. It also creates side-by-side track-and-trace systems that do not allow effective supply chain security.
- Hence, **cooperation between policymakers, law enforcement agencies and the private sector to prosecute and detect illegal trafficking needs to be deepened**. Interdisciplinary collaboration also enhances understanding of the different mechanisms of action and enables the **development of effective technical systems to secure the supply chain**, which would help to improve the product, supply chain and consumer safety.
 - Furthermore, effective measures should be jointly developed to enable the **closure of domains** where illegal goods are traded. Affected online platforms, logistics services and payment service providers should also be **encouraged or required to comply with the principles of know-your-customer and due diligence**.
7. *Legal harmonisation:* There is a lack of harmonisation of EU legislation in the fight against illegal trade, which in most cases has a cross-border nature. This allows offenders to exploit differences between national laws to their advantage and is a drawback to effective law enforcement and sanctioning options.
- In order to ensure at least **EU-wide legal standards on prosecution and sanctioning**, greater effort is required.