



SUBMISSION COVER SHEET

TOBACCO EXCISE TAX INCREASE IS PROVEN AS THE BEST WAY TO STOP CHILDREN AND YOUTH SMOKING , RECOMMENDED BY THE WORLD HEALTH ORGANISATION AND THE WORLD BANK AND MANDATED UNDER THE FCTC TREATY RATIFIED BY CHINA.. AFTER EACH TOBACCO TAX INCREASE IN HONG KONG CHILD AND YOUTH SMOKING PREVALENCE HAS DECREASED THUS PROVING THE EFFECTIVENESS OF THIS PUBLIC HEALTH MEASURE – SEE THE PROOF WITHIN THIS DOCUMENT.

60-65% OF CONTRABAND SEIZURES IN HKG DURING 2008-2010 WERE **GENUINE** PRODUCTS AND OF THESE GENUINE PRODUCTS 6.9% WERE MARKED 'HK DUTY NOT PAID' – THIS IS THREE TIMES THE WORLD CONTRABAND NORM FOR GENUINE PRODUCT SEIZURES AND NEEDS ADDRESSING BY USE OF THE ORGANISED AND SERIOUS CRIME ORDINANCE AGAINST THE SUPPLY CHAINS AND PRODUCT MANUFACTURERS - THE TOBACCO COMPANIES' DELIBERATE FAILURE TO CONTROL THEIR OWN SUPPLY CHAINS IS A MAJOR REASON FOR ILLICIT TOBACCO SMUGGLING AND WITHIN THIS DOCUMENT IS PROOF OF BIG TOBACCO'S HISTORY OF DIRECT INVOLVEMENT IN SMUGGLING OF ITS OWN PRODUCTS WHICH THEY REFER TO AS 'DUTY NOT PAID / GENERAL CARGO'.

IN EUROPE THE TOBACCO COMPANIES ARE FINED MASSIVELY IF THEIR PRODUCTS ARE FOUND IN THE BLACK MARKET AND HK SHOULD DO THE SAME. IN CANADA TOBACCO EXECUTIVES INVOLVED IN SMUGGLING THEIR OWN PRODUCTS WERE JAILED.

WITHOUT REPLACEMENT YOUTH SMOKERS BIG TOBACCO WILL BE OUT OF BUSINESS. INCREASED TOBACCO TAXATION MAKES THEIR PRODUCTS UNAFFORDABLE TO CHILDREN AND YOUTH BY WAY OF RETAIL ELASTICITY.

WORLDWIDE THE TOBACCO COMPANIES ALWAYS BLEAT THAT TOBACCO TAX INCREASES WILL CAUSE INCREASED SMUGGLING – THIS IS DISINGENUOUS SINCE THEY NEVER MENTION THAT THEIR OWN PRODUCT PRICE INCREASES WILL LIKEWISE CAUSE INCREASED SMUGGLING.

CIGARETTES KILL 50% OF THEIR USERS AND REDUCE SMOKERS' LIFETIMES AND PRODUCTIVITY BETWEEN 10 TO 15 YEARS -THE COST OF SMOKING TO HONG KONG SOCIETY INCLUDING LOSS OF LIFE PER YEAR IS AT LEAST HK\$ 72 BILLION (HKU DEPT OF COMMUNITY MEDICINE based on 1998 costs)

HK CUSTOMS DEPT FIGURES SHOWN IN THIS DOCUMENT CONFIRM ILLICIT TOBACCO SYNDICATES IN HK ARE ON THE DECLINE AS ARE THE QUANTITY OF CONTRABAND STICK SEIZURES WHILST DUTY FREE PRODUCTS HAVE BEEN LEAKED ILLEGALLY INTO THE BLACK MARKET.

ALL PRODUCTS SOLD IN HK SHOULD BE SPECIFICALLY MARKED TO ASSIST TRACKING AND TRACING OF THE PRODUCTS. IMPORTING, PEDDLING AND POSSESSION OF NON DUTY PAID PRODUCTS SHOULD MERIT PRISON TERMS SINCE ALL ARE DEFRAUDING THE GOVERNMENT OF EXCISE INCOME AND USERS WILL EVENTUALLY REQUIRE MEDICAL TREATMENT ADDING FURTHER COSTS ON GOVERNMENT FUNDS. TOBACCO EXCISE TAX INCREASE IS A GOVT PREVENTATIVE HEALTH MEASURE AND ILLICIT TOBACCO SMUGGLING, PEDDLING AND BUYING ARE CRIMES.

HK GOVERNMENT SHOULD BE INVESTING MORE FUNDS IN TOBACCO CONTROL AND ENFORCEMENT MANPOWER, ON CESSATION AND THE COSTS OF QUITTING (NICOTINE REPLACEMENT THERAPY /ACUPUNCTURE) SHOULD BE FREE TO ALL RESIDENTS WANTING TO QUIT. THE NEWSPAPER VENDOR ASSOCIATION HAS STATED TO THE PRESS THAT THEIR BUSINESS HAS **NOT** BEEN AFFECTED (RELEVANT SCMP NEWS ARTICLE IS ATTACHED WITHIN THIS DOCUMENT.)



25th March 2011

To: All Legco Members pid@legco.gov.hk
To: Subcommittee on Public Revenue Protection (Dutiable Commodities) Order 2011 meeting on 2nd April 2011 (SPRP) mleung@legco.gov.hk
To: Legco Security Panel Meeting on 8th April 2011 cb2@legco.gov.hk

Dear Sir, **SUBMISSION TO LEGCO MEMBERS ON TOBACCO TAXATION**

We are informed that the SPRP and the Security Panel will meet on the above dates and that the Tobacco Control Concern Group <TCCG> (*amongst which are Tobacco company representatives*) deputation has been permitted to attend the latter meeting .

Clear the Air NGO wishes to provide herewith a written submission to the all Legco members listed above for them to study prior to the said meetings and for the information of all members of Legco.

We are also aware that Legco members James To and Starry Lee in an ATV Newsline interview (<http://app2.hkatv.com/v3/webtv/webtv.php?program=3000006> 27th Feb 2011 Part 2) stated that they would vote against the tobacco tax increase and in an article in SCMP on 17th March Legislator Tommy Cheung reportedly stated "*We oppose the increase and will try to reverse the plan for the car tax. I also want to oppose the tobacco duty increase ... I just think the rise - no matter 100 or 200 per cent - cannot deter all people from smoking.*"

Presumably all members are fully aware of Hong Kong's requirements and obligations under China as a ratified Party to the FCTC Treaty ? Clear the Air accordingly is providing information to enlighten all members of Legco , the SPRP and the Security Panel who might have preconceived ideas on the excise duty and supposed tobacco smuggling nexus.

The Work Health Organisation **Mpower** report http://www.who.int/tobacco/mpower/mpower_english.pdf advises that the tax incidence of tobacco product retail pricing (especially in 1st world countries) should be at least 70% and in 1999 the World Bank (*Curbing the Epidemic: Governments and the Economics of Tobacco Control*) advised a tax incidence between 66.6% and 80% of retail pricing. **The main intent of tobacco excise increases is to stop children and youth from starting smoking by way of making the products unaffordable to them.** Smoking kills 50% of its users and without replacement youth smokers the tobacco companies would be out of business.

Worldwide the tobacco companies all use the same tactics when faced with their major Armageddon : regular tobacco duty increases and the death of their 'Silent Salesman' – which is plain packaging of tobacco products to take away their marketing appeal to youth. This vile and highly regulated industry will always state that '**if Governments increase tobacco tax then smuggling will automatically increase and Governments will lose revenue.**' In fact it is these companies themselves that propagate the smuggling by deliberately failing to control their supply chains as shown in the attached report.

So what is the truth ? Here is what the dedicated Task Force from HK Customs has to say:

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-----Original Message-----

From: wm_hui@customs.gov.hk [mailto:wm_hui@customs.gov.hk]

Sent: Thursday, February 18, 2010 18:01

To: James Middleton

Cc: hc_wan@customs.gov.hk

Subject: Re : Cigarette Smuggling

Dear Mr. Middleton,

Thank you for your continuous support to our enforcement against illicit cigarettes and sharing your views with our Senior Inspector Lee Hoi-man in the past. Mr. Lee has been recently posted out and replaced by Mr. Wan Hing-chuen. You may send your precious opinions to him or to me in future. We are also much grateful for the series of mails on the same subject you sent to this Department during the Lunar New Year Holiday. The relevant materials are very informative and insightful. In response, we would like to let you have our views as follows :

C&ED's effort against illicit cigarette activities

In anticipation of the greater incentive for illicit cigarette activities following the increase in tobacco duty in Feb 2009, we have stepped up enforcement actions by internal redeployment. As a result, there have been increases in number of cases and arrests.

However, the total seizure quantity has been dropping. Evidently, our stringent enforcement has cornered the culprits to scale down their operation.

Examination of cigarette seizures

Our operational objective in fighting illicit cigarettes is to protect revenue. Hence, we don't usually examine cigarette seizures in every case.

However, for cases of smuggling and distribution in nature with significant seizure quantity, we would invite the trade mark owners to examine the cigarettes. **In general, around 30% to 40% are found to be counterfeit. Since the cigarette seizures are intended for local black market, we believe the percentage can adequately reflect the overall situation.**

Control regime on cigarettes

We adopt regulatory control and enforcement strategy against any illicit diversion of the imported or locally manufactured cigarettes. The Department would consistently monitor the situation and suggest to the Policy Bureau more effective measures whenever necessary. Project Crocodile

"Project Crocodile" (the Project), which started on 1 August 2004, aims to form a united front to combat transnational cigarette smuggling activities. There are now 18 Customs Administrations participating in the project. Over the years, fruitful results have been attained because of the information exchange. The Project is running smooth and is still in force. Should you have any further opinions, please discuss with me or Mr. H C Wan (e-mail address : hc_wan@customs.gov.hk) at any time.

Best Regards,

Andy W M Hui

Divisional Commander (Anti-Illicit Cigarette Investigation)

Hong Kong Customs and Excise Department

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-----Original Message-----

From: wm_hui@customs.gov.hk

Sent: Monday, July 12, 2010 12:19 To: James Middleton Subject: Re: FW: further data

Dear Mr. Middleton,

Thank you for your enquiry.

Hong Kong Customs would, if necessary, invite trade-mark owners to examine the authenticity of cigarette seizures for the purpose of gathering evidence for criminal prosecution. As not all the brands of seized cigarettes have local trade-mark owners, we cannot conduct examination on all seized items and hence no actual figures on genuine cigarettes being seized can be obtained. **However, we can estimate that counterfeit cigarettes account for about 35% to 40% of the total seizures of illicit cigarettes.**

For cigarette seizures bearing HKDNP marks, we cannot identify the authenticity of them all, so we do not have the statistics that you requested. That said, we have looked into several cases in which cigarette examinations have been done recently. **The overall percentage of genuine cigarettes bearing HKDNP over total seizures in these cases is 6.9%.** I hope the information would be useful to you.

Best Regards,

Andy W M Hui

Hong Kong Customs

From: mark_ym_lee@customs.gov.hk [mailto:mark_ym_lee@customs.gov.hk]

Sent: Monday, February 14, 2011 14:59

To: James Middleton

Cc: customsenquiry@customs.gov.hk; catherine_py_lam@customs.gov.hk

Subject: Re: query needs reply

Dear James,

Your requested figures are as follows:

HK Customs and Excise Data	2007	2008	2009	2010
Illicit Cigarettes	☠	☠	☠	☠
Total Number of cases	40 390	21 103	18 230	17 011
Exportation / Transhipment cases	81	162	91	101
Persons arrested (importation/ distribution/ storage /peddling)	1 427	1 161	2 262	1 852
Persons arrested (exportation /transhipment)	10	8	3	2
Total Value of all seizures (\$m)	177.9	123.1	119.4	152.1
Value of exportation / transhipment cases (\$m)	3.9	8.4	5.0	54.3
Value importation/ distribution/ storage /peddling cases (\$m)	158.1	102.3	103.5	86.8
Total illicit (imp and exp) cigarette seizures (million sticks)	119.0	81.2	64.7	80.4
Export / Transhipment Cigarettes seizures (million sticks)	2.6	5.6	2.9	28.6
% of contraband seizures - Counterfeit cigarettes			35-40%	35-40%
% of contraband seizures - Genuine product cigarettes			60-65%	60-65%
% of Genuine Duty Free contraband marked 'HK Duty Not Paid'			6.90%	6.90%
http://www.customs.gov.hk/en/statistics/index.html				

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Regards. Mark LEE
Divisional Commander
Anti-Illicit-Cigarette Investigation Division
Revenue and General Investigation Bureau
HK Customs

The Hon members should by now have noticed that in fact the increased pressure from HK Customs Dept Task Force since 2009 has resulted in the illegal syndicates reducing stocks and increased seizures at the border. The number of seized contraband intended for local sale and use has **declined** from 116.4 million sticks in 2007 to 51.8 million sticks in 2010.

Of major concern to Hon Legislators must be the fact that in the past two years **60-65% of all contraband seizures in Hong Kong were genuine tobacco products** so members of the Security Panel should use the opportunity of the attendance of TCCG to question them on why they are not controlling their supply chains and thereby allowing their genuine products to appear duty-not-paid in the local black market, thereby defrauding the Government of excise revenue and also sabotaging the Government's tobacco control efforts. The Hon Members should also question the TCCG as to how **6.9% of the genuine product** contraband seizures were marked 'HK Duty Not Paid' and are thereby allegedly products leaked through the Hong Kong Duty Free outlets into the local black market.

Please find attached in this document relevant information on action taken in Europe with the tobacco companies whereby any seizures of genuine tobacco contraband are punished by levy of onerous fines on the multinationals as well as sums of Euros 400 million payable per tobacco company over a 15 years period to the EC to assist in the costs of OLAF. We need like agreements and legislation in Hong Kong as in the EU to control these tobacco companies and genuine product smuggling would stop forthwith since they do have the admitted power to control their supply chains. The Organised and Serious Crimes Ordinance could be effectively used against the perpetrators and conspirators to defraud in this illegal activity.

<http://www.canada.com/montrealgazette/story.html?id=55ff158a-1e3d-49cc-b69c-2c6b2e748f97>

Tobacco insider talks: Major firms were deeply involved in cross-border smuggling, former executive says

<http://webcache.googleusercontent.com/search?q=cache:h4GiQKlOdEJ:www.publicintegrity.org/investigations/tobacco/articles/entry/765/+canada+tobacco+smuggling+jail+executives&cd=1&hl=en&ct=clnk&gl=uk&source=www.google.co.uk>

Then suddenly on July 31, after a year of secret negotiations, Canada's two largest tobacco companies — Imperial Tobacco Canada and Rothmans Inc. — pleaded guilty to aiding and abetting tobacco smuggling from 1989 to 1994, **defrauding** Canadian governments of more than a billion dollars in unpaid taxes.

The two companies agreed to pay an unprecedented **C\$1.15 billion** (US\$1.12 billion) to Canadian governments and to plead to one count of "aiding persons to sell or be in possession of tobacco products manufactured in Canada that were not packaged and were not stamped in conformity with the Excise Act and its amendments and the ministerial regulations."

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Imperial Tobacco, maker of 16 cigarette brands including Canada's top sellers Players and du Maurier, agreed to pay US\$582 million. Rothmans, parent of Rothmans, Benson & Hedges Inc. and maker of 16 cigarette brands, agreed to US\$534 million.

Key to the settlement was the government's readiness to release all former and present executives, employees, directors and officers from civil or criminal prosecution. Also released were the companies' foreign owners and affiliates. Tobacco bosses who oversaw the smuggling could now live out their retirements without fear they might be interrupted by a spell in prison. It wasn't an idle fear. Two former executives with Canada's third largest tobacco company, RJR Macdonald, have been convicted. One served four years in jail. Six others are awaiting trial or procedures that could eventually send them to trial.

The settlement has left RJR out in the cold. The company, now called JTI Macdonald after its 2000 purchase by Japan Tobacco, faces about \$10 billion in claims from various Canadian governments.

CONTRARY TO WHAT Hon TOMMY CHEUNG SAYS – TOBACCO TAXATION WORKS – fact !

From: edmond_ma@dh.gov.hk [mailto:edmond_ma@dh.gov.hk]

Sent: Friday, March 18, 2011 11:45 AM

To: ed@cosh.org.hk; jtse@cosh.org.hk

Cc: raymond_ho@dh.gov.hk

Subject: Evidence to support raising tobacco duty

Dear Janice,

As spoken, we have summarized the some key evidence to support raising tobacco duty for your reference.

Please see whether this is useful for your for the Green Ribbon Action / other future lobbying activities.

Raising tobacco duty helps:

1. Preventing youngsters to start smoking

- Results of survey conducted by the Census and Statistics Department before (December 2007-March 2008) and after (December 2009-March 2010) increase in tobacco duty in Feb 2009 showed a significant drop in smoking prevalence from 2.4% to 1.8% among those aged 15-19, and from 12.2% to 11.0% among those aged 20-29.

2. Motivating people to quit smoking

- This is reflected by the increase in number of calls to the integrated smoking cessation hotline run by Department of Health. A total of 1324 calls were received in the first week after announcement of tobacco tax

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increase on February 23 this year, a 5-fold increase when compared to the average weekly number (266) in 2010.

- More smokers quit because of increase in tax. Among the 1280 callers who called from Feb 23 to Mar 17 and expressed (their) reason to quit, 62.8% quit because of tobacco tax / saving money, much higher than the corresponding figure (17.6%) in Jan this year.

Best regards,
Edmond

Dr Edmond Ma
Senior Medical Officer
Tobacco Control Office
Department of Health
Tel: 2961 8423

The above facts are quite clear and unambiguous. The tobacco companies will lie and deceive to all possible extents to maintain their profitability which just happens to involve addicting children and youth to nicotine and eventually killing adult smokers as collateral damage of their products.

The opinion of Legislators and the Hong Kong public on the recent Budget fiasco has caused heated debate. However decision makers must realise that the tobacco excise increase is aimed at saving the lives of children and youth and to wean blue collar members of the public away from the highly addictive nicotine products. This important Preventative Health Measure should not become collateral damage of a poor Budget. Legislators decried the Budget for lack of long term policy thinking beneficial to the general public; this excise increase is the most significant long term policy measure in the Budget as it literally goes to the heart of our children and youth and their future long term health.

Yours sincerely,

James Middleton
Chairman
Clear the Air NGO and Charity



Background information

Tobacco Companies Linked to Criminal Organizations in Lucrative Cigarette Smuggling

International Consortium of Investigative Journalists March 3rd, 2001

<http://www.corpwatch.org/article.php?id=898>

When Tommy Chui failed to show up at the grand opening of his wife's new boutique in downtown Singapore, alarm bells rang 1,600 miles away in the offices of Hong Kong's Independent Commission Against Corruption. It was March 29, 1995, and the news that Chui was missing devastated the commission's assistant director, Tony Godfrey. He immediately sent two investigators to Singapore. Three days later, on April 1, his worst fears were realized. Dockworkers found Chui's bloated body floating in Singapore Harbor.

A former director of British American Tobacco's biggest distributor of contraband cigarettes to China and Taiwan, the 38-year-old Chui had been abducted, ritually tortured, gagged, suffocated and thrown into the harbor just weeks before he was to testify against his ex-associates. Chui was the star prosecution witness in an international tobacco smuggling investigation launched in 1993 by Hong Kong's Independent Commission Against Corruption. He was about to blow the lid off a \$1.2 billion smuggling operation to China and Taiwan and implicate three former British American Tobacco executives in a HK\$100 million bribery scandal. In addition, his testimony was key to the prosecution of his two former business associates, several corrupt customs officers and various members of Asia's most notorious criminal gang, the Triad. Tobacco manufacturers have often blamed the international smuggling of their products on organized crime. But a year-long investigation by the Center for Public Integrity shows that tobacco company officials at BAT, Philip Morris and R.J. Reynolds have worked closely with companies and individuals directly connected to organized crime in Hong Kong, Canada, Colombia, Italy and the United States.

Corporate documents, court records and internal government reports -- some going back to the 1970s -- also show that BAT, Philip Morris and R.J. Reynolds have orchestrated smuggling networks variously in Canada, Colombia, China, Southeast Asia, Europe, the Middle East, Africa and the United States as a major part of their marketing strategy to increase profits. The corporate documents refer to this black market business as "duty not paid," "parallel" markets, "general trade" or "transit." But these same documents often clearly delineate between this aspect of the business and legal trade. For example, one BAT official, in a 1989 letter to associates in Taiwan, said, "With regard to the definition of transit, it is essentially the illegal import of brands from Hong Kong, Singapore, Japan, etc. upon which no duty has been paid." Hung Wing-wah still operates his tobacco distribution business out of the Philippines and, although he is wanted on smuggling-related charges in Hong Kong, BAT continues to do business with him, Godfrey of the corruption commission said.

"BAT are still selling cigarettes to a company run by a man who they know is wanted by the Independent Commission Against Corruption," he said. "We can't take any action against British American Tobacco. They commit no offence, not in Hong Kong." "BAT has in the past and probably now still deals with criminal organized crime," Godfrey said.

"A leading international tobacco company sold large quantities of duty-not-paid cigarettes, worth billions and billions of dollars, with the knowledge that those cigarettes would be smuggled into China and other parts of the world... **In my view, the tobacco companies were clearly putting their commercial interests above whatever moral duty they may have towards our society and to some extent such irresponsible behavior amounted to assisting criminals in transnational crime.**" Justice Wally Yeung Chun-kuen, Hong Kong Court of Appeal of the High Court, 1998

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guardian.co.uk

<http://www.guardian.co.uk/uk/2000/feb/03/kevinmaguire/print>

Clarke admits BAT link to smuggling

BAT exposé: special report

-
- **Kevin Maguire**
 - The Guardian, Thursday 3 February 2000 02.02 GMT
-

Kenneth Clarke, the former Tory chancellor who is now deputy chairman of British American Tobacco, today admits that the multinational company supplies cigarettes knowing they are likely to end up on the black market.

Mr Clarke publicly defends the world's second largest tobacco company for the first time after the Guardian disclosed how it profits from smuggling. Writing in today's paper, Mr Clarke says it is "faced with a dilemma" because smokers switch to other brands or counterfeiters cash in if it restricts supplies.

"Where any government is unwilling to act or their efforts are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market," says Mr Clarke.

Internal BAT documents analysed by the Guardian were dated up to 1995 but the non-executive director makes no attempt to deny that the exploitation of smuggling is continuing.

The all-party Commons health committee will today consider recalling Martin Broughton, BAT's chairman, as part of an investigation into the tobacco industry. Audrey Wise, a Labour member of the committee, said: **"If there was ever a case of being within the letter of the law but clearly outside the spirit of the law then this is a gem. Smuggled goods are illegal goods, so if you're deliberately making your goods available for smuggling knowingly and deliberately you are an accessory to the fact."**

Clive Bates, head of the anti-smoking group Ash, said: "It is now absolutely clear that vicious competition for cigarette sales in developing countries has led BAT into the manipulation of illegal markets through intermediaries. "However they try to distance themselves from it, Clarke's incredible and candid admission does mean that **they are treating smuggling as a normal part of tobacco business.** "Once they started down this route, they were inevitably led into the kinds of controlling actions we see described in the memos released in the Guardian."

The documents obtained from the firm's Guildford depository revealed widespread exploitation of smuggling around the world. BAT had previously claimed it merely turned a blind eye to smuggling but **the papers show it is central to the company's operation.**

Mr Clarke went public after pressure from MPs for a statement. He said it was "not in our wider commercial interests" but blamed governments levelling high taxes on cigarettes for the trade.

guardian.co.uk © Guardian News and Media Limited 2011

<http://www.guardian.co.uk/uk/2000/jan/31/duncancampbell>

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What they say now : Tracking and tracing – BAT website

http://www.bat.com/group/sites/uk_3mnfen.nsf/vwPagesWebLive/DO6ZYC4S?opendocument&SKN=1

The legal supply chain must be protected from infiltration by contraband and from the diversion of legitimate products into illegal channels. We agree with the WHO that tobacco manufacturers should strengthen supply chain security by introducing effective track and trace systems, and we believe this should apply to all manufacturers, whatever their size. We support the development of systems that will help to track the forward movement of goods through the supply chain, and also to trace back to show where genuine goods have been diverted from normal distribution channels. It tracks our products made in Poland and sold in the Polish market and also exported to the UK. Cartons (containing 20 packs of cigarettes), master cases (1,000 packs) and pallets (15,000 packs) are securely labelled, coded and scanned and are trackable to the intended first external customer. Government authorities, including customs, can retrieve data from our system using the unique label printed on any suspect product they find.



In conjunction with journalists in Washington and Colombia, the Guardian has never-before published details on British American Tobacco's activities around the world. Scroll down to see the original memos: - Click on the link to see all the articles.

<http://www.guardian.co.uk/bat>



<http://www.publicintegrity.org/investigations/tobacco/>

<http://www.publicintegrity.org/investigations/tobacco/articles/>

June 29, 2009 **China's Marlboro Country**

<http://www.publicintegrity.org/investigations/tobacco/articles/entry/1517/>

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A Massive Underground Industry Makes China the World Leader in Counterfeit Cigarettes
On first approach, Yunxiao seems like any other Chinese backwater caught in uneasy industrial transition. Faded advertisements line the streets downtown, where motorcyclists wearing bamboo-frond hats determinedly vie for passengers in a riot of honking. A cheerful red banner in the city center exhorts citizens to develop the local economy — and yet the message seems ironic. After all, since the 1990s, Yunxiao has already sprouted its own league of millionaires, famous throughout China. *Read more in the attached pdf file.*

<http://www.publicintegrity.org/investigations/tobacco/articles/entry/1517/>

庞大的地下烟草产业使中国成为全球假烟巨头

国际调查报道记者同盟.

云霄给人的第一印象与其他在动荡的工业化转型期发展缓慢的中国乡镇没有太大的区别：城区街道两旁竖立着褪色的广告牌，在摩托车的轰鸣声中，戴着竹斗笠的摩托车主争先恐后忙着招揽过路的乘客。市中心有一条醒目的号召市民“大力发展地方经济”的红色标语——但这个信息似乎有些讽刺意味，从上世纪 90 年代开始，云霄已经出现了一批闻名全国的百万富翁。

Japan Tobacco International / Gallaher

As for Gallaher, the 150-year-old company was bought in 2007 by Japan Tobacco International (JTI), a \$50 billion behemoth half-owned by the Japanese government. **In December 2007, OLAF and JTI struck a deal to avoid litigation by the European Commission and its member states over smuggling. To atone for Gallaher's past, JTI agreed to pay a €400 million fine.** JTI, for its part, promised to clean up the mess it had inherited. In exchange, JTI got a two-year moratorium on enforcement of smuggling statutes against Gallaher.

http://www.reportingproject.net/underground/index.php?option=com_content&view=article&id=2&Itemid=18

Philip Morris and EU agreement

<http://www.ash.org.uk/current-policy-issues/taxation-smuggling/smuggling/international-tobacco-smuggling/philip-morris-and-eu-agreement>

In 2004 the European Commission, together with 10 Member States of the European Union and Philip Morris International announced a 12 year agreement that includes an efficient system to fight against future cigarette smuggling and counterfeiting and which ends all litigation between the parties in this area. Philip Morris agreed to work with the European Commission and law enforcement authorities to help in the fight against contraband or counterfeit cigarettes. This section outlines the documents and processes towards achieving this agreement. (*visit the above link to download and view the relevant following files*)



Summary of the agreement between the European Commission and its member states and PMI

Summary of the agreement between the European Commission and its member states and Philip Morris International

Author: European Commission Published By: European Commission Published : 27/07/2004



Background to the PMI and European Commission dispute

This document outlines the background to the dispute between Philip Morris International (PMI) and the European commission.

Author: European Commission Published By: European Commission Published : 27/07/2004



European Commission and Philip Morris International sign a 12 year agreement to combat contraband and counterfeit cigarettes

European Commission and its member states reach an agreement with Philip Morris International signing a 12 year agreement to combat contraband and counterfeit cigarettes.

Author: European Commission Published By: European Commission Published : 08/07/2004



ASH press release and briefing

ASH press release and briefing asking why the United Kingdom is not included in the billion dollar deal Marlboro did with Europe on smuggling

Author: ASH Published By: ASH Published : 08/07/2004



Philip Morris anti-contraband agreement with Europe

9 July 2004. In an effort to resolving a long running dispute with the European Community, Philip Morris agreed to a landmark one billion dollar deal on tobacco smuggling. In the past tobacco industry executives have denied they aided and abetted smuggling but this agreement highlights that falsehood by showing exactly how smuggling can be controlled. Author: European Commission Published By:

European Commission Published : 08/07/2004



http://ec.europa.eu/anti_fraud/budget/ (click on links below to view files)

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Fight against cigarettes smuggling :

http://ec.europa.eu/anti_fraud/budget/2010/2010_en.html

Anti-Contraband and Anti-Counterfeit Agreement 2010

II

Anti-Contraband and Anti-Counterfeit Agreement 2010

II

Summary: The 27 September 2010 the European Commission announced a multi-year agreement with Imperial Tobacco Limited (ITL) to work together in tackling the illicit trade in tobacco products. Under the legally binding agreement, ITL will work with the European Commission, its anti-fraud office OLAF, and Member States' law enforcement authorities to help in the fight against contraband and counterfeit cigarettes. The Agreement includes substantial payments by ITL to the Commission and Member States, totalling USD 300 million (EUR 207 million¹) over the next 20 years. It should make a significant contribution to the EU's efforts to fight the illicit tobacco trade, which robs the EU and Member States of billions of euros every year.

[Press Release](#)

[Memo - Contraband and counterfeit
cigarettes: frequently asked
questions](#)

[Mutual Cessation Agreement](#)

● **Anti-Contraband and Anti-Counterfeit Agreement 2010**

● **Anti-Contraband and Anti-Counterfeit Agreement 2007**

● **Anti-Contraband and Anti-Counterfeit Agreement 2004**

● **Cigarette seizures**



European Commission and JT International (Japan Tobacco) sign 15-year 15-year Agreement to combat contraband and counterfeit cigarettes

*The European Commission, together with 26 participating Member States of the European Union^[1], and JT International (JTI) today announced a multi-year agreement that includes an efficient system to fight against future cigarette smuggling and counterfeiting. Through the Agreement, JTI will work with the European Commission, its anti-fraud office OLAF, and law enforcement authorities of the Member States to help in the fight against contraband, including the problem of counterfeit cigarettes. The Agreement includes substantial payments by JTI, which **total USD 400 million over fifteen years**. "I welcome the conclusion of the negotiations of this important agreement. It is to the advantage of the EU because it protects its financial interests," said Commission President José Manuel Barroso. "This Agreement represents a further major step forward in the continuing battle against contraband and counterfeit cigarettes," said Vice-president Siim Kallas, responsible for the fight against fraud. "Contraband and counterfeit products cheat everyone: governments, consumers and legitimate businesses. This new agreement will further enhance the ability of the European Commission and of the Member States to combat the illegal trade in cigarettes, which results in the loss of substantial tax and customs revenues each year. It sends a strong signal to the world that agreements between authorities and industry to fight illegal trade work and bring substantial benefits," he added.*

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1927&format=HTML&aged=0&language>

Fight against counterfeit

The Commission and the EU Member States point to several reasons why they view expanded anti-counterfeit and anti-contraband efforts as requiring significant priority. Among other reasons, the European Community and the Member States are losing hundreds of millions of Euros in unpaid taxes from counterfeit cigarettes. In addition, counterfeit and other forms of contraband create a parallel illegal supply chain that invades and compromises legitimate distribution channels and competes unfairly with genuine products distributed through legitimate channels.

Over the last few years, the incidence of contraband JTI cigarettes has been greatly reduced, but during the same time period, counterfeit cigarettes have become a growing threat to the European Community and the Member States. The Commission has therefore announced that it will build on existing efforts to combat the illegal trade in cigarettes which consist of: - vigorously investigating cigarette counterfeiting in close cooperation with the Member States and law enforcement officials in key locations worldwide; - targeting and interrupting the production of counterfeit cigarettes with the goal of preventing counterfeit cigarettes from being introduced into the European Community; and - recording and pursuing seizures of counterfeit cigarettes in the European Community to identify the source of the product and other relevant information.

Fight against contraband and money laundering: Know your customers and tracking and tracing

The Agreement builds on the efforts of all parties and introduces innovative procedures to combat the diversion of JTI's products into contraband channels in Europe and around the world. Today's agreement reflects the reality that success in defeating the contraband and counterfeit cigarettes trade can be aided greatly through a joint agreement whereby major manufacturers like JTI and

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European law enforcement combine their resources and enhance their coordination in combating contraband and counterfeiting.

The Agreement contains strong provisions, approved by all parties, which provide them with a mechanism for the long-term prevention of any large-scale smuggling of genuine Japan Tobacco cigarettes in the European market. The Agreement requires JTI to build on its existing review process for selecting and monitoring customers, to enhance its capabilities to track and trace certain packaging, and to provide expanded support to European law enforcement in its battle against the illegal trade in cigarettes. Under the Agreement, JTI agrees to continue limiting its sales to volumes commensurate with legitimate market demand. The Agreement also incorporates and builds into a comprehensive contractual framework JTI's existing compliance programmes.

Historically, a key concern for the European Community has been the introduction of contraband cigarettes into the European Community. For that reason, the European Community has taken vigorous action to address cigarette smuggling. European law-enforcement efforts have resulted over the past several years in the reduction of the amount of cigarettes that enter the EU as contraband. The European Commission has determined that constructive and forward-looking agreements, such as this Agreement with JTI, are useful tools in addressing these issues.

The initiative includes far-reaching product-tracking procedures that will facilitate law enforcement efforts to determine the point at which any genuine product is diverted from the authorised sales channel. Consistent with the Agreement, JTI will mark certain packaging with information indicating the intended market of retail sale, mark "master cases"¹² of cigarettes with machine-scannable barcode labels, and implement other procedures useful for the tracking and tracing of its products.

These obligations embody a far-reaching, joint tracking and tracing initiative which is consistent with the anti-contraband provisions of the WHO Framework Convention on Tobacco Control and which will underpin the efforts of the EU to promote a strong Protocol to that Convention on the Illicit Trade in Tobacco products.

Obligations under the Agreement

The European Community and the participating Member States will receive substantial payments over a number of years. The amount of JTI's payments under the Agreement totals USD 400 million over 15 years to the EC and participating Member States.

The Agreement also includes a guarantee by JTI to make payments in the event of future seizures in the European Community of its genuine products above defined quantities. These payments will be made without regard to fault or wrongdoing by JTI. These payments will be available to all participating Member States.

The Agreement excludes any future lawsuits against JTI for civil claims arising out of past conduct related to the manufacture, sale, distribution or storage of cigarettes. On April, 18 2007, JTI purchased the Gallaher group. The parties have therefore agreed on a framework and a timetable in which JTI will bring former Gallaher entities up to the standards of the Agreement, with a view to bringing them within the full scope of the Agreement.

Other future Agreements

The Commission is always prepared to have discussions with manufacturers who are willing to commit the necessary resources to improve ways to combat illegal trade in their products and associated criminal activity, such as money laundering. Producers also have a responsibility to fight illegal trade in their products, in full cooperation with relevant government authorities. This

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Agreement should therefore serve as a further model for those cigarette companies that have yet to assume fully such responsibilities.

Background

In the negotiations with JTI, the Commission represented the European Community and the Member States. The Legal Service and OLAF conducted the negotiations for the Commission. On July 9, 2004, the EC and ten Member States signed an anti-contraband and anti-counterfeit agreement with Philip Morris International ([IP/04/882](#)).

The agreement and its annexes are available on:
http://ec.europa.eu/anti_fraud/budget/cig_smug/2007_en.html

^[1] The following Member States are participating Member States under the Agreement: Austria, Belgium, Bulgaria, Czech Republic, Cyprus, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Sweden, and Spain. ^[2] "Master case" means packaging for approximately 10,000 cigarettes.



<http://www.smokefree.hk/en/home/index.html>
Hong Kong [Council on Smoking and Health](#)

Tobacco Smuggling

Taxation is one of the most effective measures for reducing tobacco consumption. The tobacco companies oppose tax increases. **More and more, they rely on the argument that higher taxes are an incentive for smuggling.**

According to the industry, increased cigarette taxes will reduce legal sales, but not total sales (legal and illegal sales combined). They argue that increased taxes will lead to increased smuggling, resulting in less revenue for governments and undermining taxation as an effective health policy to curb tobacco consumption.

The tobacco industry argues that increase in tobacco tax will lead to a massive increase in smuggling and reduced government revenues, is it telling the truth?

No. as the World Bank's report concludes, tax increases lower tobacco consumption while raising government revenue. In Hong Kong, the Customs and Excise Department works quite closely with the tobacco industry to tackle the smuggling problem. **The Tobacco Institute's move to be identified as a collaborator with Customs and Excise in Hong Kong is, in fact, a deception.** **There is a lot of evidence of the tobacco industry's deep involvement and complicity with smuggling activities around the world.** The industry only used the smuggling issue as an argument against increases in tobacco duty, which will have a direct affect on their revenue.

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The appropriate response is to crack down on criminal activity rather than freeze or reduce the tobacco tax.

Concessions on the increase in tobacco tax will instead make cheap tobacco available to smokers from both sides of duty-paid cigarette and contraband ones from the black market.

Related Links:

[Globalink - Smuggling Factsheet](#)

<http://tobaccodocuments.org/>

[Campaign for Tobacco-Free Kids - Higher Cigarette Taxes Reduce Smoking, Save Lives, Save Money](#)

WHO Technical Manual on Tobacco Tax Administration



WHO Technical Manual on Tobacco Tax Administration

	Nonserial Publication			
	World Health Organization			
	ISBN-13	9789241563994	ISBN-10	9241563990
	Order Number	11500786		
	Price	CHF 30.00 / US\$ 30.00	Developing countries:	CHF 21.00
	English	2010	134	pages

<http://apps.who.int/bookorders/anglais/dartprt1.jsp?sesslan=11&codlan=1&codcol=15&codcch=786>
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Summary

Tobacco use is the single largest cause of preventable death globally, killing more than five million people each year. **Tobacco use also creates considerable economic costs, from greater spending on health care to treat the diseases it brings on in users and those exposed to tobacco smoke to the lost productivity resulting from the premature deaths it causes.**

Of all the many interventions for reducing tobacco use, a significant increase in tobacco product taxes and prices has been demonstrated to be the single most effective and cost-effective intervention, particularly among the poor and the young. At the same time, because of the inelasticity of demand for tobacco products in most countries and the low share of tax in price in many, significant increases in tobacco taxes generate significant increases in the revenues generated by these taxes.

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This technical manual aims to help governments achieve both objectives by identifying a set of "best practices" for tobacco taxation. It documents governments' existing approaches to tobacco taxation, discusses barriers to using tobacco taxes to achieve health and revenue objectives, and provides case studies of effective tobacco tax administration. This manual is intended to be useful to tax administrators at the Ministry of Finance level by making them aware of the practices used and challenges faced by other countries. It will also be useful to officials in a country's Ministry of Health or similar organizations by providing them with a more thorough understanding of key issues in tax structure and administration.

Quote from the Manual:

*"Several approaches have been used to obtain estimates of the extent of tobacco smuggling, including relying on expert opinion, monitoring tobacco trade, comparing tobacco sales with total consumption estimated from survey data and econometric modeling of the determinants of aggregate sales data (Merriman et al, 2000). Joossens et al. (2009) review a variety of estimates and **conclude that 11.6% of global cigarette market was illicit** in or around 2007. A KPMG study, commissioned by the European Commission, estimated that in 2004 illicit trade represented approximately 8-9% of the EU-25 tobacco market (Joossens et al., 2009). To evaluate the size of the informal tobacco sector, let alone its composition is difficult, especially as it evolves over time. In 2000/01 in the UK, **most illicit cigarettes were genuine, locally manufactured products, exported to continental Europe and then smuggled back to the UK. In 2002 and 2003, leading UK tobacco manufacturers signed the Memoranda of Understanding under which they agreed to control the supply chain.** These agreements were voluntary and non-binding, and as such their effectiveness depended on the manufacturer's goodwill. **In 2006, the UK introduced changes in its legislation, setting high penalty payments. As a result of these measures, smuggling of UK genuine brands was reduced.** However, this type of smuggling was replaced by smuggling of counterfeit and cheap non-UK brands. Looking at other tobacco products, smuggling in hand rolling tobacco (HRT) remained a serious problem: more than half of HRT consumed in the UK is illegal (ASH, 2009). **There is still scope for improving the supply chain control.**"*

<http://www.thisisleicestershire.co.uk/news/Smokers-told-watch-counterfeit-cigs-duty-free-shops/article-3032360-detail/article.html>

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Counterfeit cigs bought at duty-free shop made smoker sick



Roy Pickworth, of Cedar Road, Blaby, was given the cigarettes by his son following a trip to China. Trading standards officers and tobacco firms are warning smokers to beware of counterfeit cigarettes being passed off as legitimate products in duty-free shops abroad.

The warning comes after a Leicestershire man was sick after being given a pack of 200 duty-free cigarettes he believed were Benson & Hedges.

Roy Pickworth, of Cedar Road, Blaby, was given the cigarettes by his son following a trip to China.

The 67-year-old said: **"My son bought the pack of 200 cigarettes for me from a duty-free shop in Hong Kong."**

"I foolishly thought because they were bought at an airport they would be genuine.

"The sealed carton looked genuine, but when I opened the box I noticed the individual packets were a faded silvery gold colour.

"Then, when I tried to smoke one of the cigarettes, it made me violently sick. As soon as I inhaled, it felt like my lungs and throat were on fire – it was extremely painful.

"The smell was noxious and the smoke was black and acrid – I just couldn't breathe."

Mr Pickworth contacted British American Tobacco, which manufactures the Benson & Hedges brand, and sent them a packet of the cigarettes for analysis. They confirmed the pack was counterfeit.

He said: "My concern is that these fakes could be getting into the country this way and other unsuspecting people could be affected. Luckily, I'm okay, but God knows what they put in those things."

Catherine Armstrong, of British American Tobacco, said: "An examination by our brand enforcement team confirmed that Mr Pickworth's cigarettes were indeed counterfeit.

"It is very rare to come across counterfeit products bought from an airport duty-free shop.

"Our Hong Kong office has been informed and will be investigating the matter."

She said: "We cannot say exactly what materials were in the cigarettes, but urge consumers to make sure they do buy from legitimate sellers. *In past experience, everything from cow dung and rat droppings to wood or plastic shavings can be found in counterfeit cigarettes.*

"In terms of Benson & Hedges cigarettes, the gold carton is usually very hard to reproduce. If the colour appears faded in any way, then do not smoke the products."

Dave Bull, head of Leicestershire County Council Trading Standards, said: "While it's accepted that smoking tobacco is bad for you, smoking illicit cigarettes could be a whole lot worse. Fake cigarettes are a classic counterfeit product as it's often only when the person tries to smoke them that it becomes obvious that they are illicit."

To report counterfeit goods or to get advice, call Consumer Direct on 08454 040506.



<http://tobaccocontrol.bmj.com/content/9/1/78.full>

Myth 4 (TI)

A large tax increase is undesirable because it will reduce government revenues by decreasing legal cigarette sales. This will result from decreased smoking and increased smuggling of lower priced cigarettes from neighbouring countries.

REALITY

The essential observation is that the threat of smuggling is systematically exaggerated by the tobacco industry to combat increased taxes that will discourage purchase of its products. The author is aware of no documented instances of tax revenues declining when tax rates were increased.

Myth 5 (TI)

Even if a tax increase would raise government revenues and decrease smoking, it is fundamentally unfair because its burden would fall disproportionately on the poor. Taxes should be proportional or progressive (that is, taking the same (proportional) or a larger proportion (progressive) of the income of the affluent); they should not be regressive (taking a larger share of the income of the poor than of the wealthy).

REALITY

In most nations, more of the poor smoke than do the rich. As a consequence, the poor often spend a substantially larger proportion of their incomes on cigarettes than do the affluent. Legislators can reduce concerns about inequity by dedicating some portion of the revenues from the increased tax to assist low income smokers to quit. A sizable majority of low income smokers in developed countries report that they would like to quit. Given their financial circumstances, however, they may have limited access to professional help and pharmaceutical quitting aids. The mix of greater price responsiveness among the poor and allocation of revenues toward smoking cessation in this group can make the net impact of the tax increase measure progressive.

In short, the potential regressivity of a tobacco tax increase represents much less of a concern than one might expect. **That its use by the tobacco industry to fight such increases is disingenuous is demonstrated by the fact that the industry never expresses the same concern when raising its own wholesale prices. The economic burden on the poor who smoke is identical.**

Especially given that in industrialised nations poorer smokers suffer disproportionately from the diseases caused by smoking, a larger proportion of the eventual health benefits of quitting will accrue to the low income population. *In this regard, increasing the cigarette tax is clearly a "progressive" public health policy.*



Medical News
TODAY 
www.medicalnewstoday.com

Tobacco Companies Cry Wolf: Chancellor Urged Not To Cave Into Industry Threats Over Smuggling, UK

18 Mar 2011

A submission to the Treasury in advance of next week's Budget by ASH and the UK Centre for Tobacco Control Studies (UKCTCS) endorsed by 68 health organisations has urged the government to stick to its principles and increase taxation on tobacco well above inflation. Putting prices up through taxation is, **to quote the Conservative Chancellor of the Exchequer, Kenneth Clarke, in his budget speech in 1993, "the most effective way to reduce smoking"**.

Professor Lindsey Davies, President of the Faculty of Public Health, one of the leading organisations which endorsed the submission said:

"The Government's commitment to improve the health of the poorest fastest is to be applauded but unless smoking rates amongst the poorest decline significantly it has no chance of success. Work at local level by councils and Directors of Public Health to support and motivate smokers to quit must be backed up at national level by making smoking less affordable. This means increasing taxes now and doing more to tackle smuggling."

The tobacco industry claims that the rate of smuggling and the volume of contraband sold on Britain's streets increases when excise duty goes up. **But health groups argue that controlling tax fraud is a law enforcement issue and that cracking down on smuggling, not cutting taxes is the way to bring it under control.**

Dr. Casey Quinn, health economist with the UK Centre for Tobacco Control Studies at the University of Nottingham, commented:

"In this harsh economic climate, raising tobacco taxes above the rate of inflation provides an important incentive to quit smoking, as well as raising much-needed cash for Government and measures to help smokers quit. Controlling smuggling and increasing tobacco duties should be a key Government priority as this will lead to a win-win situation: increased revenue and reduced costs to the health service as smokers quit and smoking-related diseases decline." Deborah Arnott, Chief Executive of ASH said:

"Every year the industry trots out the same argument that putting up taxes increases smuggling. Since the Government implemented its anti-smuggling strategy there has been a steady decline in the illicit market of cigarettes while at the same time, taxes have increased and smoking rates have fallen. The real reason the industry fears a tax rise is because it helps smokers quit."

Source

Action on Smoking and Health

Article URL: <http://www.medicalnewstoday.com/articles/219327.php>

Main News Category: Smoking / Quit Smoking

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Increased tobacco taxation can stop this:



<http://tobaccoatlas.org/illegal.html?iss=16&country=0> **THE TOBACCO ATLAS**

Cigarettes are the world's most widely smuggled legal consumer product. In 2006, contraband cigarettes accounted for 11 percent of global cigarette sales, or about 600 billion cigarettes. For years, the tobacco industry claimed that high cigarette taxes encouraged smuggling from low tax jurisdictions. **However, documents uncovered during recent lawsuits confirm that the tobacco industry itself is responsible or involved in many large-scale cigarette smuggling operations worldwide.**

Cigarette smuggling undermines public health efforts to reduce tobacco use by making international brands more affordable to low-income consumers and to youth, thus

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stimulating consumption. In addition, illicit products often fail to comply with health warning requirements and often violate youth access laws due to informal and underground distribution networks. Illicit trade also deprives governments of billions of dollars in annual tax revenue needed for tobacco control and to treat tobacco-related diseases. Illicit trade deprives governments of US\$40–50 billion in tax revenue each year. ***This revenue is siphoned by organized crime networks and the tobacco companies themselves, assisting in greater sales volume and higher profit margins. Tobacco companies also smuggle cigarettes to launch new brands, enter new markets, and fight price wars with competitors.***

Article 15 of the WHO Framework Convention on Tobacco Control addresses the illicit trade problem and is the basis for a new international protocol to control cigarette smuggling formulated by the parties to the Convention.

PART IV: MEASURES RELATING TO THE REDUCTION OF THE SUPPLY OF TOBACCO

Article 15 http://www.who.int/tobacco/framework/WHO_FCTC_english.pdf

HK Government must take action under Article 15 4.(e) against all tobacco companies whose genuine products are seized as contraband in Hong Kong.

Illicit trade in tobacco products

1. The Parties recognize that the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting, and the development and implementation of related national law, in addition to subregional, regional and global agreements, are essential components of tobacco control.
2. Each Party shall adopt and implement effective legislative, executive, administrative or other measures to ensure that all unit packets and packages of tobacco products and any outside packaging of such products are marked to assist Parties in determining the origin of tobacco products, and in accordance with national law and relevant bilateral or multilateral agreements, assist Parties in determining the point of diversion and monitor, document and control the movement of tobacco products and their legal status. In addition, each Party shall:
 - (a) require that unit packets and packages of tobacco products for retail and wholesale use that are sold on its domestic market carry the statement: ***“Sales only allowed in (insert name of the country, subnational, regional or federal unit)”*** or carry any other effective marking indicating the final destination or which would assist authorities in determining whether the product is legally for sale on the domestic market; and
 - (b) consider, as appropriate, **developing a practical tracking and tracing regime** that would further secure the distribution system and assist in the investigation of illicit trade.
3. Each Party shall require that the packaging information or marking specified in paragraph 2 of this Article shall be presented in legible form and/or appear in its principal language or languages.
4. With a view to eliminating illicit trade in tobacco products, each Party shall:
 - (a) monitor and collect data on cross-border trade in tobacco products, including illicit trade, and exchange information among customs, tax and other authorities, as appropriate, and in accordance with national law and relevant applicable bilateral or multilateral agreements;
 - (b) enact or **strengthen legislation, with appropriate penalties and remedies**, against illicit trade in tobacco products, including counterfeit and contraband cigarettes;

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(c) take appropriate steps to ensure that all confiscated manufacturing equipment, counterfeit and contraband cigarettes and other tobacco products are destroyed, using environmentally-friendly methods where feasible, or disposed of in accordance with national law;
(d) adopt and implement measures to monitor, document and control the storage and distribution of tobacco products held or moving under suspension of taxes or duties within its jurisdiction; and

(e) adopt measures as appropriate to enable the confiscation of proceeds derived from the illicit trade in tobacco products.

5. Information collected pursuant to subparagraphs 4(a) and 4(d) of this Article shall, as appropriate, be provided in aggregate form by the Parties in their periodic reports to the Conference of the Parties, in accordance with Article 21.

6. The Parties shall, as appropriate and in accordance with national law, promote cooperation between national agencies, as well as relevant regional and international intergovernmental organizations as it relates to investigations, prosecutions and proceedings, with a view to eliminating illicit trade in tobacco products. Special emphasis shall be placed on cooperation at regional and subregional levels to combat illicit trade of tobacco products.

7. Each Party shall endeavour to adopt and implement further measures including **licensing**, where appropriate, **to control or regulate the production and distribution of tobacco products in order to prevent illicit trade.**

Increased Tobacco Taxation can stop this:



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Here is what the newspaper vendors' association representative said :



Vendors fume at tax hike

A higher tobacco tax may force more street vendors out of business, a hawkers' association warns.

Elizabeth Law *Friday, February 25, 2011*

A higher tobacco tax may force more street vendors out of business, a hawkers' association warns.

Tobacco duty was raised by 50 cents per cigarette stick in the budget, and the Hong Kong Association of Newspaper Hawkers said the increase - HK\$10 per packet - will sharply lower their profit margin and more people will turn to cheaper illicit cigarettes.

The group called for the government to reverse its decision on the tax increase. Association vice chairman **Cheung Tak-wing** said vendors will now need even more capital to sell cigarettes, which offer a low profit margin. Before Wednesday, vendors made a **HK\$3 profit from every pack**, about 7 percent of the recommended retail price. **They usually sell 10 packs a day on average.**

When taxes were raised 50 percent in 2009, more than 1,500 newspaper stalls shut as they could no longer afford to sell cigarettes because of the capital needed. **Today, there are only slightly over 1,200 news vendors, 600 of which are newsstands.**

Lam Cheung-foo, another of the association's vice chairmen, said while tobacco accounts for only about 30 percent of revenue it draws in additional business. "When people buy cigarettes, they also buy other things such as magazines and newspapers," he said. "But when they buy illicit smokes because of the high legal price we lose their business completely." The association also urged producers to be fair and raise vendors' profit margins to 15 percent.

But a group of academics from the University of Hong Kong applauded the government's efforts to reduce smoking. They include School of Public Health director Lam Tai-hing and nursing school director Sophia Chan Siu-chee.

Calling opponents of the tax hike "enemies of public health," Lam said **smoking kills 7,000 people a year in Hong Kong. "There is no room for debate that increasing tobacco duty is the most effective control measure,"** he said. "Some say using health as a reason to support the increase of tobacco tax is weak. We think these people are totally misleading and ridiculous."

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Here is what the newspaper vendors' association representative stated a few days after the Budget : 'sales were not affected'

Smokers sniff out tax rise bargains

Store sales drop and Quitline gets more calls

Ng Yuk-hang

SCMP Mar 07, 2011

Cigarette sales at leading convenience stores have dropped by half and **calls to a government helpline by people trying to quit smoking increased more than sixfold since tobacco tax was raised in the budget by 41.5 per cent.**

But sales have not dropped at newsstands, where many smokers have taken their business because the stands sell cigarettes for HK\$2-HK\$3 a pack cheaper than convenience stores.

Since last month's budget speech, customs officers have stepped up action against illicit traffic in cigarettes. In the week after the budget speech they discovered 186 cases, compared to a weekly average of 121 last year.

The cost of a pack of cigarettes rose to about HK\$50 after Financial Secretary John Tsang Chun-wah announced a HK\$10 increase in tobacco tax on February 23. The price is at least HK\$52 in 7-Eleven and OK convenience stores, according to a snapshot survey by the Council on Smoking and Health.

One 7-Eleven shop manager said his outlet **used to sell 400 packs a day** on average. That increased to 600 just before the budget speech, when smokers anticipated the tax increase. **Now it sells only about 170 packs a day.**

He said: "Frontline employees are now under immense pressure. Smokers are always scolding them for setting the price so high. In fact, it's the company's decision."

He said many smokers decided not to buy cigarettes in the store after learning that they were HK\$2 more expensive on average. At least 60 packs a day are being left with his cashier when customers learn the price and decide against buying.

But the picture is very different among newspaper vendors. The vice-president of the **Hong Kong Newspaper Hawker Association, Tang Yap-ming, said sales were not being affected.** "It is a slap on the face for John Tsang," he said. "We were so worried that sales would drop by 30 per cent. **But they have not dropped even by 10 per cent.**"

Lee Mer, convenor of the I Smoke Alliance, said many smokers had switched to buying at newsstands, adding that her own smoking had not lessened since the tax increase.

But other smokers are trying to kick the habit. The Department of Health's Quitline has received more than 240 calls a day since the budget, over six times more than last year's daily average of 38 calls. Ninety-one smokers registered with the department's online

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cessation platform last month, a significant increase over the 35 in February last year.

Meanwhile, 183 people were arrested from February 23 to March 2 for distributing, selling, smuggling and storing illicit cigarettes, according to the Customs and Excise Department. A total of 5.44 million cigarettes were seized. Last year's weekly average was 16 people arrested and 1.46 million cigarettes seized.

Professor Lam Tai-hing, director of the school of public health at the University of Hong Kong, said it was still too early to draw conclusions about the effect of the tobacco tax rise.

"Many factors might have contributed to smokers' behaviour," he said. "Some smokers may still be hoping that the tax increase will be retracted. Some stocked up before the budget and don't need to buy cigarettes yet," he said.

But he said taxing tobacco was the most effective way to make smokers quit, and that smoking killed one out of every two smokers.

Professor Judith Mackay, World Lung Foundation senior adviser and a policy adviser to the World Health Organisation, warned that the tax rise might still be reversed. Therefore, health professionals must unify in presenting a clear picture of how effectively taxation motivated smokers quit.



Source : HK Government Tobacco Control Office - Department of Health

Comparison of cessation calls after the increase in tobacco duty

	2008	2009	2010	2011 (1 Jan – 20 Mar)
Cessation calls	4 335	15 500	13 880	5 660
Calls per day	12	43	38	72
Announcement of tax increase	No increase	25/2 increase +50%	No increase	23/2 increase +41.5%
Calls received for the first week after tax increase	(26/2 – 3/3) 63	(26/2 – 4/3) 2 293	(24/2 – 2/3) 215	(24/2 – 2/3) 1 181
	Average 9 calls /day	Average 328 calls / day	Average 31 calls /day	Average 169 calls / day

Smoking prevalence of daily cigarette smokers

	2000	2001	2002/03	2007	2008	2009	2010	2011
Age 15-19	4.5%	-	3.8%	2.4%		1.8%		-
Male	6.4%		5.3%	3.5%		2.7%		
Female	2.6%		2.3%	1.2%		0.8%		
Age 20-29	12.1%	-	14.4%	12.2%		11.0%		-
Male	19.9%		23.2%	18.4%		16.3%		
Female	4.7%		6.2%	6.1%		5.8%		
Announcement of tax increase	-	7/3	-	-	-	25/2		23/2

Thematic Household Surveys were conducted in the period of i) Oct to Nov 2000; ii) Nov 2002 to Feb 2003; iii) Dec 2007 to Mar 2008; and iv) Nov 2009 to Feb 2010 respectively. The effect of 2011 tobacco tax increase on youth smoking prevalence cannot be determined at this early stage.



From: ekhlee@fehd.gov.hk [mailto:ekhlee@fehd.gov.hk]
Sent: Friday, March 25, 2011 12:44
To: dynamco@netvigator.com
Cc: eykchan@fehd.gov.hk; cpng@fehd.gov.hk; kyau@fehd.gov.hk
Subject: Re: Fw: HK Standard

To: "James Middleton" <dynamco@netvigator.com>

c.c. (Internal) Supt(H), CHI(H), SHI(CR),

Dear Mr Middleton,

Thank you for your email of 25.3.2011.

Please be informed that there are **554 licensed newspaper hawkers in Hong Kong as at 28th February 2011.**

If you have further enquiry, please contact me at 2867 5935.

Regards

K.H.LEE, Edwin

Senior Health Inspector (Hawker), FEHD

We comment: These 554 licensed newspaper stall vendors do not have a god given right to sell with impunity a highly regulated consumer product that kills people when used as directed by the product manufacturer. Their association states they sell on average just 10 packs a day per location earning HK\$ 3 per pack. Indeed newspaper stall vendors are at grave risk of second hand smoke from their customers who come to buy tobacco as well as roadside pollution which is the highest pollution level in most areas.

The tobacco companies realise their products' tenure in first world countries is disappearing fast and are seeking other avenues such as snus and dissolvable tobacco to keep their customers addicted to nicotine. The vast majority of cigarettes sold here in Hong Kong are sold through convenience stores.

Hong Kong has an entrepreneurial society and the newspaper vendors need to seek alternative products to sell from their fixed pitches since tobacco is fast being consigned to history in Hong Kong and the rest of the civilized world.

Convenience stores already sell many of the products that newspaper vendors also sell; the vendors sell magazines and other items that the convenience stores do not have and they should apply the same business model reasoning to tobacco products' sales. Nicotine is more addictive than heroin and crack cocaine and cigarettes do more damage to society than either. In fact the Government needs to be licensing all tobacco retailers to prevent illegal sales of tobacco to minors.

Their own newspaper vendor association vice chairman has already stated in the press that association members have **seen no downturn in cigarette sales** after the Budget since buyers have taken their business away from the profiteering convenience stores.



UK BUDGET – MARCH 2011

The Daily Telegraph

<http://www.telegraph.co.uk/finance/budget/8401996/Budget-2011-7-pack-of-cigarettes.html>

UK Budget 2011: £7 pack of cigarettes

Smokers will be greeted with a £7 pack of cigarettes when they enter a shop on Thursday, after duty was raised by more than the rate of inflation.

Budget 2011: £7 pack of cigarettes Photo: ALAMY James Hall and Harry Wallop 5:58PM GMT 23 Mar 2011 From 6pm on Wednesday, duty on tobacco rose by *2pc above inflation*. On top of this, a wider restructuring of duty added **50p to the price of a packet of economy cigarettes and 33p to premium cigarettes, meaning that poorer smokers will be disproportionately affected.**

A pack of Windsor cigarettes, for instance, currently priced at about £5.13 will now cost £5.63, with 88 per cent of its retail price going to the Treasury in either VAT or duty. A pack of premium cigarettes, such as Silk Cut or Benson & Hedges, **will increase from £6.62 to £6.95.**

<http://www.independent.co.uk/news/uk/politics/cheap-cigarettes-prompt-duty-change-2250727.html>

THE INDEPENDENT Independent.co.uk Cheap cigarettes prompt duty change

By John Fahey, PA Wednesday, 23 March 2011

Cigarette smokers face a jump of up to 50 pence on a packet of 20 from 6pm today despite the Chancellor sticking to Labour's previously announced plans to raise tobacco duty by 2% above inflation, the tobacco industry said. George Osborne stuck to figures announced by Alistair Darling in March last year but announced plans to change the "tobacco duty regime" stopping companies producing cheaper cigarettes. He said: "It's clear that the structure of the tobacco duty regime is being exploited to produce cheaper cigarettes **so we will change the regime to narrow the differential between these lower cost brands and the rest, and between cigarettes and hand rolled tobacco.** *"This will reduce smoking and improve our nation's health."*

http://www.ft.com/cms/s/4c3c373c-5540-11e0-87fe-00144feab49a,dwp_uuid=34c8a8a6-2f7b-11da-8b51-00000e2511c8,print=yes.html



Tweaks to duty hit smokers of cheaper brands

By Rose Jacobs Published: March 23 2011 15:24 | Last updated: March 23 2011 22:52

8/F Eastwood Centre - 5, A Kung Ngam Village Road - Shaukeiwan, Hong Kong

Tel: (+852) 2579 9398 Fax: (+852) 2565 9537 Website: www.cleartheair.org.hk



Smokers of cheap cigarettes and rolling tobacco have been hit hard by changes to the tobacco tax regime outlined in the [Budget](#). George Osborne said he would stick with a 2 per cent above-inflation duty escalator on [tobacco](#) products but change the way the **tax is structured to narrow the price gap between lower-cost products and premium brands**.

The tweaks increase the price of an “economy” pack of cigarettes by as much as 50p, compared with a 33p rise for premium brands. As of 6pm on Wednesday evening, tax on rolling tobacco rose 10 per cent. ***“This will reduce smoking and improve our nation’s health,”*** Mr Osborne said.

Robert Branton, deputy director of the Centre for Governance and Regulation at the University of Bath, called it “great news” since ***“the price of tobacco products is the single largest weapon in the fight against tobacco related diseases”***. But the Tobacco Manufacturers’ Association argued it would simply encourage black market trade; it estimates one in five cigarettes smoked in the UK escaped excise duty, and 61 per cent of hand-rolled tobacco. ***HMRC and the UK Border Agency will announce a new anti-smuggling strategy next month.***

So how toxic is Nicotine ?

UNIVERSITY OF MINNESOTA

<http://www1.umn.edu/perio/tobacco/nicaddct.html>

DIVISION OF PERIODONTOLOGY

Tobacco is as addictive as heroin (as a mood & behavior altering agent).

- Nicotine is:
 1. 1000 X more potent than alcohol
 2. 10-100 X more potent than barbiturates
 3. 5-10 X more potent than cocaine or morphine
- A 1-2 pack per day smoker takes 200-400 hits daily for years. This constant intake of a fast acting drug (which affects mood, concentration & performance).. eventually produces dependence.

Pressures to relapse are both behaviorally & pharmacologically triggered. Quitting involves a significantly serious psychological loss... a serious life style change.

Nicotine — Botanical insecticide. **Pure nicotine is a tobacco extract highly toxic to warm-blooded animals**. The insecticide usually is marketed as a 40% liquid concentrate of nicotine sulfate, which is diluted in water and applied as a spray. Dusts can irritate the skin and are not normally available for garden use. Nicotine is used primarily for piercing sucking-insects such as aphids, whiteflies, leaf hoppers and thrips. Nicotine is more effective when applied during warm weather. It degrades quickly, so can be used on many food plants nearing harvest. It is registered for use on a wide range of vegetable and fruit crops. <http://www.hbci.com/~wenonah/hydro/pestcont.htm>

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Catastrophic brain injury after nicotine insecticide ingestion. [Rogers AJ, Denk LD, Wax PM. http://www.ncbi.nlm.nih.gov/pubmed/14980338](#) Division of Emergency Medicine, Children's Healthcare of Atlanta, Emory University School of Medicine, Atlanta, Georgia 30329, USA. **Abstract** Much attention has been paid to the long-term toxic and carcinogenic effects of nicotine-containing substances, particularly tobacco. Although rare, acute ingestions of large amounts of nicotine can produce rapid and dramatic toxicity. We present a case of an ingestion of a nicotine sulfate solution by a 15-year-old boy resulting in hypoxia and irreversible encephalopathy. The diagnosis of acute nicotine toxicity potentially could be delayed due to the fact that nicotine and cotinine are so commonly found on drug screens that they are considered "normal variants."

Puffing on Polonium

By ROBERT N. PROCTOR Published: December 1, 2006 Stanford, Calif. Luba Lukova
http://www.nytimes.com/2006/12/01/opinion/01proctor.html?_r=1&oref=slogin

WHEN the former K.G.B. agent Alexander V. Litvinenko was found to have been poisoned by radioactive polonium 210 last week, there was one group that must have been particularly horrified: the tobacco industry.

The industry has been aware at least since the 1960s that cigarettes contain **significant levels of polonium**. Exactly how it gets into tobacco is not entirely understood, but uranium "daughter products" naturally present in soils seem to be selectively absorbed by the tobacco plant, where they decay into radioactive polonium. High-phosphate fertilizers may worsen the problem, since uranium tends to associate with phosphates. In 1975, Philip Morris scientists wondered whether the secret to tobacco growers' longevity in the Caucasus might be that farmers there avoided phosphate fertilizers.

How much polonium is in tobacco? In 1968, the American Tobacco Company began a secret research effort to find out. Using precision analytic techniques, the researchers found that smokers inhale an average of about .04 picocuries of polonium 210 per cigarette. The company also found, no doubt to its dismay, that the filters being considered to help trap the isotope were not terribly effective. (Disclosure: I've served as a witness in litigation against the tobacco industry.)

A fraction of a trillionth of a curie (a unit of radiation named for polonium's discoverers, Marie and Pierre Curie) may not sound like much, **but remember that we're talking about a powerful radionuclide disgorging alpha particles — the most dangerous kind when it comes to lung cancer — at a much higher rate even than the plutonium used in the bomb dropped on Nagasaki. Polonium 210 has a half life of about 138 days, making it thousands of times more radioactive than the nuclear fuels used in early atomic bombs.**



We should also recall that people smoke a lot of cigarettes — about 5.7 trillion worldwide every year, enough to make a continuous chain from the earth to the sun and back, with enough left over for a few side-trips to Mars. If .04 picocuries of polonium are inhaled with every cigarette, about a quarter of a curie of one of the world's most radioactive poisons is inhaled along with the tar, nicotine and cyanide of all the world's cigarettes smoked each year. **Pack-and-a-half smokers are dosed to the tune of about 300 chest X-rays.**

Is it therefore really correct to say, as Britain's Health Protection Agency did this week, that the risk of having been exposed to this substance remains low? That statement might be true for whatever particular supplies were used to poison Mr. Litvinenko, **but consider also this: London's smokers (and those Londoners exposed to secondhand smoke), taken as a group, probably inhale more polonium 210 on any given day than the former spy ingested with his sushi.**

No one knows how many people may be dying from the polonium part of tobacco. There are hundreds of toxic chemicals in cigarette smoke, and it's hard to sort out how much one contributes compared to another — and interactive effects can be diabolical.

In a sense, it doesn't really matter. Taking one toxin out usually means increasing another — one reason "lights" don't appear to be much safer. What few experts will dispute is the magnitude of the hazard: the World Health Organization estimates that 10 million people will be dying annually from cigarettes by the year 2020 — a third of these in China. Cigarettes, which claimed about 100 million lives in the 20th century, could claim close to a billion in the present century.

The tobacco industry of course doesn't like to have attention drawn to the more exotic poisons in tobacco smoke. Arsenic, cyanide and nicotine, bad enough. But radiation? As more people learn more about the secrets hidden in the golden leaf, it may become harder for the industry to align itself with candy and coffee — and harder to maintain, as we often hear in litigation, that the dangers of tobacco have long been "common knowledge." I suspect that even some of our more enlightened smokers will be surprised to learn that cigarette smoke is radioactive, and that these odd fears spilling from a poisoned K.G.B. man may be molehills compared with our really big cancer mountains.

Robert N. Proctor is a professor of the history of science at Stanford University.



Complicity in contraband: British American Tobacco and cigarette smuggling in Asia

J Collin, E LeGresley, R MacKenzie, S Lawrence and K Lee

Tob. Control 2004;13;104-111
doi:10.1136/tc.2004.009357

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RESEARCH PAPER

Complicity in contraband: British American Tobacco and cigarette smuggling in Asia

J Collin, E LeGresley, R MacKenzie, S Lawrence, K Lee

Tobacco Control 2004;13(Suppl II):ii104–ii111. doi: 10.1136/tc.2004.009357

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Objectives: To examine the complicity of British American Tobacco (BAT) in cigarette smuggling in Asia, and to assess the centrality of illicit trade to regional corporate strategy.

Methods: Analysis of previously confidential documents from BAT's Guildford depository. An iterative strategy combined searches based on geography, organisational structure, and key personnel, while corporate euphemisms for contraband were identified by triangulation.

Results: BAT documents demonstrate the strategic importance of smuggling across global, regional, national, and local levels. Particularly important in Asia, contraband enabled access to closed markets, created pressure for market opening, and was highly profitable. Documents demonstrate BAT's detailed oversight of illicit trade, seeking to reconcile the conflicting demands of control and deniability.

Conclusions: BAT documents demonstrate that smuggling has been driven by corporate objectives, indicate national measures by which the problem can be addressed, and highlight the importance of a coordinated global response via WHO's Framework Convention on Tobacco Control.

There is increasing recognition of the significance of cigarette smuggling as a threat to effective health policy.¹

Importantly, this has been reflected in both negotiations for² and the final text of World Health Organization's Framework Convention on Tobacco Control (FCTC).³ This attention is partly attributable to the sheer scale of contraband, accounting for between 6–8.5% of global cigarette consumption⁴ or around one quarter of total exports.^{5–6} An additional impetus, however, has been the evidence of tobacco industry collusion in this trade provided by corporate documents. Analyses of these documents by journalists,^{7–9} non-governmental organisations,¹⁰ an international organisation,¹¹ a parliamentary inquiry,¹² and in academic journals^{5–13–16} have increased understanding of the dynamics of tobacco smuggling and created pressure for a substantive policy response.

This paper offers the first comprehensive analysis of cigarette smuggling in Asia, the critical region to the global tobacco industry¹⁷ and to the trajectory of the tobacco pandemic.^{18–19} The corporate documents of British American Tobacco (BAT) demonstrate both the enormity of smuggling in Asia and its central place in corporate strategy. While BAT has publicly denied involvement in smuggling,^{20–22} this paper analyses its internal documents to present a detailed case study of how and why BAT sought to control contraband flows across Asia.

METHODS

The limitations of tobacco document research^{23–26} and the specific difficulties of working with documents in BAT's Guildford depository²⁷ have previously been described. Such problems are magnified by the multiple sensitivities surrounding smuggling. This paper draws on documents acquired during numerous visits to the Guildford depository since its opening in February 1999. The major methodological challenge entailed acquiring sufficient understanding of BAT's corporate structure and personnel to identify potentially relevant files, and, through triangulation, identifying the major euphemisms for contraband used within the documents. Further research of the depository's contents was then conducted on an iterative basis. Search terms were

based on geography (for example, "Asia", "Indochina", "Vietnam", "HCM"), organisational terminology (for example, "Asia Pacific RBU", "export", "NBD", "SUTL"), and key personnel (for example, "Paul Adams", "PN Adams", "PNA", "Patrick O'Keefe", "O'Keefe", "PCOK").

RESULTS

Tobacco smuggling and BAT documents

While there are powerful indications that other tobacco companies have been complicit in smuggling,²⁸ the industry documents have primarily provided evidence of complicity in smuggling by BAT. This disparity reflects differences in the diverse document collections created by the Minnesota litigation, the BAT documents exhibiting distinctive characteristics. In part, this may be attributed to BAT's late entry into the litigation and its apparent strategy of swamping the Minnesota plaintiffs with documents irrelevant to the lawsuit.²⁹ This created a far broader document collection than might be expected given the terms of the Minnesota litigation.

Additionally, the documents from BAT often seem more candid than those from its competitors.³⁰ This might be attributable to variations in corporate culture, a historically lower sense of vulnerability to litigation,³¹ or inadequate procedures for excluding sensitive material from paper records. Many of the most dramatic disclosures of tobacco industry misconduct have been obtained from BAT documents, including evidence of price fixing,³² systematic document destruction,³³ and information concealment.²⁷

This comparative candour of BAT documents is effectively illustrated via smuggling. Nonetheless, the illegality and sensitivity of such practices is reflected in apparent attempts to minimise their appearance in company records.⁷ The term smuggling appears very rarely within the documents, and understanding this illicit trade is reliant on deciphering a range of euphemisms or code words.

Abbreviations: BAT, British American Tobacco; DNP, duty not paid; FCTC, Framework Convention on Tobacco Control; GT, general trade; RBU, regional business unit; SUTL, Singapore United Tobacco Limited; TTCs, transnational tobacco companies; WDF, wholesale duty free

Transit

The most easily recognised references to smuggling operations are offered by the term “transit”. This unambiguously identifies contraband operations, as demonstrated by a 1989 definition discussing illicit imports in Asia:

With regard to the definition of transit it is essentially the illegal import of brands from Hong Kong, Singapore, Japan, etc. upon which no duty has been paid.³⁴

Transit may have been viewed as an insufficiently oblique descriptor, with some indication that the use of the term was discouraged. In 1992 then territorial director Keith Dunt noted in the margins of a document: “Must not use ‘transit’ word”.³⁵

General trade (GT)

The phrase “General trade”, often abbreviated to “GT”, is seemingly BAT’s most frequently used euphemism for contraband operations in Asia. While its meaning is not so immediately evident, an extensive review of the documents leaves little room for ambiguity. A 1994 draft document, for example, subdivided BAT’s export business into three channels.* “Domestic markets” identified trade “where the product is sold duty paid”. “Duty free” (DF) designated exports to operators of facilities allowed to exclude excise from their retail price, subject to the qualification that where “DF business penetrates into the local domestic market... DF business can be regarded as GT”.

GT refers to exports made for onward sale to another market other than the market to where product was shipped, and where the packaging would normally be non market specific. Such products would often have substitute coding to identify the customer and therefore the intended end market.³⁶

Though opaque, the meaning of GT becomes clear by contrast with the reference to the other channels. Its use to designate contraband is further demonstrated by juxtaposition with legal sales. For example, an account of the first duty paid shipment to Burma in May 1993 notes that “(u)ntil then, Myanmar had always been a straightforward GT market for our brands”,³⁷ while a company plan from 1990 noted that in Taiwan “legal business has to some extent been compensated by GT sales”.³⁸

Duty not paid (DNP)

The use of “Duty not paid” or “DNP” as synonymous with contraband is most clearly demonstrated in Latin America. In Venezuela, for example, the DNP market is defined as:

...the volume of cigarettes produced in Venezuela, exported (mainly to Aruba) and re-entering Venezuela as transit plus transit cigarettes produced elsewhere.³⁹

Elsewhere DNP sales are analysed separately from legal sales in both the duty paid and duty free markets,⁴⁰ identifying DNP as describing contraband. Though used less frequently in documents relating to Asia, and slightly complicated by the government in Hong Kong using the

* A strong indication of concern to disguise references to smuggling is provided by the subsequent revision of this document. The description of domestic markets was essentially unaltered; the reference to penetration into the local market was deleted from the definition of duty free; while GT was replaced simply with “Exports All other business”.³⁶

phrase to refer to duty free,⁴¹ the region was a leading contributor to sales in this channel. A 1994 BAT global planning document noted:

In 1993, it is estimated that nearly 6% of the total world cigarette sales of 5.4 trillion were DNP sales. Eastern Europe and the Asia-Pacific region (c85 bln each) accounted for the majority of this volume...⁴²

The above categories are by no means an exhaustive list of the euphemisms used in BAT documents to describe smuggled cigarettes. The volatility and sensitivity of such practices and a need to mask their inclusion in corporate documentation have yielded a long list of comparable terms. A 1993 document described “combined exports” as the principal driver of export growth in the Asia-Pacific region, and emphasised “the sensitivity of this source of profits”;⁴³ a 1993 review of distribution of BAT brands in China emphasised the dominance of “free market sales” and “unofficial imports”;⁴⁴ a 1988 account of transit in Vietnam emphasises BAT’s need to disassociate itself from “parallel imports”;⁴⁵ while “wholesale duty free” (WDF) is reportedly a more recently favoured term.⁷

Contraband as central to corporate objectives

Smuggling can be identified as advancing key corporate objectives across multiple levels. Globally, contraband has accounted for a critical proportion of BAT’s export sales and has played a major role in efforts to displace Philip Morris as global market leader. The 1994 review of BAT’s management of export channels, for example, set itself the mission to “maximise BAT’s share of the global export business”:

This will be achieved irrespective of which sub-channel of exports is employed through the consistent management worldwide of BAT’s Brand Portfolio of International brands, and where appropriate BAT’s Regional Brands, to satisfy consumer needs and achieve the corporate goals.⁴⁶ (emphasis in original)

An appendix to an earlier draft of this review stated that the GT channel accounted for either 57% or 68% BAT’s global export business, depending on how trade in Hong Kong, China, Djibouti, and Ghana was classified.³⁶

At a regional level, in 1992 Barry Bramley, then CEO of BAT, identified the further development of GT sales as part of a twin track strategy in the Far East, “consolidating our position in the growing imported segments of the domestic markets as well as building on the successful General Trade business in the region”.⁴⁷ GT apparently accounted for 72% of exports for BAT’s Asia-Pacific region from 1992 to March 1994.³⁶

Nationally, anticipated returns from smuggled cigarettes have been critical in determining operational and investment strategies for some countries. Smuggling operations were key to BAT’s broader efforts to penetrate the huge Chinese market,⁴⁸ plans for Cambodia rested on its strategic value to regional contraband,⁴⁹ and Laos seems to have been largely viewed in terms of its smuggling potential.⁵⁰ At local level, the documents provide remarkably detailed analyses of the suitability of specific regions,⁵¹ ports,⁵⁰ islands⁵² and border crossings⁵³ as transit routes, and also describe detailed monitoring of the availability of smuggled brands in key cities such as Bangkok⁵⁴ or Ho Chi Minh City.⁵⁰

Strategic advantages of cigarette smuggling

This centrality is explained by a number of distinct advantages offered by successful sales of smuggled product.

While often highly context specific, the documents indicate several key attributes that explain the significance of contraband in the region.

Entering closed markets

A key factor in the particular importance of contraband in Asia is that several target markets were effectively closed to legitimate imports, leaving smuggling as the sole means of ensuring the availability of international brand cigarettes. In Burma part of the comparative advantage of transit seemingly lay in BAT's inability to reliably import legal cigarettes.⁵⁵ In the early 1990s Vietnam operated a ban on imported cigarettes, but BAT's marketing department emphasised the strong performance of contraband BAT brands in a SWOT analysis:

STRENGTH[S]

1. [State Express] 555 with its high level of awareness and demand has prompted wholesalers and retailers to stock the brand despite the ban and the risk.
2. SUTL with its strong network of customers in Cambodia have been able to capitalise on the demand of the Vietnamese customer despite the ban.⁵⁰

Thailand's market was also formally closed to TTCs [transnational tobacco companies] until 1990,^{56 57} but contraband operations enabled thriving trade. A 1988 report on a visit to Thailand estimated that "BAT's average monthly transit volume is about 22 mn ... earning a total group trading profit of the order of £1mn p.a."⁵⁸

Pressure for market opening

Smuggling in Asia has also been used as a means of exerting political leverage to secure market opening.^{1 59} In Thailand, for example, exploitation of contraband was presented as part of a broader strategy to undermine Thailand's ban on imports:

From a range of options in this situation, BAT's best strategy would appear to be: i) to continue to endorse the US pressure for legalization of imports, ii) to support the transit opportunities with internal promotion, and iii) to evaluate the possibility of a modest joint venture...⁵⁸

While the existence of substantial contraband markets served to undermine the perceived viability of import bans, complicity in illegal operations could also heighten sensitivities and become a political liability. The documents indicate increasing concern about transit as the prospect of market opening increased. A 1989 document cautions against overtly infringing Thailand's advertising regulations, a concern reportedly shared within Philip Morris:

The current high level of advertising for international brands which are only available through transit is a particularly prominent windmill for the proponents of this to joust at. Dollison [PM Corporate Affairs] has suggested that all companies moderate their advertising activities over this sensitive period.⁶⁰

Similar disquiet is expressed concerning negotiations for a Burma trading office that would facilitate legal importation and distribution,⁵⁵ while governmental awareness of BAT's complicity in smuggling evidently complicated negotiations for a joint venture in Vietnam.⁶¹

Undermining regulation

The ability to undermine effective health policy has been critical to the value of smuggling to tobacco companies. Successful orchestration of increased contraband flows with media pressure to curb taxation policy has occurred in countries such as Canada,⁶² Sweden,¹ and the UK.⁶³ BAT documents provide more detailed accounts of how the reliable availability of smuggled cigarettes contributed to efforts to influence public policy. In Bangladesh,¹⁰ documents suggest that BAT both exerted substantial control over flows of contraband cigarettes⁶⁴⁻⁶⁶ and presented such flows to the government as proof of the need to reverse increased excise.⁶⁷ In Burma, following protracted negotiations between government and traders, a review of duty levels was presented as a quid pro quo for a crackdown on transit according to a regional business plan.⁵⁰

A variant of this approach was seen in Thailand when TTCs warned the Deputy Prime Minister that proposed tobacco control legislation would escalate smuggling.^{68 69} Upon the opening of the Thai market to legal imports, TTCs seemingly colluded in setting pricing at a high level, believing that readily available smuggled brands would force a reduction in tax:

PM/RJR/RPE are advocating market entry [into Thailand] at 40 Baht in order to demonstrate that the legal business will be minimal, GT will continue and therefore revenue lost. The belief is that the Thai's [sic] will then reduce the Duty.⁷⁰

Similarly, 1995 proposals in anticipation of an ingredients disclosure regulation included: "We need to be ready to pump in GT stocks in case the supply is disrupted by the Regulation."⁷¹

Greater desirability of smuggled product

In some contexts part of the comparative advantage of smuggled cigarettes may lie in a perceived superiority to legal brands.^{63 72} A BAT commissioned study in Indonesia noted a preference for contraband versions of international brands, "supposed to be 'original from abroad'".⁷³ Focus groups of Marlboro smokers in Malaysia in 1987 reported that smoking smuggled imports gave "a feeling of 'class'" and was preferred to locally produced Marlboro.⁷⁴

Highly profitable

The basic rationale for complicity in smuggling, of course, was that it yielded high levels of profit. The risks associated with transit were clear, but documents suggest that BAT's corporate strategy calculated that illegality was outweighed by profitability:

Transit trade is volatile, and disruptive to the orderly operation of markets. It is in BAT's interest that markets are legal, taxed and controlled. However our primary responsibility is to meet consumers' demands as profitably as possible.⁷⁵

While acknowledging ethical questions raised by encouraging the DNP segment, Keith Dunt outlined his own view as being "that it is part of your market and to have it exploited by others is just not acceptable".⁷⁶

In some contexts, contraband was operating so successfully as to question the merits of developing legitimate business. A 1988 report predicting further opening of Asian markets described the trend as posing "a threat to traditional transit sales where BAT (UK&E), in particular, have been relatively strong".⁴⁵ A 1994 discussion of a proposed joint

venture in Burma highlighted concerns about profitability given its potential impact on illegal GT sales:

555 is our major brand priority. Were B&H to be locally produced from Year 1 and 555 only in Years 4–5, B&H may achieve an 'unfair' advantage. (we may come under pressure to reduce GT)...

"The JV financials are not net of cannibalisation of GT (eg Lucky Strike). Clearly there will be a knock on effect to BATCo. profit."⁷⁷

An earlier proposal to introduce duty paid imports into Burma discussed "the level of subsidy" this would require "bearing in mind costs as against GT".⁷⁸ In Taiwan legal sales of 555 are similarly described: "to some Taiwan has to some extent been compensated by GT sales".³⁸

BAT documents suggest a broad preference for gradually reducing reliance on the volatile contraband markets in favour of more predictable legitimate business.⁴⁷ BAT's strategy for the opening of the Thai market sought to increase "the importance of domestic end markets as against the more volatile G.T. business":

As part of the "raison d'être" of BATUKE it is key that returns from the volatile, albeit good margin and often GT markets are re-invested to achieve the more longer term objectives of BATUKE, i.e. to establish a dominant presence in stable domestic environments with a strong brand portfolio.⁷⁹

Importantly, the logic of this shift does reiterate the centrality of smuggling to achieving BAT's goals in Asia, albeit with an expectation that this would decline. Furthermore, the dominance of contraband in Thailand was remarkably persistent, accounting for an estimated 60% of total volume in 1994.⁸⁰

Managing a risky business

The BAT documents demonstrate the complexity and diversity of contraband operations across Asia, highlighting the fact that smuggling in the region has not been synonymous with or entirely controlled by BAT. The documents indicate, for example, that competitors' brands were also smuggled,^{81 82} and in Malaysia the extensive availability of smuggled kreteks constituted unwelcome competition.⁸³ There are also indications of a lack of cohesion across BAT's operating companies,^{10 84 85} while the illicit nature of the business meant that information was often imperfect and other parties could be unreliable.^{80 86 87}

Notwithstanding such qualifications, the documents indicate that BAT went to great lengths to ensure that contraband operations fulfilled corporate objectives.

Awareness and involvement of senior personnel

The significance of contraband operations for BAT meant that awareness and involvement reached the highest levels of the organisation.⁸⁸ Among issues for discussion by Sir Patrick Sheehy and Ulrich Herter, then respectively chairman and managing director of BAT Industries, during a visit to the region in 1994 was clarification of management responsibility for transit.⁸⁹ In a March 1994 memo, Paul Adams, then regional manager and now BAT's chief executive, clarified that primary responsibility for GT business lay with his regional business unit (RBU):

All GT business in Asia Pacific should now be handled by the RBU. Can we please check with [B&W vice president]

Tom Whitehair that we are now handling all GT and that therefore they are not using SUTL for any GT business.⁹⁰

Specific responsibility for managing smuggling operations in Asia was apparently delegated to Patrick O'Keeffe, regional exports manager. The job description for this post again emphasises BAT's detailed oversight of contraband operations:

(A)s the Coordinator of GT sales world-wide, his responsibilities include: ...agreeing [to] the proposed price structure of all major orders to the General Trade... Maintenance of profiles of all main dealers, and monitoring of supply routes... [and] Proactive search for new GT business.⁹¹

The requirement to identify new contraband business again illustrates that BAT's involvement far exceeded merely monitoring illicit sales. O'Keeffe (PCOK) sought to arrange pricing in Vietnam of imports of State Express 555 smuggled from Singapore in Vietnam so as not to undermine the launch of a locally produced version:

PCOK explained that BAT wanted SUTL to ensure a retail price of 11 000 Dong on 555 SDNP [Singapore Duty Not Paid] in HCM [Ho Chi Minh City] to allow 555 MIV [Made in Vietnam] an opportunity to establish itself at 10 000 Dong.⁹²

Singapura United Tobacco Limited (SUTL)

This indirect intervention in smuggled markets via SUTL (Singapura United Tobacco Limited) represents the principal method by which BAT sought to control contraband across Asia. SUTL was a long time distribution partner of BAT, and did handle legal sales of BAT products, but documents demonstrate that SUTL was also effectively granted a licence to oversee smuggling on BAT's behalf throughout much of Asia.⁴⁵ The mission statement for SUTL's distribution strategy 1995–99 was defined as:

To maximise BAT's market and profit shares of the South-East Asia/ Indian Sub-Continent export business through the most efficient distribution of international and regional brands, irrespective of sub-channel (Domestic, Duty Free, GT) to our customers.⁹³

In response to questioning by the Health Select Committee, Deputy Chairman Ken Clarke insisted that SUTL was "a perfectly legitimate wholesaler" and that, beyond serving as "our Singapore wholesaler... it is not controlled by BAT".⁹⁴ By contrast, the corporate documents indicate substantial awareness of SUTL's role in smuggling, even assessing the proportion of time spent on GT business by key SUTL personnel.⁹⁵ More significantly, the documents extensively demonstrate that contraband operations by SUTL occurred under the direction of BAT.

Direction and control

This is evident in encouragement from BAT for SUTL to expand smuggling or identify new routes. Minutes from a 1991 meeting with SUTL record senior BAT executive Anthony Pereira asking "how we were progressing with efforts to increase transit".⁹⁶ Similarly, a 1993 Singapore meeting with SUTL discussed imports to China, noting that enquiries for legal duty paid sales would be handled by BAT China whereas "SUTL are encouraged to expand overland routes through Indochina".⁹⁷ The control exerted by BAT is evident in Bangladesh,¹⁰ a 1993 memo noting that "(p)ricing

of transit brands are to be advised by IBG",⁹⁸ the International Brand Group at UK headquarters, while BAT were also apparently able to intervene to amend contraband flows.⁹⁹⁻¹⁰⁰ The close relationship is also demonstrated by Alec Stuart joining SUTL as General Manager in 1992, having previously held BAT managerial positions in Malaysia, Singapore, and Bangladesh.⁹³

The documents also indicate persistent efforts to increase BAT's control over contraband business. A 1987 meeting described "improving our knowledge of the transit end markets and taking more control of the business".¹⁰¹ An internal restructuring was proposed in 1988 to create an organisation capable of building legal sales in emerging markets "whilst supervising and controlling existing transit business".⁴⁵ The 1994 review of export channel management preferred "exclusivity of supply arrangements via one distributor so as to facilitate maximum control", highlighting the need to "control pricing as the key variable in managing in a co-ordinated and consistent fashion all the sub-channels of Exports".¹⁰²

Running legal business to support contraband

BAT's capacity to exploit contraband flows was enhanced by the seemingly widespread practice of coordinating operations across legal and illegal channels.⁹²⁻⁹⁹⁻¹⁰⁰ In several markets a small legal operation was established to provide protective cover for smuggled sales, hence the term "umbrella operations".¹⁰⁻¹¹⁻¹⁰³ A token legal presence enabled marketing and promotional activities to be undertaken in support of contraband. The first duty paid shipment to Burma was expected to "give a legal coverage for our marketing activities",¹⁰⁴ while in Laos a "legal base would be established to enable support"⁵⁰ for contraband from Cambodia.

In other contexts the dividing line between legal and illegal business could be effectively blurred; "legal imports could hide large scale transit activity".¹⁰⁵ Documents demonstrate that ostensibly legitimate duty free sales have provided an effective means of supplying smuggled cigarettes. A 1994 monthly review for Thailand noted that supply of transit cigarettes was good in most areas while "in Bangkok leakage of duty-free stocks is high".⁵⁴ In 1991 one of three main methods of reaching the market in Burma was described as being "Partial Duty Paid":

ii) Partial Duty Paid—Product arrives at ports less rigidly 'policed'.

Duty is, therefore, paid on some of the amount imported. This will vary according to the compliance of the customs personnel—the usual point of entry being Moulmein.⁵⁰

A 1994 assessment of competitors' contraband in the Philippines noted the significance of duty free sales as an enabling factor. Alongside organised transit via Malaysia and Indonesia the report identified "personal transit into 'free markets' ex official duty free retail outlets" and "leakage of product in transit for re-export".⁸² It was recommended that BAT should focus on duty free shops as "the main semi-legal distribution method open to us for penetrating the free markets":

ii) BATCo should concentrate on developing visibility and volume through the duty free shops, to attract personal transit volume into certain key free markets like Chinatown for SE555. To a degree this is already being achieved... Consideration could be, however, given to some POS [point of sale]/consumer promotional activity in this area, providing legality issues could be addressed eg advertising of consumer promotions at duty free outlets.⁸²

The sale of duty free cigarettes by international hotels in India provided "legal cover for promotions and POS [point of sale] displays".¹⁰⁶ A 1992 document indicates that this seemingly marginal channel provided for substantial leakage into domestic sales:

Of the 70 millions shipped into India last year, I am informed that around 10–20% is sold in the duty free outlets to travellers while the remainder seeps out into the local market.¹⁰⁷

In East Asia the purchase of confiscated contraband at customs auctions also provided "a shelter for subsequent purchases from other sources".¹⁰⁸

Managing sensitivity, ensuring deniability

The documents demonstrate widespread awareness among senior BAT personnel of the questionable nature of key export operations,³⁵⁻⁷⁶⁻¹⁰² the risks associated with such involvement,¹⁰²⁻¹⁰⁹ and the problems posed for relations with governments.⁶¹⁻¹¹⁰ The strategic challenge for BAT was to maintain both careful management of illicit trade and sufficient separation from it to ensure deniability. This balancing act is evident in BAT's relations with SUTL, and became more difficult to maintain in the context of joint ventures or market opening.

BAT's 1993 Asia Pacific Review noted that that long term cooperation with SUTL in both legal and illicit trade ran the risk of "unacceptably high exposure" for BAT, and it was deemed "[n]ot prudent to maintain GT trading links with SUTL and to accept as partner in any of the proposed joint ventures".¹⁰⁹ In 1993 Fred Combe of BATUKE Singapore similarly stated that, in Cambodia, Laos, and Myanmar, BAT would only formalise agreements with "bona-fide duty paid distribution companies... due to General Trade sensitivities".¹¹¹

Arguably the most explicit statement of BAT's approach to handling contraband operations is provided by a 1988 document discussing Vietnam. This establishes a clear rationale for balancing direction and deniability:

Transit: the nature of this business brings paradoxical requirements of an arm's length approach and close supervision. Where BAT has legitimate interests in the end markets it must be able to disassociate itself from direct involvement in parallel imports. Nevertheless, indiscriminate sourcing can and does lead to potentially embarrassing problems.

This conflict can be resolved by maintaining close control over the accredited export agent in the home market, backed up market intelligence garnered from end market visits...⁴⁵

DISCUSSION

Addressing the Global Congress on Combating Counterfeiting in May 2004, BAT's new chief executive Paul Adams observed that "tax revenues are essential to government services, and this is particularly so in developing countries where economic development and growth are strongly linked to it".¹¹² By contrast, the documents presented above demonstrate how BAT's corporate strategy for Asia relied on illicit trade that systematically undermines such revenues. While there is much that remains unknown about tobacco smuggling, these documents provide a powerful resource for the development of effective policy responses.

Despite the daunting scale of the problem outlined in the documents, the analysis leaves scope for optimism that it can be effectively addressed. The abolition of duty free sales, for example, would remove a key facilitator of contraband flows

What this paper adds

Asia is the key target region in the industry's global expansion. This paper offers the first comprehensive regional analysis of corporate documents focused on smuggling, highlighting how BAT sought to direct this illicit trade and its critical role in corporate strategy.

via "leakage" into domestic sales and its protective coverage for promotion of illicit sales.

Abandoning the practice of reselling confiscated stocks of smuggled cigarettes^{113 114} would remove the possibility of traders profiting from tighter enforcement. Importantly, the documents demonstrate that improved enforcement can effectively curtail the trade in contraband. In Thailand, an increased security presence at border crossings with Burma⁵³ and Malaysia⁵² reportedly curtailed flows of transit stock, while the comparatively closed and secretive nature of the Thai transit market made it more difficult to operate successfully.⁸⁰ A similar point is made by contrary examples where complicity of government officials and agencies has facilitated contraband.^{52 58 115}

A striking feature of the above documents is the extent to which smuggling has been strategically driven to advance BAT's corporate objectives, in stark contrast to public denials of complicity.²⁰⁻²² This heightens the need for political will both to halt the role of contraband in undermining tobacco control and to hold to account those active or complicit in such illicit trade. Given this need, and in light of the evidence presented above, the recent announcement by the UK's Department of Trade and Industry¹¹⁶ that its investigation into BAT's alleged involvement in smuggling would be neither published nor result in any further action is extremely disappointing. The recent agreement between the European Union (EU) and Philip Morris included provisions for compensation and seizure payments as well as protocols for compliance and for tracking and tracing.^{28 117} This could establish a valuable precedent for broader efforts to recover lost revenue and to prevent future smuggling.

Further encouragement is provided by the inclusion of a commitment to tackling contraband within the FCTC. Contraband is an inherently transnational problem that requires a coordinated global response, and its inclusion within the FCTC is an important first step.^{118 119} However, the complexity and scale of cigarette smuggling requires a more detailed and enforceable policy regimen. Specific suggestions include cessation of duty free sales as is the case within the EU; licensing of manufacturers and other parties involved in the distribution process; chain of custody markings for exported cigarettes; and stiffer penalties for those caught smuggling.⁵ There is also a clear need for ratification of the FCTC to be rapidly followed by progress towards a specific protocol to counter the illicit trade in tobacco products.

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Tobacco Companies Linked to Criminal Organizations in Lucrative Cigarette Smuggling

When Tommy Chui failed to show up at the grand opening of his wife's new boutique in downtown Singapore, alarm bells rang 1,600 miles away in the offices of Hong Kong's Independent Commission Against Corruption. It was March 29, 1995, and the news that Chui was missing devastated the commission's assistant director, Tony Godfrey. He immediately sent two investigators to Singapore. Three days later, on April 1, his worst fears were realized. Dockworkers found Chui's bloated body floating in Singapore Harbor. A former director of British American Tobacco's biggest distributor of contraband cigarettes to China and Taiwan, the 38-year-old Chui had been abducted, ritually tortured, gagged, suffocated, and thrown into the harbor just weeks before he was to testify against his ex-associates. Chui was the star prosecution witness in an international tobacco smuggling investigation launched in 1993 by Hong Kong's Independent Commission Against Corruption. He was about to blow the lid off a \$1.2 billion smuggling operation to China and Taiwan and implicate three former British American Tobacco executives in a HK\$100 million bribery scandal. In addition, his testimony was key to the prosecution of his two former business associates, several corrupt customs officers, and various members of Asia's most notorious criminal gang, the Triad.

The case of Chui and the massive BAT-fed smuggling network into China reveals the dark underbelly of a billion-dollar business fed by international corporations and operated by organized crime. While it is among the more sensational examples of corporate tobacco's implication in international smuggling and its links to organized crime, it is far from an isolated instance.



Tobacco manufacturers have often blamed the international smuggling of their products on organized crime. But a year-long investigation by the Center for Public Integrity shows that tobacco company officials at BAT, Philip Morris, and R.J. Reynolds have worked closely with companies and individuals directly connected to organized crime in Hong Kong, Canada, Colombia, Italy, and the United States. In fact, one Italian government report obtained by the Center states that Philip Morris and R.J. Reynolds licensed agents in Switzerland were high-level criminals who ran a vast smuggling operation into Italy in the 1980s that was directly linked to the Sicilian Mafia. Corporate documents, court records, and internal government reports — some going back to the 1970s — also show that BAT, Philip Morris, and R.J. Reynolds have orchestrated smuggling networks variously in Canada, Colombia, China, Southeast Asia, Europe, the Middle East, Africa, and the United States as a major part of their marketing strategy to increase profits. The corporate documents refer to this black market business as "duty not paid," "parallel" markets, "general trade," or "transit." But these same documents often clearly delineate between this aspect of the business and legal trade. For example, one BAT official, in a 1989 letter to associates in Taiwan, said, "With regard to the [definition of transit](#), it is essentially the illegal import of brands from Hong Kong, Singapore, Japan, etc., upon which no duty has been paid."

Q. What is transit trade?

A. Transit is the movement of goods from one country to another without payment of taxes and tariffs. It is more commonly known as smuggling.

— Internal BAT document

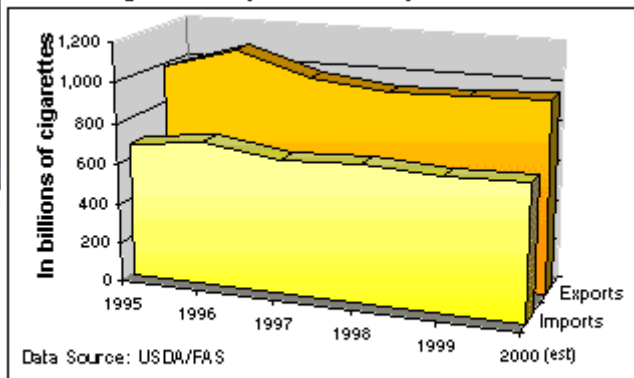
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Global Cigarette Imports and Exports



Tweddle



The disparity between global exports and global imports has averaged around 30%.

The [See the full document in PDF format.](#)
companies
have sought
to undercut rising government taxes, which studies show are
the main reason most smokers quit, as well as to gain market
share on their competitors or on government-controlled
tobacco monopolies by offering competitively priced popular

international brands on the black market. The result has been tax evasion on a global scale that has greatly depleted government treasuries, especially in Third World countries. Cigarette smuggling has also fostered international crime and money laundering and alarmed growing numbers of law enforcement officials worldwide. Attracted by huge profits, quick turnovers, a captive market, and relatively light penalties if caught, organized crime now controls large sectors of the smuggling.

"Organized criminals, who have traditionally been involved in smuggling illicit narcotics, are suddenly realizing that tobacco is a good thing to get into, as you make just as much money, and it's perhaps not quite as anti-social," Douglas Tweddle, the outgoing director for compliance and facilitation at the World Customs Organization in Brussels, told the Center. "The public generally aren't against you if you're selling smuggled cigarettes; in fact, they rather appreciate you. And if you get caught, in virtually all countries, the penalties for smuggling tobacco are a great deal less than smuggling heroin or cocaine." In the United States, cigarette imports have risen so dramatically that investigators are looking into whether the country is being used as a way station in the global smuggling trade. "Profits from cigarette smuggling rival those of narcotic trafficking," then-U.S. Customs Commissioner Raymond Kelly told Congress last year. "The United States plays an important role as a source and transshipment country."

The investigation by the Center's International Consortium of Investigative Journalists is based on a review of thousands of pages of corporate and government documents and dozens of interviews with law enforcement officials, smugglers, and other sources worldwide. It indicates that tobacco smuggling is increasingly dominated — often with the knowledge and consent of the tobacco companies — by a handful of criminal organizations that in some cases have links to organized crime. The Italian Mafia in Western Europe, East European gangs, Triads in Asia, drug cartels in Colombia, and motorcycle gangs and the American mafia in North America all have become entrenched in the game. Licensed distributors for the manufacturers feed these organized crime syndicates billions of cigarettes worldwide, often with corporate knowledge. "A primary driving force behind the proliferation of cigarette smuggling in both Colombia and Europe is the need of narcotics traffickers, Colombian, Russian, and others, to launder enormous amounts of money that can no longer be laundered through banks," said one recent court filing in a cigarette smuggling case.

The black market trade

It's estimated that about one in every three cigarettes exported worldwide is sold on the black market. This enormous business is operated through a web of offshore companies and banking institutions that often employ the same routes and distributors. Russian and Italian mafia use Cyprus and Montenegro. The drug cartels and U.S. mafia use Aruba and Panama. The same names turn up in smuggling networks into Colombia, Canada, and Europe. In Southeast Asia, the same distributors who smuggle out of Hong Kong to China also control distribution out of the Philippines and Singapore. The Center investigation shows that the manufacturers funnel massive amounts of their brand name cigarettes into these smuggling networks, often employing circuitous routes in an apparent attempt to shield themselves from accusations of wrongdoing. Distributors and manufacturers work hand-in-hand to feed this market.

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But, in some cases, the manufacturers have worked directly with organized crime figures. In Colombia, tobacco companies are alleged to have helped launder drug money and to have worked closely with distributors who are involved in drug trafficking. A Colombian lawsuit against Philip Morris and BAT accuses them of involvement in drug-money laundering through what is known as the "black market peso exchange," a circuitous system by which drug dollars are laundered for clean pesos through the purchase and importation of such goods as cigarettes and alcohol. In a federal civil racketeering lawsuit launched in 2000, Colombia's governors accused tobacco company executives of illegally entering the country to organize smuggling networks and retrieve cash payments, which were then smuggled out for deposit in offshore banks. Company employees are also alleged in the lawsuit to have bribed border guards. And their agents have been implicated in illegal cash campaign contributions to

Colombia's former president Ernesto Samper.

In Italy, court cases and police and government reports reveal an intricate web of Mafia families that through bribery, intimidation, and murder control the smuggling of billions of Philip Morris and R.J. Reynolds cigarettes into Europe through Cyprus, Albania, and Montenegro. In Spain, at least one major distributor for RJR is allegedly a black market distributor linked to illegal drug trafficking. In Canada, RJR sales executives dealt directly with smugglers linked to the American and Canadian mafia.

In some cases, tobacco industry executives actively played various gangs off against each other and solicited and received millions of dollars in kickbacks or bribes in return for selling to preferred criminal syndicates, according to court records and sources.

"[W]e act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market."

—Kenneth Clarke,
deputy chairman of BAT

The Center investigation also shows that when senior or mid-level executives have been charged criminally with aiding and abetting smuggling, tobacco companies often don't cooperate with investigators. In a Louisiana case, for example, lawyers for one tobacco company used their connections in the administration of former President Bill Clinton to force the removal of a prosecutor pursuing a Brown & Williamson sales executive for smuggling into Canada. The major tobacco companies all vigorously deny any involvement in the smuggling of their products. In a statement to the Center, BAT also said it knew of no evidence "to substantiate allegations that some of our employees or distributors have worked with criminal organisations and/or organised crime." Companies such as BAT have stated that they can't be expected to keep track of their 90,000 employees, even though in many cases those named in smuggling are senior managers. The companies also argue that they sell a legal product to wholesalers over whom they exercise no control. Kenneth Clarke, BAT's deputy chairman and the former Conservative chancellor of the exchequer, told the British House of Commons health select committee on February 16, 2000, that "there is no evidence I have ever seen that BAT is a participant in this smuggling. We seek to minimize it and avoid it."

However, writing in the February 3, 2000, issue of The Guardian, in response to a Center expos released a few days earlier, Clarke complained that high cigarette taxes caused smuggling and added: "where governments are not prepared to address the underlying causes of the problem . . . we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market." Top BAT executives, at a meeting last summer, considered the company's marketing strategy in light of expanding investigations, media reports, and civil lawsuits. An industry source told the Center that BAT executives discussed halting all "transit" business but worried that shareholders would be furious at the resulting drop in profits, which one government source estimated to be as high as 500 million pounds (US \$720 million) annually. BAT decided to continue the "transit" business, the industry source said, but no longer to refer to it as transit, DNP, or GT. The new company term is "WDF" for "Wholesale Duty Free." The executives also discussed taking steps to counter any civil and penal actions that could threaten the company's survival, the source said.

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Related Lawsuits

Massive smuggling has sparked a growing number of lawsuits. In a 12-month period ending last year, Canada, the governors of Colombia, Ecuador, and the European Union all filed separate racketeering suits in the United States against the tobacco giants. Seven nations — Germany, Spain, France, Italy, Belgium, the Netherlands, and Finland — have since joined the EU suit.

Click on the links to read the full text of the RICO lawsuit filed on behalf of:

- [The European Community](#)
- [The Colombian Governors](#)
- [Canada](#)

Among the charges, the EU accuses the tobacco companies of aiding and abetting smuggling, involvement in organized crime, defrauding state treasuries of billions of dollars, laundering drug money, and committing wire fraud and mail fraud.

In addition, criminal investigations have multiplied. In the United States, several grand juries are examining the allegations of tobacco company involvement in cigarette smuggling, including one in Raleigh, N.C., and another in New York. A multi-agency investigation, coordinated out of Atlanta, is also looking into possible corporate involvement in cigarette smuggling and its related crimes, such as money laundering, according to federal government sources. Canada, Italy, and Britain have also launched criminal investigations. Still, with the exception of one case in Syracuse, New York, where a unit of RJR called Northern Brands International pleaded guilty in 1998 to smuggling-related charges, the tobacco industry has not faced criminal prosecution.

The growing list of civil cases, however, could prove devastating. Faced with possible treble damages under the U.S. Racketeering Influenced and Corrupt Organizations (RICO) Act, the tobacco companies are vigorously fighting the lawsuits. Already, allegations have surfaced in the Colombian lawsuit that Philip Morris is corrupting the legal process through threats and the destruction of documents. BAT is alleged to have engaged in influence-peddling by putting political and government officials in Colombia on paid consultant contracts. An affidavit sworn in September 2000 by Jos Manuel Arias Carrizosa, the executive director of the Colombia Federation of Departments [or states] says that Philip Morris Vice President J. Armando Sobalvarro tried to persuade Arias, in an October 27, 1999, meeting, that a lawsuit against Philip Morris was "not in the Departments' best interests." Sobalvarro noted that Philip Morris was lobbying Washington for a large aid package for Colombia and concluded the visit by threatening Arias that if the lawsuit against Philip Morris proceeded, "there would be blood." For investigators like Hong Kong's Godfrey, there is "absolutely no doubt" that BAT knew its cigarettes were being smuggled into China and Taiwan. "[BAT is] a very sophisticated company," he said in an interview. "There's no reason why they shouldn't know." Godfrey also said he believes that bribery became institutionalized at BAT-Hong Kong. Blood, threats, bribery, and corruption are no strangers to cigarette smuggling. And tobacco companies seem to know that as well as anyone.

**Reported by Maud S. Beelman, Bill Birnbauer, Duncan Campbell, William Marsden, Erik Schelzig and Leo Sisti and written by William Marsden. The [International Consortium of Investigative Journalists](#) is a project of the Center for Public Integrity. This investigation was supported by www.theRake.com.*

CHINA

The Chinese consume almost one out of every three cigarettes manufactured worldwide, or 1.6 trillion out of about 5.2 trillion cigarettes consumed annually. And, according to industry figures, their consumption grows about 2 percent each year. It's no wonder, then, that in the early 1990s British American Tobacco considered China "key to BATCo's longterm success," according to an internal company document. With this in mind, the same document continued, "as long as free market sales remain dominant, alternative routes of distribution of unofficial imports need to be examined, evaluated, and, if appropriate, maximised."

Despite steep import taxes as high as 430 percent and severe quotas on tobacco imports, BAT quadrupled sales in China, to just over 46 billion cigarettes in 1993, from 11 billion in 1989, according to company figures. A 1993 BAT document titled "Asia/Pacific Review" and marked "secret" states that only 5.4 percent of BAT's total China business passed through legal channels: China's National

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Hung



Lui

Tobacco Corp., the country's tobacco monopoly. The same document laments BAT's "dependence on continued transit trade into China." The rest came through what BAT variously referred to as the

"free market," "general trade," or duty-free "leakage." Essentially, it was smuggling by distributors working out of Hong Kong, the Philippines, and Singapore. Court documents in Hong Kong, reviewed by the Center, show that between 1987 and 1993 BAT sold at least HK\$8.5 billion (US \$1.2 billion) worth of cigarettes (about 50 billion cigarettes) to a Hong Kong-based network, smuggling into China and Taiwan. The network was backed by the Triad, Asia's most notorious criminal organization. Hong Kong authorities calculate that pipeline profits multiplied sevenfold, with the smugglers and street retail vendors earning total gross profits of about HK\$60 billion (US \$8.3 billion).

It was this smuggling operation that led, on March 29, 1995, to the savage killing of Tommy Chui in Singapore harbor. Experts testified that Chui's murder had all the hallmarks of a Triad killing. The three diving belts with their four, five, and six lead weights, plus the pattern in which his car keys had been placed next to the abduction car, were Triad warnings to anyone who might consider talking to police about cigarette smuggling. In 1996, a Hong Kong court sentenced a Triad soldier to 27 years for Tommy Chui's murder. An appeal is pending. Three others are still at large. In October 1996, Henfrey Tin Sau-kwong, who is described by Hong Kong's Independent Commission Against Corruption as a Triad enforcer, was jailed for five years for trying to intimidate Chui from giving evidence. The sentence was later increased to six years. The major role played by Triad societies in smuggling BAT cigarettes into China had become clear to authorities a year before Chui's murder. In 1994, Chui gave police three lengthy, sworn statements chronicling cigarette smuggling and high-level corruption at BAT. Most of his sworn statements later were admitted into the court record. Even in death, Chui's words lived on.

At the center of the BAT smuggling conspiracy was a Hong Kong distribution company called Giant Island Ltd. (known as GIL), which was founded in the mid-1980s to export cigarettes. Chui had been a director until 1993, when he resigned after a disagreement with the company's founder and majority owner Hung Wing-wah. Chui cashed in his multimillion-dollar profits and moved to Singapore. A third director, Chong Tsoi-jun, ran the daily accounts. Bank statements plus documents seized at Giant Island's office largely substantiate Chui's testimony. They show that until March 14, 1994, when Hong Kong authorities raided Giant Island offices, Giant Island had been BAT's major distributor into China and Taiwan, organizing the smuggling of billions of cigarettes. To assure that Giant Island remained a favored distributor, Chui said the company greased the network by bribing three successive directors responsible for exports at BAT-Hong Kong.

According to Chui, the first was Wai Pong. Between 1986 and February 1990, a total of about HK\$45 million (US \$6.2 million) was paid to Wai, Chui said. Pong quit in mid-1989 and immigrated to Canada. His successor was his assistant Leo Chan King-wai. Chui said Giant Island paid Leo Chan a kickback of HK\$50 on every box (50 cartons, or 10,000 cigarettes) of the best-selling State Express 555, and HK\$30 a box for the poorer-selling Hilton brand. Leo Chan was shot in the face while he walked through the garage of his apartment building because, according to Chui's statement, he was steering business away from Giant Island and into another Triad-backed company. Leo Chan recovered, later retired from BAT and followed Pong as an immigrant to Canada.

The next man to assume the top export job at BAT-Hong Kong was Jerry Lui Kin-hong. The Chinese-born Lui had a master of business administration degree from a Canadian university and worked for the international accounting firm Peat Marwick and for Philip Morris before joining BAT's U.S. subsidiary, Brown & Williamson. In June 1990, Lui was transferred to BAT's Hong Kong office with the task of increasing his company's sales into China. In the tradition of BAT export executives out of Hong Kong, Lui immediately climbed on Giant Island's gravy train. Chui said that Lui solicited and was paid HK\$2 million (US \$277,200) by Giant Island for

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continued favorable treatment. Lui also persuaded Giant Island to pay him another HK\$3 million (US \$415,800) immediately after his promotion in January 1992 to export director at BAT Hong Kong. It was a sort of signing bonus. Lui also continued the practice of taking HK\$50 for each box of BAT's State Express 555 sold to Giant Island. Chui explained in his statement that he opened an account for Lui with the Union Bank of Switzerland's Hong Kong branch, where he paid the bribes. He told investigators for the Independent Commission Against Corruption: "At that time, GIL ordered about 45,000 boxes of '555' from BAT every month. Taking \$50 per box, the monthly bribe payments due to Lui amounted to approximately HK\$2 million. This is in addition to the \$5 million he had obtained initially." As export director, Lui sold BAT cigarettes to four authorized export groups. Giant Island was by far the favored agent. "Should the cooperation of such a key person be obtained, problems on the supplies of export cigarettes would be solved," Chui said in one of his statements to ICAC. "Lui had been the commercial director with BAT during the period of late 1991 to April 1993 and the bribes paid into this account with cheques through me totalled in excess of HK\$25 million (US \$3.5 million)," Chui said. Over the same period, BAT paid him only HK\$2.5 million (US \$346,500). Lui was making more money in bribes than in salary.



Giant Island also bribed customs officers for expediting export documents and favoring its deliveries at bonded warehouses, where duty-free cigarettes were stored awaiting export. The Wo On Lok Triad Society protected Giant Island and its smuggling routes, Chui said. Giant Island bought two M-16 machine guns and other firearms to guard its cargo from pirates in the South China Sea. Chui said Giant Island had shares in five vessels on the route from Hong Kong to Kaohsiung, Taiwan. Each carried up to 4,000 boxes of cigarettes to meeting points on the high seas, where they off-loaded the cargo to fishing boats destined for China or Taiwan. The Taiwan-bound cigarettes were wrapped in plastic bags so they could be hidden under ice on the fishing boats.

BAT pumped a phenomenal amount of cigarettes through Giant Island. On average, Giant Island smuggled 132,000 boxes — the equivalent of about 132 40-foot shipping containers — to China and Taiwan each month, just on the Kaohsiung-Hong Kong route, according to court records. Giant Island also had seven freighters transporting BAT cigarettes from Singapore (and, more recently, Subic Bay in the Philippines) to fishing boats in the South China Sea. Once identities were confirmed using torn bank notes with the same serial numbers, the cigarettes were loaded onto the fishing boats for Taiwan or mainland China. This business, averaging

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100,000 boxes a month, earned Giant Island about HK\$6.5 million a month in freight charges alone. An analysis of BAT's own figures shows that it steered a majority of its Hong Kong export business to Giant Island. In 1992 alone, the tobacco company sold 16.98 billion cigarettes to Giant Island. This exceeded the amount sold to BAT's other export agents, who received a combined total of only 16.74 billion cigarettes. According to an Ernst & Young tax investigation of Giant Island, plus sales figures presented in court, Giant Island and its related companies earned profits of between HK\$555 million (US \$77 million) and HK\$749 million (US \$104 million) on sales of BAT cigarettes between 1987 and 1994.

In September 1994, six months after the raid on Giant Island, its founder Hung fled Hong Kong. He cleaned out his Luxembourg bank account of about US \$140 million and immigrated to Canada, where he bought a large home in Vancouver. He is still wanted by Hong Kong's Independent Commission Against Corruption on corruption charges and is believed to be living in both Canada and the Philippines, where ICAC believes he still exports BAT cigarettes into China. Hong Kong authorities charged Hung's partner Chong in December 1994 with conspiring to offer bribes to BAT officers and civil servants. He was later charged with a HK\$60 million tax fraud. In September 1996, he leaped to his death from the 26th floor of his luxury Hong Kong apartment building.

Jerry Lui left BAT in April 1993. According to a letter found in the BAT archives and dated Sept. 29, 1992, BAT wanted to "get rid" of Lui because of concerns over an "[issue of trust](#)," which was not explained. BAT had planned to transfer him back to Brown & Williamson. Instead, Lui left the company altogether and, in partnership with Hung and others, established a warehousing operation in the bunkers and storage sheds of the former U.S. naval base at Subic Bay in the Philippines. British American Tobacco cigarettes were stored there and distributed to the black market in China and elsewhere. At the request of Hong Kong authorities, the FBI arrested Lui in 1995 in Boston, where he was visiting a friend. Lui's advisers, legal and public relations, launched a vigorous media and political campaign that went all the way to former Secretary of State Madeleine

Albright, but ultimately failed to stop his extradition.

While awaiting the outcome, Lui granted an interview to a BBC television journalist, during which he conceded that billions of BAT cigarettes were smuggled into China. "I think ICAC is interested in me because they allege these duty-free cigarettes ultimately are being smuggled into China. And they were, yes. The problem here is that my job is to sell to the agents, appointed agents of BAT cigarettes; in turn, the agents sell to what we call the runners. Now if the runners try to smuggle into China, it's the runners' problem. It's not BAT's problem. Because the title has changed." But Lui acknowledged on camera that

BAT knew the cigarettes would be smuggled into China, that Subic Bay had become a center for supplying the Chinese black market, and that BAT monitored sales in China.

After a battle that ended in the U.S. Supreme Court, Lui was extradited to Hong Kong in May 1997. In June 1998, after a 25-day trial, he was found guilty of conspiracy to accept bribes of HK\$23.25 million (US \$3.2 million) and a HK\$10 million (US \$1.3 million) unsecured loan. He was sentenced to three years and eight months in prison, fined HK\$500,000 (US \$69,300), and ordered to pay HK\$10 million (US \$1.3 million) restitution and prosecution costs of HK\$11 million (US \$1.5 million). Lui, who refused a request for an interview, is out on HK\$1 million bail, pending an appeal hearing set for March 20.

BAT, in a statement to the Center, said, "we are not aware of any evidence to substantiate allegations that some of our employees or distributors have worked with criminal organisations and/or organised crime." But Judge Wally Yeung Chun-kuen, who sentenced

"The problem here is that my job is to sell to the agents, appointed agents of BAT cigarettes; in turn, the agents sell to what we call the runners. Now if the runners try to smuggle into China, it's the runners' problem. It's not BAT's problem."

— Jerry Lui,
BAT's former export director in Hong Kong

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Herter

Lui, said it appeared that Lui was carrying out company policy, and he put most of the blame directly on BAT. "A leading international tobacco company sold large quantities of duty-not-paid cigarettes, worth billions and billions of dollars, with the knowledge those cigarettes would be smuggled into China and other parts of the world," the judge said at the time. "Apparently the company turned a blind eye to the problem. They took the attitude that as long as they did not directly involve themselves in smuggling, what distributors did with the cigarettes was none of their concern." Hung Wing-wah still operates his tobacco distribution business out of the Philippines and, although he is wanted on smuggling-related charges in Hong Kong, BAT continues to do business with him, Godfrey of the corruption commission said. "BAT are still selling cigarettes to a company run by a man who they know is wanted by the Independent Commission Against Corruption," he said. "We can't take any action against British American Tobacco. They commit no offence, not in Hong Kong. BAT has in the past and probably now still deals with criminal organized crime," Godfrey said.

America

Dino Bravo, a former World Wrestling Federation wrestler and mob enforcer, was sitting in his leather recliner, programming his new VCR on March 12, 1993, when two men walked into his luxury home just north of Montreal and shot him seven times in the head. Police later found in his home stacks of cash and documents related to the cigarette smuggling business. One investigator, who wished to remain anonymous, said in an interview that Bravo was murdered because he was skimming from a mob smuggling network for which he collected the money. A Canadian smuggler, in an interview with the Center for Public Integrity, said the same thing. He added that Bravo had purchased a cigarette relabeling operation in Champlain, New York, that repackaged and relabeled cigarettes, which Canadian-based manufacturers sent to the United States. The cigarettes were then smuggled back into Canada.

In the end, however, Bravo was a bit player in a much bigger game largely controlled and regulated by the major tobacco companies. He was killed at the peak of tobacco smuggling in Canada. Federal and provincial governments had more than doubled their tobacco taxes, driving the cost of a carton of 200 cigarettes to as high as \$50 Canadian (US \$38). While the manufacturers vigorously lobbied the government to reduce taxes, they fed the smuggling networks through elaborate U.S. and Caribbean routes. Each of the three major Canadian manufacturers — RJR-Macdonald, BAT's Imperial Tobacco Ltd. (working with Philip Morris), and Rothmans Benson & Hedges — exported billions of cigarettes into the United States, from where they were smuggled back into Canada.



In a June 3, 1993, [letter to BAT](#) senior executive Ulrich Herter, Imperial Tobacco president and CEO Don Brown stated that smuggling represented 30 percent of total sales in Canada, and "until the smuggling issue is resolved, an increasing volume of our domestic sales in Canada will be exported, then smuggled back for sale here." Noting that Imperial had to pay a royalty to Peter Jackson (Overseas) Ltd. for every du Maurier brand cigarette sold outside Canada, Brown complained that Imperial should not have to pay the royalty for exports to the United States since they were being smuggled back to Canada. "Paying royalty on volume actually sold in Canada . . . not only impacts on earnings but also renders us less competitive," he wrote. He added that the company can "fairly accurately estimate those volumes sold outside Canada and those returning from the total." Brown admitted in an interview that in 1993 the company exported 6 billion Canadian brand cigarettes into the United States, where nobody smokes Canadian cigarettes. BAT subsidiary Brown & Williamson marketed Imperials du Maurier brand in the United States. In 1996, U.S. Customs agents arrested Michael Bernstein, a B&W regional sales manager, Richard Wingate, B&W's sales account manager for the New Orleans area, and six others and charged them with trafficking in cigarette contraband into Canada. All defendants pleaded guilty.

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An undercover agent posing as a smuggler recorded a conversation in which Bernstein said that he received permission from Imperial Tobacco to sell to the agent. Bernstein said that Imperial Tobacco threatened to cut off the sales "if and when we get snagged with the packet of stuff anywhere in Canada." Bernstein said Imperial was ready to continue to sell small orders "as long as we don't get snagged." Federal agents also searched B&W's headquarters in Louisville, Kentucky, in January 1995 but found nothing that would connect the company to conspiracy to smuggle into Canada. Agents claimed in the [search warrant affidavit](#) that evidence existed that the company had been smuggling into Mexico. The affidavit also states that Wingate told agents that a B&W corporate supervisor told him he had ordered an employee "to destroy the paperwork evidencing recent potentially illegal sales of cigarettes into Mexico." The affidavit states that Wingate and Bernstein said "that the company's organizational structure necessitated new marketing strategies. According to them, these strategies included selling cigarettes to smugglers."

During the undercover investigation, which started in 1993, agents taped Bernstein and Wingate discussing the smuggling and what would happen if they got caught in the Canadian operation, in which the cigarettes were said to be bound for tax-free fishing vessels off the Louisiana coast. "As far as Brown & Williamson is concerned, that product was brought in for consumption on those Vietnamese fishing boats,"

"It's an easy sale. It's only a slap on the wrist if you get caught."

—Former B&W regional sales manager Michael Bernstein

Bernstein says. He later adds: "Were we personally any part of this? No, we were not. Did anyone ever call you up and say 'I need a hundred cases for Canada'? No." He then related to Wingate a similar case in Boston where he was selling to Portuguese fishing vessels. "It was all being flushed into the Boston market and whatnot. Wherever it can be, wherever anybody can make a buck, I promise you, Dick, they're going to make a buck. Especially on cigarettes." He added: "It's an easy sale. It's only a slap on the wrist if you get caught."

In fact, he was right. Bernstein, who initially agreed to cooperate with authorities, later refused to help after meeting with his B&W-paid lawyers, Reid H. Weingarten and Mark J. Hulkower, both former Justice Department employees. Weingarten once said he was "very, very close at the [Justice] Department" to former Deputy Attorney General Eric Holder. Weingarten and Hulkower wrote a 42-page letter to then-Attorney General Janet Reno on February 9, 1996, arguing that the prosecutor in the case, Peter Strasser, should be removed for prosecutorial misconduct and grand jury abuse. Reno didn't buy their argument but still removed Strasser from the Bernstein case "to be safe," according to a court document filed by the U.S. Attorney's office. Bernstein was later fined \$1,000 and sentenced to two years probation. Wingate, who cooperated with authorities in their investigation and refused B&W's offer of legal assistance, was sentenced in 1997 to six months in a halfway house, followed by three years probation, and fined \$8,250.

'Tobacco companies knew it all'

Richard Ward directed international sales at Imperial's head office in Montreal and was responsible for sales into the United States. He was the contact with B&W. One Canadian smuggler, who wished to remain anonymous, told the Center that he met Ward in his offices at Imperial's headquarters at least four times to negotiate cigarette shipments into the United States. Did Ward know that he was dealing with a smuggler? "Yes," said the smuggler. "I have spent 30 years hiding my activities from society. Yet Richard Ward knew more about my activities than any policeman ever found out. So I guess what I am telling you is that tobacco companies knew it all. They know where the product is. When they ship from their warehouse (in Montreal) to Miami, they know that it's shipped to Miami but it's actually going to end up on the streets of Montreal and Toronto." The smuggler continued: "In my discussion with Richard Ward it's very clear to me that tobacco companies knew more about smuggling and how it worked and how to improve it than any smugglers on Earth. And to show just how good they were and just how intimate their knowledge was, when the business moved

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The Niagara Falls, N.Y., restaurant where Thompson met with Miller and the Tavanos.

from interprovincial to international, the tobacco companies ended up with more of the provincial and federal taxes than the smugglers did, and they took it not with willful blindness. They were participants without being in the room."

In answer to written questions to Imperial Tobacco, Ward, speaking through the company's public relations department, denied he ever met with smugglers. Imperial also shipped to the United States billions of Players, the most popular brand in Canada. Because Philip Morris has the U.S. rights to Players, Imperial signed a royalty and marketing deal with the company in 1992. They agreed to maintain the Canadian packaging. But health labels had to meet U.S. regulations. So, labels were changed in the United States at places such as Bravo's Champlain relabeling and warehousing operation. The operation had been originally set up by Michel Sylvestre, a convicted cocaine dealer with connections to the Hells Angels. Sylvestre and John Gareau, a local ship chandler currently under indictment in Canada for tobacco smuggling, had guidance from Imperial in locating labeling machines from Britain, the smuggler told the Center. However, it was RJR-Macdonald, RJR's Canadian subsidiary, which set up the most aggressive smuggling network.

In 1992, company president Ed Lang and vice president Stan Smith ordered sales executive Les Thompson to meet with Larry Miller and brothers Lewis and Bob Tavano. Miller and Bob Tavano both had criminal records: Miller for armed robbery in Chicago and Tavano for fraud and bribery. Lewis Tavano was charged in the 1970s with bookmaking. The charges were dropped and he moved to Las Vegas, where he ran a sports bookmaking and loan operation. Police in Buffalo, New York, say the Tavanos were linked to the late Stefano Magaddino, a Buffalo crime boss. Thompson later said in an interview that his bosses at RJR told him to sell as many cigarettes as he could to Pine Partnership, the company set up by Miller and the Tavanos. Thompson met with the two men at a restaurant in Niagara Falls, New York, where a plan was laid out to sell them millions of Export 'A' — RJR's best-selling brand in Canada. The company then set up a corporate structure designed to take the operational aspect of the smuggling business out of Canada. RJR created Northern Brands International, located at RJR's head office in Winston-Salem, North Carolina.

The company had only two employees, Peter McGregor, who was in charge of finance, and Les Thompson, who was responsible for sales. Their sole job was to sell into the Canadian black market, according to Thompson and confidential documents from a 1993 RJR executive meeting in Winston-Salem. RJR-Macdonald also set up separate offices in a building opposite its downtown Toronto headquarters to manage any communications with Northern Brands. The company had its offices swept for bugs, Thompson said. To further distance itself from the operation, RJR-Macdonald transferred equipment from Canada to Puerto Rico, where it began large-scale manufacturing of its Canadian brand cigarettes. The entire output of the plant was sold to smugglers, primarily Pine Partnership. The sales arrangements were made through Northern Brands International, Thompson said.

Before entering the United States, the Puerto Rico cigarettes were "washed" through offshore tax havens, such as Aruba. R.J. Reynolds International Special Markets in Winston-Salem, run by an Italian-Canadian named Franco Gabriele, signed a deal in March 1992 with International Duty-Free Trading N.V. and its managing partner Bryan Harms, a shipping agent based in Aruba whose family would later be linked to a smuggling operation involving another tobacco multinational. In 1992 and 1993, RJR shipped about US \$65 million worth of cigarettes through Harms' company. The shipments, however, were only book entries. According to Harms, the money never actually went through his company accounts. Nor did he have to handle the cigarettes. For his services, Harms charged RJR a total \$3 million, he said. The cigarettes were then shipped to U.S. warehouses located in free trade zones close to the border in Buffalo and Champlain, New York. From there, they were shipped into the Ackwesasne American Indian reserve, which straddles the

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U.S.-Canada border. Indians smuggled the cigarettes across the St. Lawrence River on small boats and into Canada. Other shipments were smuggled through border stations in Quebec, Ontario, and in British Colombia, court records show.

RJR-Macdonald also shipped directly into the United States from its Montreal plant. The shipments went to free trade zones, where ownership was transferred to companies like Pine Partnership. From there, they were trucked to the Indian reserve or smuggled back across the border through customs stations. RJR's Thompson said that at the time, RJR-Macdonald was pouring a little more than 60 percent of its production into the black market and earning more than US \$60 million in net profits annually from the smuggling. RJR cemented its relationship with Miller and the Tavanos by wining and dining them at Grand Prix races, professional golf tournaments, baseball games, and at the exclusive Sonora Lodge, a fishing club in British Colombia. It was also a favorite resting place for Hells Angels who, according to Thompson, often shared the fun with the Tavanos and Millers as they schmoozed with RJR executives.

Rogue or company man?

After his arrest, company officials portrayed Thompson as a rogue operator. But when he ran his one-man, direct-to-smugglers sales department at Northern Brands International, it was another story. During those years, his bosses repeatedly commended him for his excellence. They threw a party for him and gave him an Indian headdress in joking recognition of his sales to American Indian smugglers. On June 23, 1993, RJR-Macdonald president Pierre Brunelle wrote to Thompson that his "hard work and dedication to the company have made significant contribution to the success we have realized over the years especially in recent months." Thompson's 1993 performance evaluation applauded him for hitting "every target and objective assigned to him."

As one former RJR senior executive told the Center, NBI and Les Thompson saved RJR-Macdonald from possible bankruptcy. By 1993, Canadian manufacturers were shipping slightly more than 17 billion Canadian brand cigarettes a year to the United States, where, as one police officer later testified, there is "almost absolutely no market for Canadian tobacco products." By 1994, about 35 percent of cigarettes sold in Canada was contraband, with the figure going as high as 75 percent in areas of Quebec. Faced with mounting crime and depleted tax revenues, the Canadian government in 1994 rolled back cigarette taxes. The smuggling slowed but did not stop.

Manufacturers still kept the networks running and, according to court testimony last year from RCMP Sgt. Raymond Blair Lutz, large-scale smuggling continued until 1998. Lutz told a pretrial hearing in Montreal in February 2000 that manufacturers were still sending millions of cigarettes to the J. Stanley Company in New Jersey. In what police call "around the flagpole" smuggling, J. Stanley shipped the cigarettes in bond back to Canada, where they were sold to smugglers, who reshipped them back to the U.S. still in bond. They were then smuggled back into Canada. The process was designed to distance the tobacco companies and J. Stanley from the smuggling. "Millions to billions" of dollars worth of cigarettes were smuggled into Canada from 1995 to 1998 using this process, Lutz said.

After Canadian taxes came down, Thompson said he was put in charge of marketing cigarettes to ship chandlers along the U.S. eastern seaboard for smuggling to Europe. His boss was Richard La Rocca. Thompson said he helped organize huge duty-free shipments from East Coast ports funneled through ship chandlers such as J. Stanley. RJR sent regular container loads of cigarettes on ships bound for Europe, claiming tax-free status by pretending the cigarettes were for on-board crew consumption only, he said. Each container holds about 10 million cigarettes and carries a wholesale value of as much as US \$350,000. (J. Stanley, in a plea agreement last year, pleaded guilty in Canada to tobacco smuggling charges and paid \$150,000 Canadian in fines and forfeitures. Charges were dropped against its owner, George Mannina. Canadian police have testified that U.S. Customs tried to persuade the RCMP not to charge

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Mannina because he was cooperating with one of their investigations. Mannina also owns Lamco International, a California warehouse and chandling operation.)

Thompson said that in 1998, La Rocca, who was general manager of RJR's Latin American office in Miami, told him to curtail shipments because of the increased numbers of seizures and negative media reports in Europe about tobacco smuggling. "He (La Rocca) said it's important that we back off from the noise that's happening in Western Europe," Thompson said. "Dick was very clear to me: Do not totally stop selling to . . . the ship chandlers. Reduce the volume. Instead of giving them a load every week, give them a load once a month or so. Just to keep the distribution channels alive. Dick said: I've got experience with that. Dick worked in Spain, the Canaries. He was the general manager there." Thompson said La Rocca once told him he knew Michael Haenggi, who bragged to the press in 1998 that he sold millions of RJR's Winstons to smugglers who smuggled them into Spain. Thompson said that La Rocca had been instructed to warn Haenggi that if he didn't "zip his lips," he would be cut off by RJR. "I understood from Dick that that statement was coming to him indirectly from (CEO of RJR Nabisco) Steven Goldstone," Thompson said.

A lawsuit filed last November by the European Union against R.J. Reynolds and Philip Morris alleges that RJR specifically recruited La Rocca because of his knowledge of the Spanish market. The lawsuit says RJR urged La Rocca to help set up a network "by which RJR cigarettes . . . were smuggled into the European Community and, more particularly, into Spain." La Rocca has been working for Japan Tobacco, Inc., since it bought RJR's international operations in March 1999. He remains general manager of the company's Latin American operations and works out of the same Miami office. Contacted by telephone at his Miami office, La Rocca hung up as soon as a reporter mentioned he was researching a story on tobacco smuggling.

The EU lawsuit also alleges that RJR dealt with a distributor in Spain who the company knew, or should have known, was involved in drug trafficking. The suit does not name the distributor but states that he has had "several publicized bouts with the law enforcement agencies in Spain in regard to his alleged narcotics trafficking." On June 10, 1998, an agent at the U.S. Bureau of Alcohol, Tobacco, and Firearms informed Thompson that he was the target of a smuggling investigation and advised him to get a lawyer. At the same time, a grand jury in Syracuse, New York, charged Miller, the Tavano brothers, Northern Brands International, and 16 other people with money laundering, smuggling, and fraud. They all pleaded guilty. Miller was sentenced to 17 years, and Bob Tavano got four years plus a \$1 million fine. Lewis Tavano is dying of cancer and is to be sentenced in early March.

When RJR learned that Thompson was a target of a criminal investigation, it immediately set up meetings between Thompson and Steven Heard, the company's New York lawyer, and Washington, D.C., lawyers Weingarten and Hulkower, the same former Justice Department lawyers Brown & Williamson used in the New Orleans smuggling case. Heard, a gruff, gravelly voiced veteran of tobacco court battles, traveled to RJR-Macdonalds headquarters in Toronto and started interviewing employees and senior executives. Thompson said documents dealing with Ed Lang and pre-NBI days suddenly went missing. Top executives were transferred to Switzerland and Asia. Stan Smith, who was second in command of the company, left RJR and later moved to England.

Former RJR employee Franco Gabriele agreed to testify before the Syracuse grand jury in return for immunity. When Heard learned that Gabriele had made a deal with the government, he threatened to "publicly destroy his reputation." Thompson said he asked Hulkower, the RJR-hired attorney, if that was also a warning to him. Hulkower said it was. In a deal negotiated by Heard, NBI pleaded guilty in December 1998 to a customs violation and agreed to pay \$16 million in fines and forfeitures — only a fraction of the money it earned from smuggling into Canada. As part of the plea bargain, the U.S. government agreed not to pursue RJR any further in the Northern District of New York. Thompson said the company lawyers told him, "The government is just saber rattling, stand tall, don't get scared with this thing. We'll get through it." But standing tall didn't help Thompson.

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Three months after the NBI deal, Customs agents arrested Thompson at the Detroit border with Canada and charged him with fraud and laundering the proceeds of crime. Hulkower told Thompson that RJR would not back him and advised him to plead guilty. Facing a possible 20 years in prison, Thompson pleaded guilty to

laundering \$72 million and got six years in prison and a \$100,000 fine. He also

pleaded guilty in Canada to conspiracy to defraud the Canadian government and got a three-year suspended sentence and agreed to cooperate in ongoing investigations. Upon his arrest, RJR publicly stated that Thompson was a rogue operator in the company. No other RJR executive was ever charged in the case. The Canadian government sued RJR and Northern Brands International in 1999 in U.S. federal court for racketeering and fraud. The government's lawyer, Fred Bartlit, told a U.S. federal court judge in Syracuse last year, "This is a case of legitimate business that hooked up with organized crime." The international smuggling world is small, and the names of Harms, Gabriele, and Aruba would surface again in other smuggling investigations. One of them is in Italy.

***"This is a case of legitimate business
that hooked up with organized crime."***

—Canadian government lawyer
Fred Bartlit

Italy

On the night of February 23, 2000, as a full moon drifted in and out of scattered clouds, revenue agents with Italy's Guardia di Finanza drove along a highway near the Adriatic port of Brindisi. They were hunting tobacco smugglers. Suddenly, out of the darkness, a Range Rover with reinforced front bumpers and its headlights off swung across the highway and deliberately crashed into the agents' tiny Fiat Punto. Alberto De Falco, 33, and Antonio Sottile, 29, were killed. Two others sitting in the back seat were seriously injured.

Driving in the Range Rover, which was crammed full of contraband Marlboro and Merit cigarettes, were Giuseppe Contestabile and Adolfo Bungaro, two soldiers of local crime boss Bruno Rillo. Rillo, who was not in the Range Rover, was arrested and convicted of smuggling. Contestabile and Bungaro were convicted of smuggling and still face murder charges.

The killing of the two agents in Brindisi reflects the powerful underworld interests involved in tobacco smuggling into Italy. Like many other countries in the European Union, Italy's tobacco taxes are high. The country also has a state monopoly over manufacture and distribution, which keeps prices high and, therefore, makes smuggling that much more lucrative. Italian authorities have compiled several recent intelligence reports gleaned from investigations and court trials dating to the early 1980s. According to one of these reports obtained by the Center, tobacco smuggling was transformed in the early 1980s from a cottage industry into "an incredible commerce of thousands of cases" worth "hundreds of millions" of lira per shipload, transacted through Swiss bank accounts.

The July 16, 1999, report by an Italian parliamentary commission investigating the Mafia and other criminal organizations said smuggling international-brand cigarettes was "one of the most important sources of illicit gain" for organized crime and one that was facilitated by international links with tobacco manufacturers, especially Philip Morris. Beginning in the early 1980s, Philip Morris and RJR, from offices in Basel, Switzerland, ran a cigarette export operation through three Swiss companies that had close ties to Italian organized crime, the 53-page report said. These licensed distributors were identified as Balmex AG, owned by Patrick Laurent; Basilio AG, owned by George Kastl; and Algrado AG, owned by Werner Denz. "This circuit . . . constituted the supply channel for the tobacco smugglers," the report said. A senior Italian magistrate said the report incorrectly named Patrick Laurent when it should have named Patrick Monnier of Vaud, Switzerland, who is wanted along with several other key figures on charges of cigarette smuggling and membership in a mafia-like organization.

Two channels were established to smuggle into Italy, according to the report. Cigarettes manufactured under license in Switzerland were shipped directly to Albania. Cigarettes manufactured in the United States were shipped to warehouses in Antwerp, Belgium, and then to Albania. From Albania, the cigarettes were smuggled into Italy or the Middle East. "The contraband moved . . . across predetermined commercial channels," the report said. These channels were also used for drug trafficking and money laundering under

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Two members of the Guardia Di Finanza anti-contraband unit in Italy confiscate cases of Marlboro cigarettes last May.

the supervision of Kastl and Denz, who, the report said, had smuggling backgrounds and "notable criminal stature in these two specific fields."

Kastl and Denz were also identified in the report as having direct connections to the Sicilian Mafia in Palermo. In 1984, a Florence court sentenced Kastl to 26 years in prison for trafficking 82 kilograms of heroin. Other Italian intelligence reports obtained by the Center show that in the 1990s the main route for tobacco smuggling into Europe was changed to go through Montenegro's Adriatic ports and then by speedboat to Italy, where the Puglia coast from Gargano to Brindisi is ground zero in the tobacco battles. In fact, by the early 1990s Brindisi had become criminalized by cigarette smuggling, according to Italian authorities. Italian police and revenue officials charge that the Mafia runs the smuggling and that Montenegrin government officials, who receive millions of dollars in kickbacks, sanction it. Once again, the main suppliers, Italian police and government officials say, are Philip Morris and R.J. Reynolds distributors.

A 240-page internal report on international cigarette smuggling compiled in 1997 by Italy's tax and customs police, the Guardia di Finanza, describes the smuggling hierarchy as it existed during the 1990s. The report, obtained by the Center for Public Integrity, states that smuggling into Europe is divided among various crime families connected to the Sicilian, Camorra, and Sacra Corona Unita organized crime syndicates. They operate the smuggling through a "pyramid" of 19 people living in Italy, France, Switzerland, and Greece. These traders hide their activities behind numerous front companies located in tax havens such as Switzerland, Liechtenstein, Panama, British Virgin Islands, Gibraltar, Cyprus, Belize, Netherlands Antilles, and the Channel Islands. The report claimed that tobacco smuggling in Europe caused an estimated \$700 million annually in losses to governments and legitimate merchants.



Again, throughout the 1990s, Mafia bosses struggled for control of this lucrative business. According to Italian court records, Neapolitan Camorra boss, Ciriaco De Mita, nicknamed "the prince," "the engineer," or "the uncle," attempted in 1993 to monopolize smuggling and duty free businesses in Montenegro. He conspired to gain control of Montenegrin government warehouses, which he would hold through a Panamanian company called Gisto, based in Lugano, Switzerland. At least 50 containers a month, primarily Marlboros, would be sent to warehouses in Montenegrin ports of Zelenika, Bar, and Katar. The cigarette cases would then be transferred to speed boats and shipped at night across the Adriatic to Italy's Puglia region, about 100 miles away.

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According to documents obtained by the Center, Mazzearella, seeking support for his venture, contacted individuals close to Milo Djukanovic, Montenegro's then-prime minister and current president. This was quickly granted and Mazzearella received a license from the government-owned company ZetaTrans to be the exclusive cigarette trader through Montenegro. But Italian investigators uncovered the conspiracy and, on September 27, 1993, Mazzearella was arrested in Lugano. The case is still before the courts.

Meanwhile, billions of contraband cigarettes are still run out of Montenegro, Italian police say. Last December, Italian police arrested Francesco Prudentino, 52, while he was Christmas shopping in Greece. Prudentino, who operated out of Montenegro, is named in a 1999 report by Italian investigators as a key mob-connected international tobacco smuggler and was on Italy's list of the 30 most-wanted fugitives. Prudentino was charged with smuggling, being a member of a mafia-like organization, and murder. He was extradited to Italy in February. Italian Finance Minister Ottaviano Del Turco has said publicly that he expects Prudentino to be a key figure in Italy's cigarette smuggling investigation and might provide information about possible links to the multinational tobacco companies.

The 'Fiduciario'



A principal player in the smuggling through Montenegro is Gerardo Cuomo, a Neapolitan with Mafia connections. The 1999 parliamentary report refers briefly to a March 21, 1985, meeting in Puglia between Cuomo and Filippo Messina, who was identified as a Mafia member, tobacco smuggler, and heroin dealer. Other Italian investigative reports have identified Cuomo as one of the top players in Italy's Mafia-run cigarette smuggling operation. Cuomo was arrested on May 10, 2000, in Zurich on an Italian warrant for cigarette smuggling out of Montenegro and for being a member of a mafia-like organization. The investigation implicates more than 80 people, including Italian Mafiosi and Swiss bankers. Cuomo, 54, is in a Swiss jail, fighting extradition. Court records show that for years, Cuomo has acted as a business representative for the Italian mob. A senior Italian investigator, citing an internal federal police memo from the 1980s, said Cuomo was linked to Mafia boss Giuseppe "Pino" Savoca, who was connected through his Palermo-based family to Tot Riina, the "boss of bosses" of the powerful Corleone Mafia family. Riina is serving a life sentence for the murder of the anti-mafia judges Giovanni Falcone and Paolo Borsellino.

Cuomo has a long history of tobacco smuggling. In the 1980s, he was sentenced to a total of nine years for cigarette smuggling and drug trafficking. His co-defendant was Pietro Vernengo, a loyal Riina lieutenant. A 146-page classified report, prepared in 2000 for the Guardia di Finanza by the head of its organized crime unit, identified Cuomo as "fiduciario," or trustee, of Philip Morris. The report, which examined the key figures in Italy's cigarette smuggling operation, did not elaborate on that relationship. The current warrant for Cuomo's arrest, signed by Judge Daniela Rinaldi on October 21, 1999, claims that Cuomo is the "owner" of one of four tobacco licenses issued by Montenegro and that he smuggled cigarettes from Montenegro to Italy through a criminal organization. However, Cuomo told Italian prosecutor Giuseppe Scelsi on July 26, 2000, that only one company — a Panama-registered company called Santa Monica owned by Franco della Torre — was licensed by Montenegrin authorities to trade cigarettes. Cuomo said he, in turn, was one of four subcontractors to Santa Monica and that he had to pay della Torre's company \$55 to \$70 a case [10,000 cigarettes] as a sort of licensing fee, and was required to purchase at least 25,000 cases a month.

Della Torre of Lugano, Switzerland, is well known to Swiss and Italian police. He was a defendant in the "Pizza Connection" trials in the 1980s involving Mafia heroin traffickers and was sentenced by a Swiss court to 18 months in jail for drug trafficking. In late February, Scelsi filed charges against della Torre, alleging he was a smuggler and a member of a mafia-like organization. Transcripts of

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Italian police wiretaps, obtained by the Center, reveal that Cuomo also has close Montenegro political ties. In 1996, Italy's Anti-mafia Investigative Agency taped a telephone conversation between Cuomo and Santo Vantaggiato, a fugitive from Italian law hiding in Montenegro. The two men were discussing the election in Montenegro, and Cuomo boasted that he was close to senior Montenegrin politicians. He mentioned that if his "friends" got in, he would be "much stronger." Vantaggiato was murdered in Montenegro two years later in a mafia war.

A series of wiretaps by the same agency also reveals close connections between Cuomo and former RJR sales executive Franco Gabriele. Gabriele, 51, left RJR in 1993 and started a company called Italian Tobacco USA Inc. in Winston-Salem, North Carolina (The same Gabriele who has an immunity deal with U.S. authorities in exchange for testimony about RJR and smuggling into Canada.) In the conversation between Cuomo and Gabriele, according to a transcript obtained by the Center, the two men discussed the coming privatization of the government-owned Italian Tobacco Monopoly and the possibility that it could be purchased by Philip Morris. Cuomo wanted to position himself so that his people could buy a stake in the company and become distributors. He asked Gabriele if he was "well connected" and could give him "some suggestions." "I'm already giving you inside details," Gabriele replied. "Use them with discretion. I don't want them to come up."

Another taped conversation in 1996 revealed Gabriele trying to sell containers of Marlboros to Cuomo for shipment out of either Aruba or Canada to warehouses in Cyprus or Antwerp, even though Philip Morris already manufactures Marlboros in Europe, and Italy's Tobacco Monopoly manufactures them under license for sale in Italy. In a third conversation, Gabriele talked to Cuomo and his nephew Sandro Cuomo about shipping RJR's Winstons to Spain from Aruba. "We have to deal with the Winston cigarettes of Reynolds," Gabriele says. "We send them to somebody who brings them to the Spanish peninsula. We have done it many times; nothing has ever been found."

Gabriele has since given grand jury testimony on cigarette smuggling cases in the United States. His lawyer Ed Gerber said he has arranged immunity from prosecution for Gabriele with U.S. authorities in return for Gabriele's cooperation in tobacco smuggling investigations. Philip Morris denies the allegations. "We do not condone, assist, or promote contraband," David R. Davies, vice president for corporate affairs for Philip Morris Europe, said. He said Philip Morris, the world's leading cigarette company, would work with the EU and European governments to help fight smuggling. Del Turco, Italy's finance minister, said that help was virtually "nonexistent."

Latin America

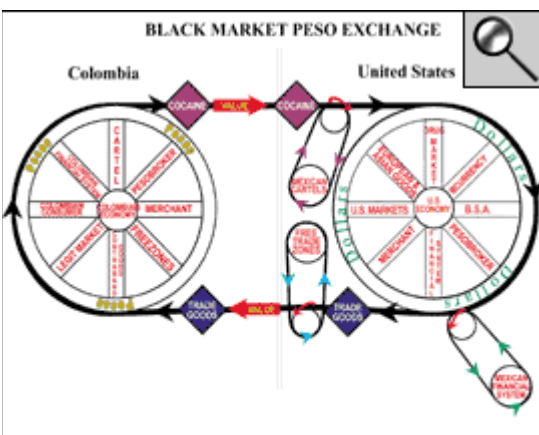
Twenty miles off the northern coast of Venezuela lies a tiny, sunbaked island called Aruba. Like so many self-governing Caribbean islands that cling to the coast of the Americas, it has been a smugglers' paradise since colonial times. For decades, it also has been a linchpin in an illegal tobacco trade that Colombian authorities claim comprised as much as 90 percent of cigarettes sent into Colombia. The chief purveyors were two powerful Aruba families by the names of Mansur and Harms. For more than 50 years, Philip Morris — the main distributor in Latin America — was the Mansur Free Zone Trading Company, N.V. (The company's name changed to Glossco in 1999 after years of unwelcome scrutiny. President Clinton in 1996 publicly identified Aruba "as a major drug-transit country" and noted that "a substantial portion of the free-zone's businesses in Aruba are owned and operated by members of the Mansur family, who have been indicted in the United States on charges of conspiracy to launder trafficking proceeds.") British American Tobacco, meanwhile, used the services of Roy Harms Jr.'s Romar Free Zone Trading Co., N.V., as its distributor for parts of Latin America, and R.J. Reynolds worked with his cousin Bryan Harms, who figured in the Canadian smuggling case. In August 1994, the United States indicted cousins Eric and Alex Mansur along with 52 others allegedly involved in a massive drug

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money-laundering enterprise. The investigation, dubbed Operation Golden Trash, targeted an alleged conspiracy that used narco dollars to purchase cigarettes, alcohol, and household electronics, which were sold to individuals and businesses in Colombia. The proceeds would then flow to cocaine barons. The Mansur cousins were extradited to Puerto Rico in March 1998. After posting more than \$1 million in bond and spending several years on bail shuttling between Miami and Puerto Rico, they were allowed last October to return to Aruba.

Operation Golden Trash was part of a much larger money-laundering investigation called Operation Polar Cap. In the early 1990s, U.S. law enforcement authorities froze numerous bank accounts of tobacco distributors, charging they were part of a drug money-laundering conspiracy. According to the civil racketeering lawsuit filed last year against Philip Morris and BAT alleging complicity in tobacco smuggling and money laundering, the governors of 25 of Colombia's 32 states, plus the capital district of Bogot, charged that Philip Morris knew that these agents and distributors had been investigated and/or indicted by the United States for money laundering. But when Philip Morris learned that its distributors were accused of money laundering, it did not sever its business



The black market peso exchange is a circuitous system by which drug dollars are laundered. For more information, visit <http://www.treas.gov/fincen/advisu9.pdf>.

relationship. "Instead, they established a secretive and circuitous route by which they could sell cigarettes to those entities without detection by law enforcement," the lawsuit states.

A 'circuitous route'

Under this cloak-and-dagger system, customers had to order shipments by telephone through remote offices, including one in Uruguay. Customers were then directed to pay Maraval AG, a company in Basel, Switzerland, for the shipments. The lawsuit claims that delivery was then organized by a second Swiss company called Weitnauer, a multimillion-dollar global transport and retail company that deals in goods such as tobacco, alcohol, and jewelry and owns duty-free shops in North America. Philip Morris documents from January 1993 identify Weitnauer as a Philip Morris customer dealing in "various DF" markets, an apparent reference to duty-free

markets. Thompson, the RJR sales manager convicted of smuggling, said Weitnauer was one of "the most widely used customers servicing the southern borders black market. They are financially encouraged to penetrate the border through the guise of normal duty free operation." Weitnauer was also listed in BAT documents as a "general trade" and "transit" client, though in the 1980s BAT refused to do any further business with Weitnauer apparently because the company was diverting cigarettes beyond BAT control.

Prior to 1997, the lawsuit states, the cigarettes were delivered from Philip Morris plant in Richmond, Virginia. After that year, Philip Morris changed its routing and first sent them to Belgium, where ownership was transferred to Weitnauer. From there they were shipped to Aruba or Panamanian free trade zones operated by the Mansurs, and then into Colombia's special customs zone, Maicao, just across the border from Venezuela. The racketeering lawsuit claims that this circuitous route was to distance Philip Morris from smuggling into Colombia and to make it difficult for investigators to distinguish between legitimate and contraband sales. For instance, a [November 3, 1998, invoice](#) obtained by the Center shows that Maraval AG billed a Mansur-owned company in Panama named Marlex, S.A., for the sale of \$494,648 worth of U.S.-made Philip Morris cigarettes.

The lawsuit also charges that Philip Morris sold tobacco to smugglers in exchange for narco dollars in what is commonly referred to as the "black market peso exchange." Instead of repatriating narco dollars from their U.S. sales points, money launderers simply use them to purchase goods, which are then exported to Colombia and other Latin American countries and sold for pesos. The pesos then flow into the Colombian bank accounts of the drug barons. Philip Morris employees traveled to Colombia and entered the country

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Internal Philip Morris documents include press clippings that describe Lopesierra as a smuggler and "the Marlboro man."

illegally, the lawsuit claims, "paying bribes to ensure that their passports were not marked so as to reflect that they had entered Colombia." These employees were present in Colombia when their distributors received "large amounts of cash." The cash was then smuggled out of Colombia into Venezuela and deposited into banks and transferred into the coffers of Philip

Morris, the lawsuit states.

One of Philip Morris' main distributors within Colombia was Santander Lopesierra, at one time a senator in the Liberal Party. Dubbed "the Marlboro Man" by the Colombian media, in reference to his alleged cigarette smuggling activities, Lopesierra is named in a U.S. federal court affidavit filed in conjunction with the Mansur money-laundering indictment. In that affidavit, an FBI agent working undercover says he was told by Jaime Tovar, one of the original defendants in the Mansur indictment, that Lopesierra was part of a scheme to convert narco dollars into shipments of goods bound for Colombia. "Lopesierra told Tovar that he was involved in the pool system of drug trafficking, whereby he would combine his load of drugs with those of other drug dealers into a single large shipment destined for the United States or Puerto Rico," the agent, Sergio Siberio, said in his [1997 affidavit](#) in support of the Mansurs extradition from Aruba to the United States. "Individual traffickers in the United States received the drugs and sold them for U.S. currency. The traffickers would then deliver the cash to couriers approved by the drug lords who would convert the cash into cashier's checks made payable to specific businesses owned by Lopesierra and the Mansurs."



Samper

In other words, Lopesierra laundered narco dollars through the books of Mansur firms in Aruba, which he disguised as payments for items he was importing into Colombia, according to Tovar, a Lopesierra relative and former employee. Copies of canceled checks made out to Mansur-owned companies and deposited in Mansur-owned Interbank Aruba N.V. and submitted as evidence as part of the Colombian lawsuit against the tobacco companies demonstrate, lawyers assert, the circle by which drug money is laundered through cigarette purchases. "It's a matter of taking the money from the money launderer who initially wrote the checks, through the Philip Morris distributor, through the bank of that distributor, and up to Philip Morris," attorney Kevin Malone argued on November 27, 2000, in seeking a court order for further bank records related to his case.

"It's a matter of taking the money from the money launderer who initially wrote the checks, through the Philip Morris distributor, through the bank of that distributor, and up to Philip Morris . . ."

—Kevin Malone,
lawyer for the Colombian governors and the
European Union

Internal Philip Morris documents, released during the tobacco litigations of the late 1990s, include press clippings that described Lopesierra as a smuggler and "the Marlboro man." Lopesierra is also listed in a 1991 Philip Morris document [Philip Morris International Latin American Region: Strategic Plan, 1991-1993] as being one of the company's "Tax Free Customers," along with Mansur Trading, among others. The Mansur and Lopesierra names also surfaced in funding scandals that plagued the election campaign of former Colombian President Ernesto Samper. The Colombian news magazine *Semana* published in August 1995 details of what it said was a taped conversation between then-candidate Samper and a friend, Elizabeth Montoya de Sarria. She insisted that he should meet personally with "the people of Philip Morris," whom she further identified as "the presidents of Interbank." Later, Samper's campaign treasurer Santiago Medina told Colombia's attorney general's office, which investigated the Samper campaign irregularities, that two members of the Mansur family, who "handled the distribution of Marlboro in Central America," met with Samper in early 1994 and gave him more than \$500,000. Colombia's Congress, which was dominated by Samper's Liberal Party, cleared him of any wrongdoing, and he left office in 1998. By then, however, the U.S. government had pulled his visa, claiming he was a "truly corrupt president."

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Montoya, who press reports said had business ties to Lopesierra, was murdered in 1996 under as-yet unclear circumstances. No charges have ever been filed against Lopesierra for smuggling or money laundering, but a source in Colombia's attorney general's office, speaking on condition of anonymity, said Lopesierra was under preliminary investigation for the creation of paramilitary or "self-defense" groups in the northern coastal region of the country. Philip Morris International told the Center in January 2000 that Philip Morris had cut all business ties with the Mansurs in 1998. However, the Mansurs own an Aruba company called Superior Tobacco Co. N.V., which manufactures Marlboro Red and Marlboro 100 cigarettes, according to an employee at Superior. Internal Philip Morris documents show that Superior Tobacco became a Philip Morris licensee in June 1966. A March 1996 Philip Morris Companies "Quarterly Directors Report" listed Superior Tobacco Co. N.V. of Aruba as a licensee. And according to the March 2000 issue of Tobacco Reporter, a magazine about the tobacco industry, Superior Tobacco still held a license agreement with Philip Morris. Company registry documents at the Aruba Chamber of Commerce show that all seven directors of Superior are Mansurs. The Mansurs also own Superior Tobacco Company in neighboring Curacao.



Under their October 11, 2000, bail modification order, the Mansur cousins were allowed to return to Aruba to live with their families and work as sales managers for Universal Brands, identified in court papers as an import-export company with offices in Aruba. Universal Brands is based in Curacao and is registered as "retailer of tobacco products." A source in Colombia's customs office, the DIAN, told the Center that Universal Brands exported Colombia-made cigarettes to Curacao in 2000. These Universal brand cigarettes have been showing up on the Venezuelan black market.

'Their management plan'

Allegations against BAT employees of smuggling, money laundering, bribery, and illegal entry into Colombia are similar to those against Philip Morris. Lawyers for Colombia's governors, who receive the revenue from taxes on cigarette sales, said in their lawsuit that BAT was "well aware" that virtually all of the cigarettes passing through its Aruba-based distributor were being smuggled. BAT's distributor was Roy Harms Romar. BAT "made these smuggled cigarettes a part of their management plan," the lawsuit states. The Center's investigation showed that [Romar executives were treated](#) by BAT to a posh hotel in the Knightsbridge section of London and tennis matches at Wimbledon. Beyond that, BAT employees would travel to Maicao, the entry point for most smuggled goods into the rest of Colombia, where they "would deal directly with cigarette smugglers, resolve customer complaints involving issues such as stale products, and would promote the sale of new products," the suit contends.

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It goes on to charge that BAT employees were present when large amounts of cash, totaling as much as \$1 million, were received by the distributors. In some cases, they received prepackaged cash covered in talcum powder. "This is the way in which narcotics traffickers commonly packaged and transferred large amounts of cash in order to prevent the detection of the scent of the narcotics on the currency," the lawsuit states. The distributors and the BAT employees then took the cash by car to Venezuela, where it was deposited in Venezuelan banks in exchange for cashier's checks. The checks were then transported either to banks in Miami or the Caribbean and, from there, the money was transferred to BAT's accounts in Louisville, Kentucky, or in the UK, the lawsuit claims.

BAT corporate documents indicate that the company was aware as early as 1991 of the possibility that drug money was used to buy its cigarettes as part of a money-laundering scheme. In a January 15, 1991, [memo marked "Secret"](#) from Latin American regional director Peter Hazel to BAT chairman Barry Bramley, regarding his trip to Aruba, Hazel said that he had met with Harms to discuss the "increasingly important amount of business" they were doing for BAT's Venezuelan subsidiary, Bigott. Hazel then stated that Harms "enlightened" him about "really rather a murky business . . . being whether drugs money could be being used."



On March 8, 1995, Keith Dunt, then BAT's regional director for Latin America, received an e-mail, forwarded from BAT's field office, about the "difficulty of obtaining clean \$" that BAT's Venezuelan subsidiary had in January. "It was necessary, in December, to reduce the selling price from US \$125 to US \$96 per case, ie in line with Belmont HL price (such that Romar could then sell through at US \$106 per case and receive clean US\$)." Although tobacco companies claim to have no relationship with smugglers, lawyers representing the Colombian governors and the European Union contend "Philip Morris, BAT, and RJR operate their smuggling operations in almost identical fashions."

In a court filing in late February, the lawyers submitted corporate documents and correspondence, which they said demonstrated the extent to which tobacco companies "micro-manage" smuggling operations. A February 22, 1994, [letter to Ed Lang](#), head of RJR-Macdonald, from attorneys for a by-then disgruntled Bryan Harms discusses the business relationship between the company and Harms, who was smuggling RJR cigarettes into Colombia. Other correspondence between RJR and Harms reveals the [extent of the company's oversight](#) and its [collaboration with Harms](#). The letter, now in the court record, said that RJR had "zero percent of the back-door cigarette market into Colombia" when RJR approached Bryan Harms in 1989 about working with the company. The letter also describes the "Colombia backdoor ports of Maico [sic] and Turbo" through which Harms later pumped RJR's cigarettes. "Business was good," the letter states, "and in 1992 a volume of US \$3,080,570.23 of RJR cigarettes were sold into Colombia."

The letter notes that the cigarettes came from plants in Canada and Winston-Salem, North Carolina. RJR shipped the Canadian cigarettes to Aruba via New York and the U.S. cigarettes via Miami. The cigarettes were then shipped by Harms company to Maicao. Cash payments out of Maicao were transported by Harms "representatives across the Venezuelan-Colombian border by car to Maracaibo" and then flown to Aruba. "As can be appreciated, a very high-risk operation," the letter states. Conflict between Harms and RJR was sparked by RJR's October 1992 decision to deal with a rival Spanish distribution company that had opened an office in Colombia. An angry Harms complained in the lawyers letter that RJR was wrong to disagree with his assessment that "only a token legal importation of 200 cases of cigarettes was required, since the market of cigarettes would continue to be dominated by smuggled (tax-free) cigarettes for years to come." The letter notes that the 200 cases of cigarettes imported legally would give RJR "the right to advertise its [sic] brands legally" and also the right to allow another distributor to "move his Maicao stocks with the documentation of the 200 cases as cover." The letter claims "this procedure has been used effectively for many years by other U.S. tobacco companies."

Related Lawsuits

Click on the links to read the full text of the RICO lawsuit filed on behalf of:

- [The European Community](#)
- [The Colombian Governors](#)
- [Canada](#)

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Even though illegal imports of cigarettes into Colombia have been declining due to increased policing, Colombian tax and customs authorities say they continue to seize large quantities of smuggled cigarettes, despite signed agreements with Philip Morris and BAT pledging them to do everything in their power to halt the illegal trade. Lawyers representing Colombia's governors and the European Union claim in their RICO action that "throughout the 1990s and continuing into the year 2000, the Philip Morris Defendants continued to knowingly sell cigarettes to smugglers, or distributors who sell to smugglers, and have gone to great lengths to conceal this fact from the various law enforcement agencies and customs agencies around the world charged with the monitoring of cigarette sales. For example, throughout 1999 and into the year 2000, the Philip Morris Defendants on numerous occasions notified prosecutors and customs officials within the government of Panama that there is currently no authorized dealer in the Colon Free Trade Zone in Panama for the tobacco products of the Philip Morris Defendants," the lawsuit says. "However, the Philip Morris Defendants continue to sell their products to persons in the Colon Free Trade Zone and conceal these."

Africa

In his statement to Congress in March 2000, the head of U.S. Customs — a former Marine and New York City cop who rose to the rank of police commissioner before turning to federal and international law enforcement — alerted lawmakers to a new and alarming problem. There had been a "dramatic increase" in the number of cigarette imports to the United States, starting roughly in the last half of 1999. "International cigarette smuggling has grown to a multibillion-dollar-a-year illegal enterprise linked to transnational organized crime and international terrorism," Commissioner Raymond Kelly said. He noted that cigarette smuggling profits now rivaled those of drug trafficking, with the United States playing an important role as a source and transshipment country. "Large sums of money related to cigarette smuggling flow through U.S. financial institutions," Kelly added. Congress had already held two hearings on the laundering of drug dollars through the purchase of U.S. goods, including cigarettes, and several worried manufacturers (though not from the tobacco industry) had reportedly held talks with Justice Department officials on the matter.

Kelly testified that Customs had "taken steps to disrupt and dismantle some of the smuggling networks in cooperation with foreign law enforcement officials" and was "studying the dramatic increase of cigarette imports into the United States in the last two quarters of 1999." Kelly, who has since stepped down as Customs commissioner, declined to be interviewed about this subject. But an internal government memo on the dramatic rise in cigarette imports to the United States, obtained by the Center, shows that the value of cigarette imports nearly doubled in 1999 over the previous year, from \$91.6 million in 1998 to \$172.2 million in 1999. The total for 2000 was expected to be at least as high, if not higher. The import figures have caught law enforcement's attention because they are greater than even those registered during the height of the Canadian smuggling scam, when Canadian cigarettes were exported to the United States, allegedly for consumption, but smuggled back into Canada, where cigarette taxes were much higher.

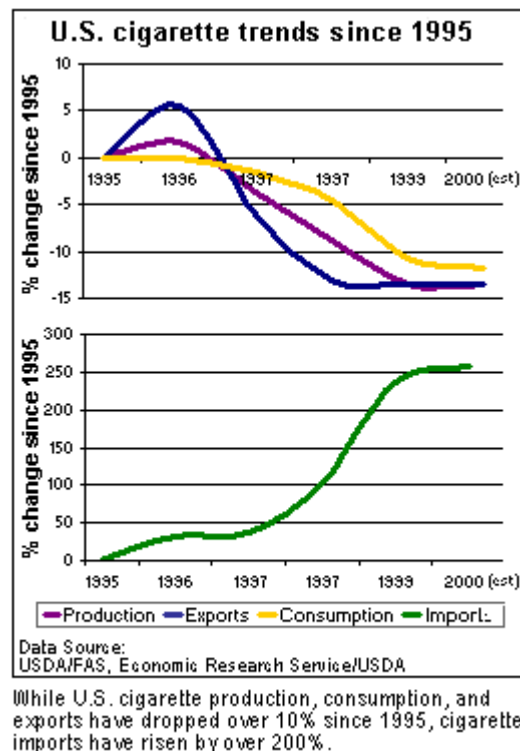
For example, cigarette imports to the United States were valued at \$15 million to \$18 million a month during the Canadian smuggling heyday in 1993-1994, the memo said. Since October 1999, the monthly cigarette importation rate has been between \$20 million and \$25 million and was increasing to about \$30 million a month. In addition to the unexplained rise in imports — the majority of which are said to be international brands, mostly Philip Morris and R.J. Reynolds products — authorities have noted an increase in exports from countries that had not previously shipped cigarettes to the United States, including Spain, Switzerland, India, Korea, Greece, and Latvia.

A Center analysis of cigarette imports to the United States since 1995 shows a similar trend. Based on data from the U.S. Agriculture Department, which tracks cigarette imports and exports, cigarettes imported to the United States for consumption (as opposed to imported cigarettes entering legally bonded warehouses for possible transshipment to other locations) doubled between 1998 and 1999, from 4.3 billion sticks a year to 8.6 billion sticks. The 1999 import figures the most recent available were nearly three times

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greater than 1997 imports. Imports from Spain, Japan, and India rose the most dramatically over the past five years, according to USDA data. In 1995, Spain exported 10.9 million cigarettes for U.S. consumption. By 1999, that number had jumped to 2.6 billion cigarettes. Imports from Japan and India also increased by more than a billion cigarettes over the same period.



In a country where smoking rates have declined nearly 18 percent over the last decade, and cigarette exports and domestic production have each dropped 13 percent over the last five years, law enforcement authorities are puzzled by the rise in cigarette imports for consumption. They suspect that, as during the Canadian smuggling operation and as Kelly suggested before Congress, the United States might again have become a way station on the global black market trade. "That would suggest we've got a bunch of cigarettes coming in and transiting the United States," said one law enforcement official, on condition that he not be further identified. Duties on container loads of cigarettes bound for the United States are significantly cheaper than for the European Union or Canada, about \$125,000 per container load compared with about \$1 million, adding to the profit margin of smuggling cigarettes via the United States. U.S. officials said it was possible that the rising cigarette imports were increases on paper only, because only a fraction of all goods entering or leaving the United States are ever inspected at the country's ports. Indeed, the racketeering lawsuits that have been filed against the tobacco companies contend that the "vast majority" of smuggled cigarettes are shipped from the United States and that the companies regularly filed false documents with U.S. Customs and the Bureau of Alcohol, Tobacco and Firearms "so as to deceive . . . and allow the smuggling to continue."

Cyprus

On August 28, 2000, a ship owned by Greek Cypriot Christos Tornaritis attempted to ram a patrol boat of armed customs officers off the coast of Crete. The officers had tracked the 1,542-ton Cambodian-registered freighter from the Cyprus port of Limassol to Port Said, Egypt. It was now bound for Latvia. The officers seized the "Marina" and discovered 7 million packs of British-made cigarettes on board, brands normally smoked only in the United Kingdom. The entire cargo was worth about 17 million pounds [US \$23.8 million] on the black market in Britain. Investigators from Britain and Greece have since discovered that when the cargo reached Latvia it was

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to be diverted to a fictitious front company called "Kazakh-Pakistani Joint Venture" run by a former KGB officer from Kazakhstan, then smuggled back into Britain. The ship was one of 14 seized last year in Greek waters loaded with British brand cigarettes. The British government claims about one in every three cigarettes smoked is smuggled. British Customs officers seized a record 2 billion smuggled cigarettes in 2000 compared with 1.3 billion in 1999. This has led to losses climbing to about 2.5 billion pounds [US \$3.75 billion] for the British treasury, the government claims. Cyprus has become a principal hub for this vast smuggling trade, according to investigators. British Customs and Excise say about 6 billion British brand cigarettes are exported to Cyprus each year even though the island has only 700,000 people.

British Customs believe that the vast majority end up right back in Britain, brought in by a number of criminal organizations. Tornaritis, 34, is a rising star over the Cyprus corporate landscape. The scion of an important Cypriot family, he has almost overnight become one of the richest men in Cyprus. His principal corporate vehicle is CT Tobacco, now listed on the Nicosia stock exchange. His newfound wealth has allowed Tornaritis to buy Cyprus' most important football team, Olympiakos, as well as purchasing race horses and property. CT Tobacco Ltd. has transit warehouses in Belgium, Cyprus, and in Thessaloniki, Greece. CT Tobacco sells various international brands, including those of R.J. Reynolds, Philip Morris and the U.K. company Gallaher.

Although Tornaritis claims to be the Cyprus agent for Britain's Imperial Tobacco, the British tobacco company has denied any connection with him. CT Tobacco claims in its prospectus to have quintupled its turnover in 2000 and now contemplates entering the tobacco manufacturing business.

Cyprus has not always been a major tobacco hub for British cigarettes. Until recently, that honor went to Andorra, the tiny principality tucked into the Pyrenees on border of France and Spain. After Britain imposed steep tax increases, exports to Andorra from the U.K. increased from 13 million cigarettes in 1993 to 1.52 billion in 1997. This represented a 116-fold increase and a 140-a-day habit for every man, woman, and child in Andorra. Spanish and Andorran Customs stopped the tax-free imports. By January 1998, British exports to Andorra had dried up. Only 435 million British cigarettes were shipped annually to Cyprus before Andorra was closed to smugglers, according to recent U.K. press reports. After the crackdown on tax-free imports to Andorra, that figure skyrocketed to 11 billion before stabilizing at 6 billion. A large portion of these cigarettes comes from Imperial's U.K. factory. In 1999, Imperial exported 16.5 billion cigarettes, brands smoked almost exclusively in Britain. This represents a 40 percent increase over 1998. The company's international operating profit in the first half of 2000 was 115 million pounds [US \$172.5 million] compared with 93 million pounds [US \$153.5 million] in 1999. Gallaher, which is Britain's second major exporter to Cyprus, increased first half-year volumes in 2000 to 8.6 billion cigarettes, up from 6.8 billion cigarettes in 1999. Both companies deny collusion in smuggling and say they deplore it.

Cyprus has been a traditional transit point for cigarettes into the Middle East. Documents obtained by the Center show that as early as 1976, BAT's American subsidiary Brown & Williamson employed the services of Kental Traders Ltd. of Cyprus to handle "DNP" [duty not paid] or "transit" cigarettes into Turkey, Syria, Jordan, Yemen, Sudan, Ethiopia, and Somalia with hope of opening routes into Iraq and Iran.

BAT and Brown & Williamson's long-term involvement in what their own documents indicate was an illegal business became evident when two separate quarrels arose in 1983 involving Kental and rival tobacco agents fighting over the smuggling trade in Lebanon. The first quarrel was over 2,970 cases of BAT cigarettes smuggled into Lebanon by Kental. BAT had contracted with Kental to pay a Lebanese trader named Souren Khanamirian two dollars for every case of cigarettes smuggled into Lebanon. At the time, Khanamirian was a board member of The Regie, which was Lebanon's government-controlled tobacco monopoly. Documents obtained by the Center show that Khanamirian complained in 1983 to BAT that he had not received his commission on the shipment. BAT settled the

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SOUREN KHANAMIRIAN
 MANUFACTURERS REPRESENTATIVE
 IMPORT - EXPORT
 P. O. Box 900
 BEIRUT - LEBANON

No. 401

Date March 18th, 1983

RECEIPT

Received from: B.A.T. (U.K. & Export) Ltd,
 The sum of: Starling Pounds Four Thousand
Only
 For: Representing Outstanding commissions from KENTAL owing 3000 Cans of D.Havir.
 Amount: £4000/-
It is understood that BAT (U.K. & Export) Ltd, will try to recover this amount from KENTAL.

[Signature]

A BAT internal document shows that in March 1983 the company paid Khanamirian's commission directly from its own accounts.

matter in March 1983 by paying the commission from its own accounts directly to Khanamirian. BAT then billed

Kental for reimbursement.

The BAT document notes that Khanamirian was paid a

commission for "transit deliveries that go to Lebanon [sic]." The

"[Y]our Lebanese agent should not be involved directly or indirectly . . . in the transit business, which is unlawful and a criminal offence in Lebanon . . ."

—Kental Traders,
B&W's transit agent into Lebanon

second quarrel broke out in 1984 in the midst of the Lebanese civil war when Brown & Williamson's official agent in Lebanon, Albert Abella, was found to be selling "duty not paid" cigarettes in Lebanon and Syria. Concerned that Abella was selling contraband in his own backyard, Kental Traders complained on October 10, 1984, to Brown & Williamson that "your Lebanese agent should not be involved directly or indirectly because by participating in the transit business, which is unlawful and a criminal offence in Lebanon, when the time of normalization will come, both Abella and Brown and Williamson might have catastrophic repercussions and of course being black-listed."

The issue was addressed again in a June 18, 1986, fax from W.L. Telling at Brown & Williamson (Europe) to W.B. Knable at Brown & Williamson. Telling said he was "concerned that our official agent in Lebanon (Abella) is directly involved in DNP to the same territory. No other manufacturer has been willing to accept this risk." The concern grew out of the fact that Abella, through his company Peregrini, was also the official agent for the Lebanese tobacco monopoly, The Regie. One internal Brown & Williamson document, dated April 29, 1987, noted that this "conflict of interests" could "cause considerable embarrassment and commercial disadvantage to Brown & Williamson, should the Lebanese Authorities decide to take an official interest in the Peregrini/Theily movements of cigarettes to and from Lebanon." The same documents cautioned "were his [Abella's] transit activities to be seized upon by the Lebanese Authorities, this conflict of interests could well have serious commercial repercussions for Brown & Williamson in the area."



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It is not clear how Brown & Williamson settled its problems with Abella. But by 1987, documents indicate that Kental was in firm control of the transit market into Lebanon. A 1987 Kental document shows the company annually pumping about 4 billion cigarettes into Lebanon's transit market (over The Regies imports of 3 billion). The document notes that Lebanon is the "visa for all brands for entering many other countries. So the success of B&W hopefully soon will escalate in all Middle East countries." At the time, the chaos of civil war still seized the country.

What's Next

The proliferation of tobacco smuggling is so widespread that it is sometimes hard to distinguish between criminal organizations, which do the actual smuggling, and the manufacturers who feed it and often oversee it. RJR executives meeting with criminals in Niagara Falls to discuss smuggling into Canada, or BAT executives in Hong Kong taking bribes to feed a Triad-backed smuggling ring, or Mafia bosses in Italy with a seemingly endless supply of Marlboros via Cyprus and Montenegro, all raise serious questions about international corporate participation in a conspiracy to defraud governments. Have BAT, Philip Morris, RJR, and Japan Tobacco become mafia-like organizations involved in massive illegal operations? This is the fundamental question posed by the Racketeering Influenced Corrupt Organizations (RICO) actions launched last year in the United States against the major manufacturers by countries including Canada, Colombia, Ecuador, the European Union, and several of its member states.

The allegations against some of the world's largest multinational corporations are astonishing fraud, racketeering, money laundering, and conspiracy. But victory in court will not be easy, as witnesses and documents become harder to subpoena. Before selling its international operations to Japan Tobacco in 1999, RJR moved that division in 1992 to Switzerland. The RJR executives who masterminded the Canadian smuggling now work in Europe or Asia. BAT moved its transit business, under BAT International, to Zug, Switzerland, in 1997. And Philip Morris recently announced it would transfer top executives of its international tobacco operations to Lausanne, Switzerland. It already manages its European, African, and Middle East business out of the Alpine tax haven.

For now, all eyes are on the Canadian lawsuit. A U.S. federal judge dismissed it last year, ruling that it was basically about tax law and an 18th century rule that prevents U.S. courts from enforcing the tax laws of foreign countries. Canada has appealed, and the European Union has filed a supporting brief. Hearings will likely be held within the next three months. But the countries are facing a powerful adversary with huge financial resources and political clout. U.S. President George W. Bush is considered a friend of big tobacco as is his attorney general John Ashcroft. Deputy attorney general-nominee, Larry D. Thompson, comes from the Atlanta law firm of King and Spalding, which represented the Canadian Tobacco Manufacturers Council, a defendant in Canada's racketeering lawsuit against RJR.

Members of Bush's Cabinet and inner circle are also considered pro-tobacco. Karl Rove, a longtime Bush friend who now holds the title of senior adviser to the president, was a paid political consultant for Philip Morris for five years. Lawyers and law enforcement officials privately wonder whether the new U.S. administration will continue to invest resources into investigating tobacco smuggling despite its magnitude and its criminalization of corporate entities.

"What you have is one big smuggling conspiracy from the standpoint of the cigarette manufacturers, their distributors, the money launderers; it's the same people doing the exact same

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"What you have is one big smuggling conspiracy from the standpoint of the cigarette **thing.**"

manufacturers, their distributors, the money launderers; it's the same people doing

the exact same thing," Kevin Malone, the attorney representing the European Union

and Colombia's governors, said in court last November. "It's only when the cigarettes

branch out to the individual smugglers that there's any diversity in the scheme at all.

Just to give you an example," Malone continued, "If a smuggler in Colombia wants to buy cigarettes, or a smuggler in Italy wants to

buy cigarettes, they both order them from the same company, they get delivery from the same distributor, and they are all shipped

from the same warehouse in Antwerp, Belgium. So in fact they are in essence one and the same; it's a consolidated scheme."

—Kevin Malone,
lawyer representing European Union and
Colombian governors



Tobacco Underground

Overview

By Marina Walker Guevara | [October 19, 2008](#)

The illicit trafficking of tobacco is a multibillion-dollar business today, fueling organized crime and corruption, robbing governments of needed tax money, and spurring addiction to a deadly product. So profitable is the trade that tobacco is the world's most widely smuggled legal substance. This booming business now stretches from counterfeiters in China and renegade factories in Russia to Indian reservations in New York and warlords in Pakistan and North Africa.

It began with a basic mathematical equation: In 1995 [two scholars in Europe found](#) that almost one-third of the world's cigarette exports had simply vanished. Somehow, billions of cigarettes, once exported, had mysteriously gotten lost in transit.

Only it wasn't that mysterious. Starting in 1999, a team of reporters from the International Consortium of Investigative Journalists pored over thousands of internal industry documents and [uncovered](#) how leading tobacco companies were colluding with criminal networks to divert cigarettes to the world's black markets. Big Tobacco was doing it for profit — to boost sales and gain market share — as it avoided billions of dollars in taxes while recruiting growing numbers of smokers around the globe. The tobacco industry, as it turned out, did not merely turn a blind eye to the smuggling — it managed the trade at the highest corporate levels.

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Argentine security forces arrest smugglers trying to ship cigarettes across the Pilcomayo River from Paraguay, a top producer of contraband cigarettes. *Credit: Prefectura Naval Argentina.*

Those revelations, and others that followed, helped lead to government inquiries, lawsuits, and promises of a global treaty to crack down on the illicit cigarette trade. Since 2004, two major tobacco companies, [Philip Morris International](#) and [Japan Tobacco International](#), have agreed to pay a combined \$1.65 billion to the European Community and 10 member states to settle litigation that would have further exposed their involvement in cigarette smuggling. They have also committed publicly to help fight trafficking in tobacco. Similarly, this July, Canada's two largest cigarette companies, Imperial Tobacco Canada and Rothmans Inc., [pleaded guilty to aiding smuggling](#) during the early 1990s; they are to pay a combined \$1.12 billion, the largest such penalties ever levied in Canada.

Yet, despite the exposés, the lawsuits, and the settlements, the massive trade in contraband tobacco continues unabated. Indeed, with profits rivaling those of narcotics, and relatively light penalties, the business is fast reinventing itself. Once dominated by Western multinational companies, cigarette smuggling has expanded with new players, new routes, and new techniques. Today, this underground industry ranges from Chinese counterfeiters that mimic Marlboro holograms to perfection, to Russian-owned factories that mass produce brands made exclusively to be smuggled into Western Europe. In Canada, the involvement of an array of criminal gangs and Indian tribes [pushed seizures of contraband tobacco](#) up 16-fold between 2001 and 2006. "The big companies know that to some extent the golden period of smuggling is gone," observes Belgium-based sociologist Luk Joossens, a World Health Organization expert on tobacco smuggling and co-author of the 1995 study that first alerted the world that billions of exported cigarettes had gotten lost in transit. "You have still the normal small-scale smuggling, but you also have counterfeit production, illicit manufacturing. . . and a lot of small companies that are involved. So the whole area of illicit trade has become much more complex." [Joossens also said](#) that while Big Tobacco's participation in cigarette smuggling in Western Europe and North America has largely been curtailed, the situation remains murky in Africa and other developing areas of the world.

This week smuggling experts, customs officials, and diplomats from nearly 160 countries are gathering in Geneva, Switzerland, to push for what has eluded governments for decades: a global crackdown on the black market in tobacco. Under the auspices of the WHO's three-year-old [Framework Convention on Tobacco Control](#) — a global treaty to curb tobacco use — delegates will work on implementing a protocol to stop cigarette smuggling. But the proposed measures face plenty of challenges. Some countries, such as Japan, have slowed negotiations on smuggling. Meanwhile, several other countries, including the United States, have so far refused to ratify the FCTC altogether.

Organized crime syndicates and terrorist groups such as the Taliban rely on cigarette smuggling to help finance their activities.

The stakes are formidable. Experts [estimate](#) that contraband accounts for 11 percent of all cigarette sales, or about 600 billion sticks annually. The cost to governments worldwide is massive: a whopping \$40 billion to \$50 billion in lost tax revenue during 2006. Ironically, it is those very taxes — slapped on packs to discourage smoking — that may help fuel the smuggling, along with lax enforcement and heavy supply. (A pack of a leading Western brand that costs little more than \$1 in a low-duty country like Ukraine can sell for up to \$10 in the U.K.) That potential profit offers a strong incentive to smugglers.

But it is more than lost revenue that is at risk. Illicit tobacco feeds an underground economy that supports many of the most violent actors on the world stage. Organized crime syndicates and terrorist groups such as the Taliban and Hezbollah facilitate global distribution and use the profits to finance their activities. In Canada alone, police believe that 105 organized crime groups are engaged in the illicit tobacco trade, including motorcycle gangs and the Italian Mafia. Criminal organizations "are doing more than just smuggling cigarettes," notes [John W. Colledge](#), who oversaw international tobacco smuggling programs at the U.S. Customs Service between 1999 and 2002. "They are engaged in human, drugs, and weapons trafficking."

Perhaps even more troubling is the impact that smuggling has on the public health crisis caused by tobacco. Worldwide, one out of 10 adults dies prematurely from tobacco-related diseases such as lung cancer, emphysema, cardiovascular disease, and stroke. If current trends hold, tobacco will kill about 500 million people currently alive. By 2030, that figure will reach 8 million deaths a year, and with cigarettes being heavily marketed in poorer countries, 80 percent of those deaths will be in the developing world. Over the 21st century, [say health experts](#), an estimated one billion people could die from tobacco use.



industrial-size yogurt mixer. Credit: Guardia di Finanza.

Resourceful smugglers hide contraband cigarettes in an

At a time when nations are increasingly trying to crack down on smoking, smugglers put cheap cigarettes into the hands of those most vulnerable — young people and the poor. In addition, the trade is pushing the supply steadily into the black market, selling cut-rate cigarettes of often dubious quality. Of special concern is the advent of a massive counterfeiting industry. Once a minor problem, today underground factories in China, Paraguay, and Eastern Europe manufacture literally billions of fake cigarettes — Marlboros, Camels, 555s, Mild Sevens — an uncontrolled industry that law enforcement is only beginning to grapple with. Many of the smokes are made from the lowest quality tobacco, full of stem and sawdust, and spiked with unusually high levels of nicotine. Other packs contain far worse. Tests reveal that counterfeit cigarettes carry a bevy of products that could further shorten even a heavy smoker's life: metals such as cadmium, pesticides, arsenic, rat poison, and human feces.

Despite the stakes, cigarette smuggling remains a tough crime to investigate and prosecute. Factories are set up in regions of the world with weak controls and high levels of corruption, such as the crime-ridden Russian exclave of Kaliningrad, Guangdong province in China, and South America's notorious Tri-border area between Argentina, Brazil, and Paraguay. The distribution systems are complex, the smuggling routes circuitous and hard to track.

Smugglers take advantage of an "in transit" system used in free trade zones and other shipping centers, which allows for temporary tax suspension while the tobacco is en route to a third country. As a result of lax controls, cigarettes get "lost" along the way, with huge numbers failing to arrive at their intended destination. Cigarettes, for example, may sit for weeks in free trade zones in Panama or Dubai until they are sold. Then they pass quickly through multiple buyers in a short period of time, complicating efforts to identify where "leakages" occur. On occasion, cigarettes are even illegally sold at sea, where vessels offload them to smaller boats that take them to shore. In the Balkans, they are sold by the trunk-load to smugglers who line their cars up at the borders of the European Union. And in the United States, tobacco suppliers ship millions of the tax-free smokes to Indian reservations, where they are unloaded to smugglers, bootleggers, and online merchants.

Counterfeit cigarettes have tested positive for a range of dangerous ingredients, from arsenic to rat poison.

Despite its broad impact on health, crime, and taxes, tobacco smuggling receives strikingly little attention from authorities. Lenient sentences are the norm; in some countries, cigarette smuggling is not even considered a crime. Nor is it a priority for law enforcement agencies, even in the West, which spend the majority of their resources tackling drug, arms, and terrorism cases. In the United States, for example, the Bureau of Alcohol, Tobacco, Firearms and Explosives devotes a paltry 2 percent of its personnel and budget to tobacco programs.

Eight years after its original series on tobacco smuggling, ICIJ has assembled a new team of reporters to illuminate this shadowy transnational business. Based on reporting from 15 countries, our new project looks at the influence of organized crime and terrorist groups, as well as the continued complicity of distributors, wholesalers, and tobacco companies themselves. Here, then, is our first series of articles and an interactive website that serve as the entry point to the team's investigative work. Among our initial findings:

- **Jin Ling: Made To Be Smuggled.** A network of renegade cigarette factories now stretches across Eastern Europe and Russia, and its products are flooding the European Union. The trade, worth at least \$1 billion annually, involves just one brand: Jin Ling. With packaging resembling that of Camel, Jin Ling has no legal market and does no advertising. Indeed, the cigarette appears to be produced exclusively for the black market. ICIJ reporters located the company's headquarters in the Russian exclave of Kaliningrad, and revealed how the firm's billions of cigarettes are smuggled across the continent.

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cigarettes, found hidden in a truck bed. Credit: Guardia di Finanza.

A recent Italian seizure of contraband LM and Marlboro

- **China: A Counterfeiting Giant.** When the Chinese obtained the technology in the late 1990s to reproduce the protective holograms on packs of top Western cigarette brands, a tobacco counterfeiting giant was born. Today, China has become by far the world's largest supplier of counterfeit cigarettes — producing roughly 200 billion sticks annually. Vessels loaded with Chinese fakes of Marlboro, Newport, and other brands — in shipments disguised as chinaware, toys, and furniture — now stream into ports worldwide. ICIJ traces the path of several groundbreaking cases, including the story of Charles and May Liu, a charming couple whose massive smuggling network helped move a billion counterfeit cigarettes from China into the United States.

- **The Gallaher Record.** While some big tobacco companies curtailed their role in smuggling, the U.K.'s top cigarette maker, Gallaher, instead turned to distributors in developing countries who funneled tens of millions of cigarettes to places with no real market — and then smuggled them back into the European Union. Internal documents reveal that Gallaher even hired an executive to oversee the trade. ICIJ reporters working in Cyprus and London pieced together the most comprehensive analysis to date of Gallaher's worldwide smuggling and dumping strategy.

In the coming months, ICIJ will continue to unfold its investigation into tobacco trafficking. Look for new stories from the front lines of this ever-shifting trade, from the underground factories of China and America's Indian reservations to the lawless border lands of northwest Pakistan and southeast Paraguay. In all of this, we will be looking for accountability — who is responsible for the growing trade in illicit tobacco, whether criminal godfathers, terrorist chiefs, shady distributors, or corporate executives.

You can help. Have a tip on the illicit tobacco trade? Send ideas to icijtobacco@icij.org.

Marina Walker Guevara is deputy director of the International Consortium of Investigative Journalists, a project of the Center for Public Integrity.

The Center for Public Integrity relies on grants and donations to support its work. The ICIJ *Tobacco Underground* project is generously supported by a grant from the [Johns Hopkins Bloomberg School of Public Health](#).

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During 2000 and 2001, a team of reporters from the International Consortium of Investigative Journalists broke a series of landmark stories exposing how leading tobacco companies worked with criminal networks to smuggle cigarettes around the world. Relying on interviews with insiders and thousands of internal industry documents, the unique team - based in six countries - pieced together how smuggling played a key role in big tobacco's strategy to boost sales and increase market share. Those revelations, and others that followed, helped prompt lawsuits and government inquiries, and led to promises of a global crackdown on the illegal trade in tobacco.

The series was reprinted or written about in more than 40 publications in 10 countries, including Australia, Brazil, Colombia, Denmark, the U.K., and the United States. Here is the complete ICIJ series, from its first stories in 2000 on industry involvement in smuggling to the exposés of 2001 revealing big tobacco's collusion with Colombian drug cartels, the Italian Mafia, and North American motorcycle gangs.

THE ORIGINAL SERIES Click on the links below : <http://www.publicintegrity.org/investigations/tobacco/pages/archives/>

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[Global Reach of Tobacco Company's Involvement in Cigarette Smuggling Exposed in Company Papers](#)

[Philip Morris Accused of Smuggling, Money-Laundering Conspiracy In Racketeering Lawsuit](#)

[U.K. Considering Formal Investigation Into Cigarette Smuggling](#)

[Tobacco Firms Used Suspected Drug Traffickers, EU Lawsuit Claims: Lawsuit accusations include money laundering, wire fraud and mail fraud](#)

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<http://www.globalink.org/en/smuggling.shtml>
<http://old.ash.org.uk/luk/lukdocs/turningoffthetap.pdf>
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http://tobaccodocuments.org/health_canada/50257744.html
http://www.sourcewatch.org/index.php?title=Patanegra_cigarettes
http://www.smoke-free.ca/pdf_1/RCMP-Chron-2001.PDF
<http://repositories.cdlib.org/ctcre/tcpmus/Smuggling2003/>
<http://2006.confex.com/uicc/wctoh/techprogram/P1394.HTM>
<http://www.thenation.com/doc/20020506/schapiro>
<http://www1.worldbank.org/tobacco/tcdc/365TO392.PDF>
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<http://www.publicintegrity.org/investigations/tobacco/articles/entry/1397/>
<http://www.publicintegrity.org/investigations/tobacco/articles/>
(several articles and multi media)

1. June 01, 2009

The Montenegro Connection

Love, Tobacco, and the Mafia

"My little cat ... I'm going crazy without you You have repeatedly betrayed me, I think Little cat, when are you coming? ... I love you, little cat." On Jan. 4, 2001, Dusanka Pesic Jeknic, representative of the Montenegrin trade mission in Milan, Italy, was speaking on the phone at her home in the southwest of the city. Milo Djukanovic, at that time president of Montenegro, was calling from the capital Podgorica. Billions of people around the world had just hailed the New Millennium. Dusanka, nicknamed "Duska," the beautiful 41-year-old

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widow of the late foreign minister of Montenegro, was alone, far from her country. And she spoke out freely about everything: love, tobacco, and crime. [Read more](#)

2. June 01, 2009

[Djukanovic's Montenegro a Family Business](#)

As EU Membership Looms, So Do Troubling Questions

Montenegrins may have been surprised late last year to learn that the global financial crisis had arrived in their tiny Balkan country. Newspapers, the Internet, and even a James Bond film painted Montenegro as the Monte Carlo of Eastern Europe. The nation's mountainous, tree-lined coast, medieval walled cities, and stone ruins set the scene for a boom in luxury hotels and private villas. [Read more](#)

3. March 27, 2009

[Canada's Boom in Smuggled Cigarettes](#)

Indian Tobacco Factories, Organized Crime Control a Billion-Dollar Black Market

Gary Godelie has been a tobacco farmer most of his life, struggling to keep alive a family farm that produces what most everyone agrees is a death crop. Whacked by global competition undercutting his prices, not to mention a dwindling number of Canadian smokers, he often thinks of getting out of the business. [Read more](#)

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3. October 19, 2008

[The Expert: Watch an interview With Luk Joossens](#)

Sociologist Luk Joossens is one of the world's top experts on tobacco smuggling. In 1995, he co-authored a paper that... [Read more](#)

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[The Smuggler: Listen to Jorge Abraham](#)

Jorge Abraham was a tobacco smuggler from El Paso who masterminded the trafficking of as many as half a billion... [Read more](#)

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[The Expert: Listen to John Colledge](#)

In his more than 30 years in law enforcement, John W. Colledge investigated cigarette smuggling, narcotics, money laundering, and arms... [Read more](#)

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[The Undercover Cop: Listen to Ex-FBI Agent Tom Zyckowski](#)

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GENERAL INFORMATION ON TOBACCO SMUGGLING

[International tobacco smuggling](#). Produced by [Action on Smoking and Health \(ASH\)](#).

[How big was the global illicit tobacco trade problem in 2006?](#) The Framework Convention Alliance.

[Map of global smuggling routes for illegal cigarettes](#). The Tobacco Atlas, Second Edition. Dr. Judith Mackay, Dr. Michael Eriksen, and Dr. Omar Shafey.

[Tobacco and Terror: How Cigarette Smuggling is Funding our Enemies Abroad](#). Apr. 2008. Prepared by the U.S. House Committee on Homeland Security, Republican staff.

BIG TOBACCO AND SMUGGLING

[Tobacco Companies Linked to Criminal Organizations in Lucrative Cigarette Smuggling](#). Mar. 2001. The International Consortium of Investigative Journalists.

[Progress in combating cigarette smuggling](#). Sept. 2008. Luk Joossens and Martin Raw.

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[The Big Cigarette Companies and Cigarette Smuggling](#). Produced by the [Campaign for Tobacco-free Kids](#).

[Key to the Future: British American Tobacco and Cigarette Smuggling in China](#). July 2006. Kelley Lee and Jeff Collin.

[The cigarette transit road to the Islamic Republic of Iran and Iraq: Illicit tobacco trade in the Middle East](#). June 2004. *Tobacco Control*.

[British American Tobacco and the insidious impact of illicit trade in cigarettes across Africa](#). July 2008. *Tobacco Control*.

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[Kim's bad habit](#). Jan. 30, 2006. Velisarios Katoulas. *Time*.

[Tobacco roads: Tobacco is staining the Balkans](#). 2007. Organized Crime and Corruption Reporting Project.

[Tobacco Traffic](#). Apr. 2002. PBS NOW documentary with Bill Moyers.

[BAT Expose](#). 2000-2001. *The Guardian* and the International Consortium of Investigative Journalists.

Tobacco-related news resources
[Global Link News](#)

[CorpWatch Tobacco](#)

[Tobacco.org](#)

[Tobacco Control Journal](#) (newest articles require subscription)

[Tobacco Journal International](#) (sections require subscription)

EFFORTS TO REDUCE TOBACCO SMUGGLING

[Smoke-free legislation around the world](#). Produced by [Action on Smoking and Health \(ASH\)](#).

[Cigarette smuggling: Federal law enforcement efforts and seizures increasing](#). May 2004. The U.S. General Accounting Office.

[The Framework Convention Alliance \(FCA\)](#).

Founded in 1999, the FCA represents over 100 countries working to develop and ratify the World Health Organization's Framework Convention on Tobacco Control, the world's first global public health treaty. [Read more](#) about the Framework Convention on Tobacco Control.

[Philip Morris-EU anti-contraband agreement](#)

[Japan Tobacco-EU anti-contraband agreement](#)

[Highlights of the Japan Tobacco-EU agreement](#) (Produced by ASH)

[European Anti-Fraud Office \(OLAF\)](#).

OLAF is an investigative body charged with fighting fraud and corruption within the European Union, as well as other irregular activities.

[The Financial Action Task Force \(FATF\)](#).

Established by the G-7 in 1989, FATF is an inter-governmental organization that combats money laundering and terrorist financing.

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[U.S. Bureau of Alcohol, Tobacco, Firearms and Explosives.](#)

Among its other duties, ATF investigates and works to prevent the illegal trafficking of tobacco products within the United States.

[Prevent All Cigarette Trafficking Act \(PACT\)](#) of 2008.

Passed by the U.S. House of Representatives in September 2008, the PACT Act makes it a felony to sell tobacco in violation of state tax laws, and also clamps down on cigarette shipments made through the U.S. Postal Service.

[Campaign for Tobacco-free Kids](#)

[Global Link](#)

[Asia Pacific Association for the Control of Tobacco](#)

[Global Partnerships for Tobacco Control](#)

[Global Smoke-free Partnerships](#)

[National Council Against Smoking \(South Africa\)](#)

INDUSTRY SOURCES AND COUNTRY DATABASES

World Bank: Economics of Tobacco, [Country Data Profiles](#).

The American Nonsmokers' Rights Foundation. [The Tobacco Industry Tracking Database](#).

The World Health Organization, Regional Office for Europe. [Tobacco Control Database](#).

Industry documents

Following a spate of health-related lawsuits in the United States in the late 1990s, some of the world's largest tobacco companies were forced for the first time to make their internal company documents publicly available. Here they are, maintained, searchable, and updated in a variety of locations:

[Legacy Tobacco Documents Library](#)

[Tobaccoarchives.com](#)

[Tobaccodocuments.org](#)

[Tobacco Institute Document Site](#)

[British American Tobacco Documents Archive](#)

[Philip Morris Document Site](#)

[R.J. Reynolds and Brown & Williamson Document Site](#)

[Lorillard Document Site](#)

Company websites

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[British American Tobacco](#)

[China National Tobacco Corporation](#)

[Japan Tobacco](#)

[Imperial Tobacco Group](#)

[Gallaher Group](#)

OTHER RESOURCES

[Johns Hopkins Institute for Global Tobacco Control](#)

[UCSF Center for Tobacco Control Research and Education](#)

[University of Michigan Tobacco Research Network](#)

[Tobacco Law and Policy. Law Journal Articles Database.](#)

[Euromonitor: Tobacco.](#) (requires subscription)

[The World Health Organization. Report on the Global Tobacco Epidemic, 2008.](#)

[Regional Office for Europe. Tobacco Control Database](#) <http://data.euro.who.int/tobacco/>

<http://old.ash.org.uk/html/factsheets/html/fact17.html>

<http://www.hm-treasury.gov.uk/d/433.pdf>

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TOBACCO, TERRORISM, & ILLCIT TRADE

**China, Paraguay, Ukraine:
Inside the World's Top Smuggling Hubs**

**Taliban, al-Qaeda, Other Terrorists
Funded by Cigarette Black Markets**



JUNE 29, 2009

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This report is part of *Tobacco Underground*, an investigation by the International Consortium of Investigative Journalists. ICIJ is a project of the Center for Public Integrity in Washington, D.C.

To see the complete investigation, please go to <http://www.publicintegrity.org/investigations/tobacco>.

TOBACCO
UNDERGROUND
The Booming Global Trade in Smuggled Cigarettes

Overview

Marina Walker Guevara

The illicit trafficking of tobacco is a multibillion-dollar business today, fueling organized crime and corruption, robbing governments of needed tax money, and spurring addiction to a deadly product. So profitable is the trade that tobacco is the world's most widely smuggled legal substance. This booming business now stretches from counterfeiters in China and renegade factories in Russia to Indian reservations in New York and warlords in Pakistan and North Africa.

It began with a basic mathematical equation: In 1995 two scholars in Europe found that almost one-third of the world's cigarette exports had simply vanished. Somehow, billions of cigarettes, once exported, had mysteriously gotten lost in transit.

Only it wasn't that mysterious. Starting in 1999, a team of reporters from the International Consortium of Investigative Journalists pored over thousands of internal industry documents and uncovered how leading tobacco companies were colluding with criminal networks to divert cigarettes to the world's black markets. Big Tobacco was doing it for profit — to boost sales and gain market share — as it avoided billions of dollars in taxes while recruiting growing numbers of smokers around the globe. The tobacco industry, as it turned out, did not merely turn a blind eye to the smuggling — it managed the trade at the highest corporate levels.



Argentine security forces arrest smugglers trying to ship cigarettes across the Pilcomayo River from Paraguay, a top producer of contraband cigarettes. Credit: Prefectura Naval Argentina

Those revelations, and others that followed, helped lead to government inquiries, lawsuits, and promises of a global treaty to crack down on the illicit cigarette trade. Since 2004, two major tobacco companies, Philip Morris International and Japan Tobacco International, have agreed to pay a combined \$1.65 billion to the European Community and 10 member states to settle litigation that would have further exposed their involvement in cigarette smuggling. They have also committed publicly to help fight trafficking in tobacco. Similarly, this July, Canada's two largest cigarette companies, Imperial Tobacco Canada and Rothmans Inc., pleaded guilty to aiding smuggling during the early 1990s; they are to pay a combined \$1.12 billion, the largest such penalties ever levied in Canada.

Yet, despite the exposés, the lawsuits, and the settlements, the massive trade in contraband tobacco continues unabated. Indeed, with profits rivaling those of narcotics, and relatively light penalties, the business is fast reinventing itself. Once dominated by Western multinational companies, cigarette smuggling has expanded with new players, new routes, and new techniques. Today, this underground industry ranges from Chinese counterfeiters that mimic Marlboro holograms to perfection, to Russian-owned factories that mass produce brands made exclusively to be smuggled into Western Europe. In Canada, the involvement of an array of criminal gangs and Indian tribes pushed seizures of contraband tobacco up 16-fold between 2001 and 2006. "The big companies know that to some extent the golden period of smuggling is gone," observes Belgium-based sociologist Luk Joossens, a World Health Organization expert on tobacco smuggling and co-author of the 1995 study that first alerted the world that billions of exported cigarettes had gotten lost in transit. "You have still the normal small-scale smuggling, but you also have counterfeit production, illicit manufacturing. . . and a lot of small companies that are involved. So the whole area of illicit trade has become much more complex." Joossens also said that while Big Tobacco's participation in cigarette smuggling in Western Europe and North America has largely been curtailed, the situation remains murky in Africa and other developing areas of the world.

This week smuggling experts, customs officials, and diplomats from an estimated 160 countries are gathering in Geneva, Switzerland, to push for what has eluded governments for decades: a global crackdown on the black market in tobacco. Under the auspices of the WHO's three-year-old Framework Convention on Tobacco Control — a global treaty to curb tobacco use — delegates will work on implementing a protocol to stop cigarette smuggling. But the proposed measures face plenty of challenges, with some countries showing limited concern over the issue, while others, including the United States, have so far refused to ratify the FCTC altogether.

The stakes are formidable. Experts estimate that contraband accounts for 12 percent of all cigarette sales, or about 657 billion sticks annually. The cost to governments worldwide is massive: a whopping \$40 billion to \$50 billion in lost tax revenue during 2006. Ironically, it is those very taxes — slapped on packs to discourage smoking — that may help fuel the smuggling, along with lax enforcement and heavy supply. (A pack of a leading Western brand that costs little more than \$1 in a low-duty country like Ukraine can sell for up to \$10 in the U.K.) That potential profit offers a strong incentive to smugglers.

But it is more than lost revenue that is at risk. Illicit tobacco feeds an underground economy that supports many of the most violent actors on the world stage. Organized crime syndicates and terrorist groups such as the Taliban and Hezbollah facilitate global distribution and use the profits to finance their activities. In Canada alone, police believe that 105 organized crime groups are engaged in the illicit tobacco trade, including motorcycle gangs and the Italian Mafia. Criminal organizations “are doing more than just smuggling cigarettes,” notes John W. Colledge, who oversaw international tobacco smuggling programs at the U.S. Customs Service between 1999 and 2002. “They are engaged in human, drugs, and weapons trafficking.”

Perhaps even more troubling is the impact that smuggling has on the public health crisis caused by tobacco. Worldwide, one out of 10 adults dies prematurely from tobacco-related diseases such as lung cancer, emphysema, cardiovascular disease, and stroke. If current trends hold, tobacco will kill about 500 million people currently alive. By 2030, that figure will reach 8 million deaths a year, and with cigarettes being heavily marketed in poorer countries, 80 percent of those deaths will be in the developing world. Over the 21st century, say health experts, an estimated one billion people could die from tobacco use.

At a time when nations are increasingly trying to crack down on smoking, smugglers put cheap cigarettes into the hands of those most vulnerable — young people and the poor. In addition, the trade is pushing the supply steadily into the black market, selling cut-rate cigarettes of often dubious quality. Of special concern is the advent of a massive counterfeiting industry. Once a minor problem, today underground factories in China, Paraguay, and Eastern Europe manufacture literally billions of fake cigarettes — Marlboros, Camels, 555s, Mild Sevens — an uncontrolled industry that law enforcement is only beginning to grapple with. Many of the smokes are made from the lowest quality tobacco, full of stem and sawdust, and spiked with unusually high levels of nicotine. Other packs contain far worse. Tests reveal that counterfeit cigarettes carry a bevy of products that could further shorten even a heavy smoker's life: metals such as cadmium, pesticides, arsenic, rat poison, and human feces.



Resourceful smugglers hide contraband cigarettes in an industrial-size yogurt mixer. *Credit: Guardia di Finanza.*

Despite the stakes, cigarette smuggling remains a tough crime to investigate and prosecute. Factories are set up in regions of the world with weak controls and high levels of corruption, such as the crime-ridden Russian exclave of Kaliningrad, Guangdong province in China, and South America's notorious Tri-border area between Argentina, Brazil, and Paraguay. The distribution systems are complex, the smuggling routes circuitous and hard to track.

Smugglers take advantage of an “in transit” system used in free trade zones and other shipping centers, which allows for temporary tax suspension while the tobacco is en route to a third country. As a result of lax controls, cigarettes get “lost” along the way, with huge numbers failing to arrive at their intended destination.

Cigarettes, for example, may sit for weeks in free trade zones in Panama or Dubai until they are sold. Then they pass quickly through multiple buyers in a short period of time, complicating efforts to identify where “leakages” occur. On occasion, cigarettes are even illegally sold at sea, where vessels offload them to smaller boats that take them to shore. In the Balkans, they are sold by the trunk-load to smugglers who line their cars up at the borders of the European Union. And in the United States, tobacco suppliers ship millions of the tax-free smokes to Indian reservations, where they are unloaded to smugglers, bootleggers, and online merchants.

Despite its broad impact on health, crime, and taxes, tobacco smuggling receives strikingly little attention from authorities. Lenient sentences are the norm; in some countries, cigarette smuggling is not even considered a crime. Nor is it a priority for law enforcement agencies, even in the West, which spend the majority of their resources tackling drug, arms, and terrorism cases. In the United States, for example, the Bureau of Alcohol, Tobacco, Firearms and Explosives devotes a paltry 2 percent of its personnel and budget to tobacco programs.

Eight years after its original series on tobacco smuggling, ICIJ has assembled a new team of reporters to illuminate this shadowy transnational business. Based on reporting from 15 countries, our new project looks at the influence of organized crime and terrorist groups, as well as the continued complicity of distributors, wholesalers, and tobacco companies themselves. Since 2008, the series has exposed the billion-dollar smuggling of Russian-made Jin Ling cigarettes to the European Union; the involvement of North American Indian reservations in a massive black market in Canada and the United States; and the alleged role of Montenegro Prime Minister Milo Djukanovic in a decade-long smuggling scheme with the Italian Mafia.

Here is ICIJ’s latest series of articles, presented also online in our award-winning interactive website. Among our findings:

- **Terrorism and Tobacco: Extremists, Insurgents Turn to Cigarette Smuggling.** Terrorists are increasingly turning to cigarette smuggling for funding. The move is part of a larger trend toward use of criminal rackets by terrorists, who find trafficking in cigarettes a high-profit, low-risk way to finance operations. Among the groups are Pakistan’s Taliban militias, for whom cigarettes are now second only to heroin as a funding source.

- **China’s Marlboro Country: A Massive Underground Industry Makes China the World Leader in Counterfeit Cigarettes.** China now produces an unprecedented 400 billion counterfeit cigarettes annually. Cheap Chinese fakes are now sold in major cities worldwide, from New York delis to London storefronts. Officials believe China is the source of 99 percent of U.S. counterfeit cigarettes and up to 80 percent of those in the European Union. Lab tests reveal the Chinese counterfeits release 80 percent more nicotine and 130 percent more carbon monoxide than brand-name cigarettes, and have impurities that include insect eggs and human feces.

- **Smuggling Made Easy: Landlocked Paraguay Emerges as a Top Producer of Contraband Tobacco.** Paraguay’s renegade factories produce more than 20 times what the country consumes, and are now responsible for 10 percent of the world’s contraband tobacco, experts estimate. The vast majority of the cigarettes — up to 90 percent of production, worth an estimated \$1 billion— disappears into an often violent black market, law enforcement officials say.

- **Ukraine’s “Lost” Cigarettes Flood Europe: Big Tobacco’s Overproduction Feeds \$2 Billion Black Market.** Each year, the world’s four top multinational tobacco companies – Philip Morris International, Japan Tobacco International, Imperial Tobacco, and British American Tobacco – produce and import 30 billion cigarettes in Ukraine beyond what the country can consume, fueling a \$2 billion black market that reaches across the European Union. Today, Ukraine is rivaled only by Russia as the top source of non-counterfeit cigarettes smuggled to Europe.

For more on Tobacco Underground, visit our website at: www.publicintegrity.org/investigations/icij.

Marina Walker Guevara is deputy director of the International Consortium of Investigative Journalists, a project of the Center for Public Integrity.

Terrorism and Tobacco

Extremists, Insurgents Turn to Cigarette Smuggling

By Kate Willson

For centuries, blue-turbaned nomadic Tuareg tribesmen have led caravans of camels across the expanses of the Sahara. Laden with millet and cloth from Africa's West Coast, the caravans traveled unmarked paths to trade for salt and dates in Timbuktu, across the sand plains of Niger, and into the mountain oasis of the Algerian south.

Smugglers take the same routes today — driving SUVs along paved roads or with guidance from the Tuareg and satellite phones — to move weapons, drugs, and, increasingly, humans — through the Sahara for transport across the Mediterranean Sea. The paths are no longer known as the Salt Roads of the Tuareg, but as the “Marlboro Connection,” named after the most lucrative contraband along this 2,000-mile corridor.

Among those who control this underground trade is al-Qaeda in the Islamic Maghreb (AQIM), an Algeria-based terrorist organization widely believed to have been backed by Osama Bin Laden. Descended from the Salafist Group for Preaching and Combat (known by its French acronym, GSPC) the group has hundreds of members and is blamed for a bloody campaign of bombings, murders, and kidnappings across North Africa and Europe. “They are a significant threat,” says Lorenzo Vidino, author of *Al Qaeda in Europe*. “Of all Islamic terrorist groups, they have the most extensive and sophisticated network in Europe. ... And among their activities, smuggling is particularly important.”

Military officials and scholars say cigarette smuggling, in fact, has provided the bulk of financing for AQIM. The money comes not directly from smuggling, but from charging protection fees to others moving untaxed cigarettes through the Sahara. The most smuggled brand is Marlboro, followed by Gauloises and American Legend, as well as counterfeited Rym, a popular Algerian brand.

Al-Qaeda's North Africa affiliate isn't alone. After crackdowns on fundraising following the 9/11 attacks, terrorist groups worldwide have increasingly turned to criminal rackets, officials say. And smuggling cigarettes — either untaxed or counterfeit — has proved a particularly lucrative, low-risk way to fund operations.

Hezbollah, the Taliban, and al-Qaeda are involved in smuggling cigarettes; so are the Real Irish Republican Army (Real IRA) and the Kurdistan Workers' Party (PKK). Terrorist financing through cigarette smuggling is “huge,” says Louise Shelley, a transnational crime expert at George Mason University and an advisor to the World Economic Forum on illicit trade. “Worldwide — it's no exaggeration. ... No one thinks cigarette smuggling is too serious, so law enforcement doesn't spend resources to go after it.”

“Cigarettes are easy to smuggle, easy to buy, and they have a pretty good return on the investment,” adds David Cid, a former FBI counterterrorism agent and deputy director of the Memorial Institute for the Prevention of Terrorism in Oklahoma City. “Drug dogs don't alert on your car if it's full of Camels.” And, he notes, “The other advantage is you don't go to jail for 50 years.”

Traditional terrorist networks aren't the only armed groups making money from the underground cigarette trade. Insurgents and paramilitary forces are also on the take. Many of the world's longest-running civil wars are fueled by contraband, according to a 2002 study by Stanford University's James Fearon. And tobacco is only one of



Osama Bin Laden provided seed money for al Qaeda in the Islamic Maghreb, an Algeria-based terrorist group financed heavily by proceeds from trans-Saharan cigarette smuggling. *Credit: Federal Bureau of Investigation*

the favored commodities. Cocaine smuggling has largely propelled the FARC's 40-year insurgency in Colombia. Diamonds have funded civil wars in Sierra Leone and Angola. And opium has fueled drawn-out conflicts in Burma and Afghanistan.

The increasing use of smuggled tobacco by terrorist and insurgent groups parallels the rapid growth of a multi-billion-dollar trade in cigarette smuggling around the world. Huge tobacco black markets have arisen from New York State to Paraguay to Eastern Europe, as smugglers move cheap and counterfeit cigarettes to sell in lucrative high-tax regions. The illicit trade is fueling addiction, health experts say, by making inexpensive cigarettes widely available, while robbing governments of sorely needed tax revenue. At the same time, officials warn, the booming black markets are fueling not only some terrorist groups but dozens of organized crime gangs, who find the big profits and low risk hard to resist.

In addition to al-Qaeda in the Islamic Magreb, at least a half-dozen terrorist groups and insurgencies have profited from the black market in tobacco. Among the others:

The IRA

Both the Provisional Irish Republican Army and the militant splinter group Real IRA have used cigarette smuggling to finance their operations. While both groups seek the unification of the island of Ireland, the Provisional IRA announced in 2005 that it would henceforward use only peaceful means. The Real IRA continues to employ terrorist tactics including robbery, bombings, and assassinations, most recently shooting dead two British soldiers in Northern Ireland in March.

"Cigarette smuggling has definitely been a major source of funding for the Provisional IRA — not only the Real IRA — and other terrorist groups in Northern Ireland," said Rogelio Alonso Pascual, an IRA expert teaching at Madrid's Universidad Rey Juan Carlos.

The Real IRA has flooded Ireland with contraband cigarettes and imported counterfeit versions of popular brands. Authorities say the group is responsible for nearly all the smuggled tobacco seized in Northern Ireland, and they say cigarette smuggling has emerged as a top funding source for the organization. Combined, the IRA groups reaped an estimated \$100 million in proceeds from cigarette smuggling over a five-year period, according to a 2004 report by William Billingslea, an analyst for the U.S. Bureau of Alcohol, Tobacco, Firearms, and Explosives.

In March, a Miami man was indicted in connection to a cigarette smuggling ring with ties to the Real IRA. The arrest comes after a seven-year investigation stretching from the Canary Islands to Panama, through the port of Miami and on to Ireland and the UK. U.S. and European officials declined to comment, saying the case is "complex" and ongoing.

The Taliban

In the restive tribal belt of Pakistan — where Osama bin Laden is thought to be hiding — some of the most hunted Taliban militias collect money from cigarette smugglers in exchange for allowing Marlboro knock-offs and cheap local brands to flow into Afghanistan and China. Cigarettes have become an increasingly important source of financing for the groups, second only to the heroin trade, according to Pakistani intelligence officials.

As NATO forces battled Taliban in Afghanistan, the insurgents increasingly sought sanctuary along the ungoverned border regions of Pakistan where both the Taliban and the vast majority of Pakistanis are Sunni Muslim and ethnic Pashtuns. The Khyber Agency, a border province boasting the most-traveled trade route between the two countries, is also the hotbed of cigarette counterfeiting in Pakistan.

The PKK

The Kurdistan Workers' Party (PKK) long controlled the smuggling routes between Turkey and northern Iraq.

Blamed for thousands of deaths since its inception in 1978, the leftist group comprised of Turkish Kurds has sought to establish a Marxist state in southeastern Turkey. The PKK has carried out bombings of Turkish governmental security forces and popular Turkish tourist sites.

The PKK funds itself through donations from sympathizers, trafficking in narcotics and arms smuggling, and by charging a fee for every container of cigarettes allowed to pass through its territory. Whereas the group controlled the flow of contraband cigarettes into Iraq during the 1990s, they now control the flood of counterfeit cigarettes streaming out of Iraq, according to Sharon Meltzer, an expert on cigarette smuggling and transnational crime at American University. “It’s still going on; it’s just changed direction,” she said. “Now counterfeit factories are operating openly in Iraq.”

Hezbollah

Hezbollah, the Lebanon-based militia and political organization, is also engaged in tobacco trafficking. The radical Shiite group receives a significant percent of its financial support from Iran, but also relies on proceeds from smuggling cigarettes and other goods.

In three connected U.S. cases since 2000, defendants tied to Hezbollah have pleaded guilty to smuggling low-tax cigarettes from North Carolina and untaxed cigarettes from New York Indian reservations to the high-tax state of Michigan. Nearly 50 defendants have faced federal charges ranging from cigarette smuggling and money laundering to material support for terrorists. Investigators say the operations made millions of dollars, some of it traced back to Hezbollah leaders in Lebanon. The network's kingpin — Mohamad Hammoud — is serving time at a medium-security federal prison in Indiana. His projected release date: September 2135.

The U.S. Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) is investigating a number of cigarette smuggling cases that appear linked to terrorism, according to Associate Chief Counsel Jeffrey Cohen. “It’s not because terrorists like cigarettes particularly, but because it’s an easy way to finance things,” Cohen says. In most U.S. cases, groups send money through hawala, a parallel banking remittance system that relies on family, ethnic, and regional ties. Because there are few records, he adds, “it’s difficult to know how much of this is going to terrorists and how much is going to food and education.”

The use of hawala makes it exceedingly difficult to track money in such cases, agrees Phil Awe, acting chief of ATF’s alcohol and tobacco enforcement branch. “The information is anecdotal,” says Awe, who investigated the U.S. Hezbollah cases. “There are a lot of small villages where Hamas, Hezbollah, and others are ruling. If you’re sending money back to those small villages where extremist groups operate, there’s a good chance some of that money is ending up with them.”

FARC

FARC has evolved from the world’s largest, strongest, Marxist-based insurgency into what is widely seen today as a criminal outfit that is the world’s largest supplier of cocaine. The group began by charging taxes on coca-growers in FARC-controlled regions but has since developed into a self-sustaining cocaine trafficking organization.

To launder its money, FARC and other Colombian narcotraffickers use what is known as the black market peso exchange in which they smuggle drugs to the U.S. and sell the dollars to informal bankers called “peso brokers.” The peso broker in turn sells these dollars to Colombian exporters who buy U.S. goods with the laundered funds. Those export goods are then smuggled back into Colombia.

“In Colombia, well established drug routes were easily converted into cigarette-smuggling routes,” Interpol’s Ralf Mutschke said in written testimony to the House Committee on the Judiciary in 2000. DEA’s Alvin James said



Mokhtar Belmokhtar has collected a litany of noms de guerre during his years as lead cigarette smuggler for al Qaeda in the Islamic Maghreb, including “Emir of the Sahel” and “The Marlboro Man.” *Credit: Interpol*

U.S. manufactured cigarettes, “especially Marlboros, Kents, and Lucky Strikes, made up a large portion of the trade goods that were smuggled into Colombia and financed by this process.”

Anyone trafficking drugs from Colombia to the United States is at least tangentially involved in smuggling cigarettes from the United States to Colombia, authorities say. Traditional drug cartels, left-wing guerrilla groups, and the equally brutal right-wing paramilitary groups jostle for market share. The players and brands have changed over the years, but investigators say the market remains the same.

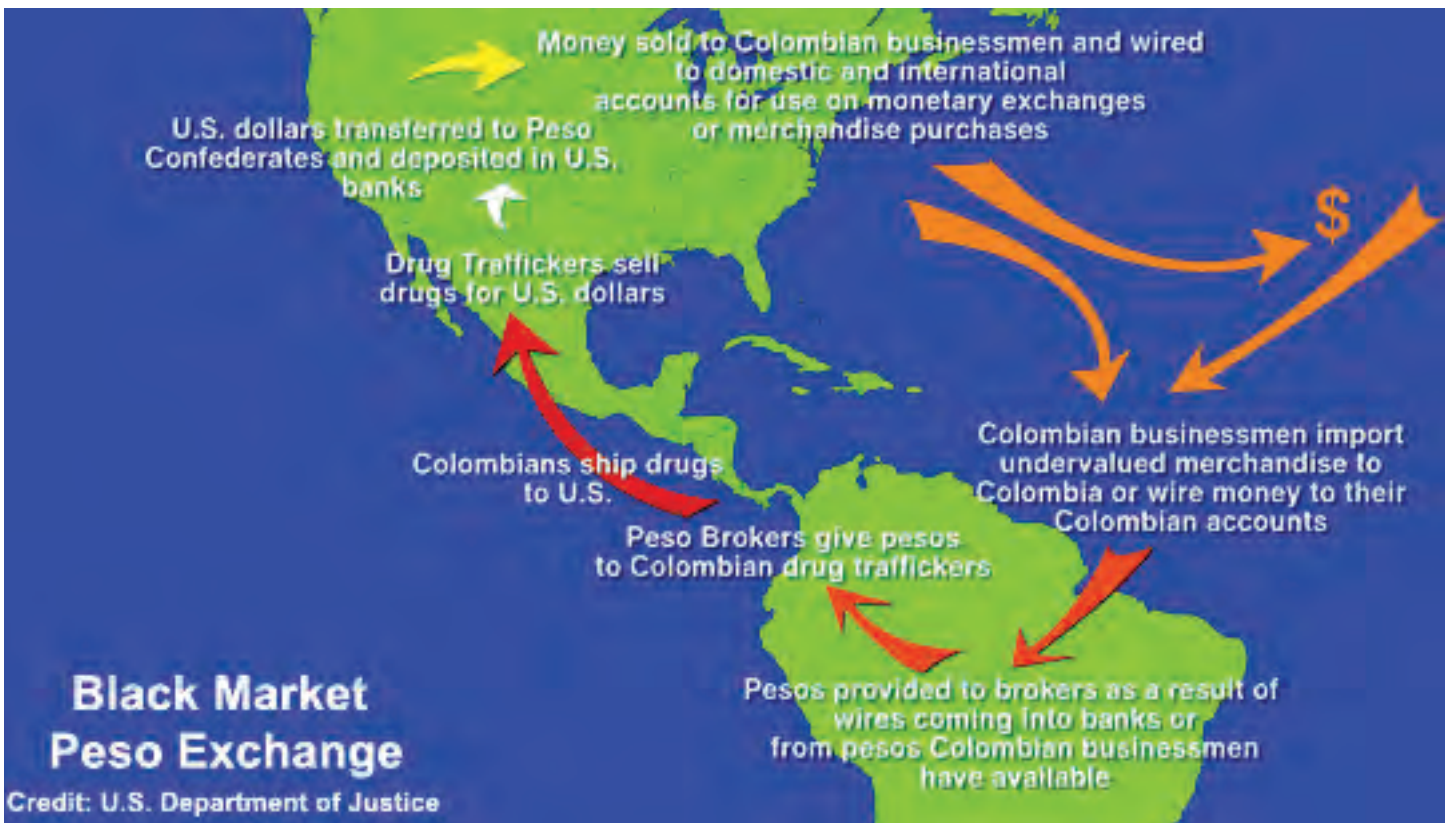
The primary transit points for the cigarette black market run through Aruba and Panama. Panama customs authorities confirmed in April a seizure of cigarettes belonging to FARC, but could not provide details pending an ongoing investigation.

The CNDP

Seven thousand miles from the coca-rich plains of Colombia, in the dense jungles of eastern Congo, rebels allegedly profit from a millionaire tobacco tycoon who recently pleaded guilty to cigarette smuggling.

A U.N. Security Council investigative body called the Group of Experts reported in December that Tribert Rujugiro Ayabatwa, a tobacco tycoon who pleaded guilty to cigarette tax evasion charges in South Africa, has been funneling money to a Congolese rebel group that has committed human rights violations including recruitment of child soldiers, mass rape, and murders.

More than five million people have died in the Congo since 1998, making it among the most lethal conflicts since World War II. The vast majority of fighting now occurs in the east between three opposing forces: the Congolese military, a Hutu-backed rebel group, and a Tutsi-backed rebel group called The Congres National Pour la De-



To launder its money, FARC and other Colombian narco-traffickers use the black market peso exchange to launder money through imported goods.

Credit: U.S. Department of Justice

fense du Peuple (CNDP). Led by Laurent Nkunda, the CNDP has perpetuated serious human rights abuses that include mass murder, torture, rape, forced recruitment of children, and slavery, according to the U.N.'s Group of Experts

Rujugiro owns Mastermind Tobacco Company, which produces Yes cigarettes, and Congo Tobacco Company, which produces Supermatch cigarettes, according to company filings. Rujugiro has cigarette factories across central and eastern Africa, as well as tobacco fields in many sub-Saharan countries. He also has factories and transport companies in Dubai, and has stakes in banking, oil, real estate and construction companies across Africa. Rujugiro is also an advisor to Rwandan president Paul Kagame, according to the U.N. findings.

The Group of Experts has uncovered a series of e-mails and individuals who claim that Rujugiro has been supporting the CNDP through cash payments and supplies, and that he pays the CNDP to allow the traffic of his untaxed cigarettes. Rujugiro has denied the allegations of smuggling and CNDP ties in a post on his website and in a letter to a Rwandan newspaper.

Port authorities seized 97 million contraband Supermatch cigarettes in Ghana earlier this year, investigators say. The cigarettes were manufactured in the United Arab Emirates, stamped with fake "Sale in Ivory Coast" stamps, and destined for Mali, where they are not licensed for sale. Supermatch, meanwhile, has become the most smuggled brand into Uganda.

Rujugiro's South Africa operation was shuttered in 2006, when the South African Revenue Service froze the company's assets and filed fraud charges against him and his son. Rujugiro left the country and was arrested at Heathrow airport in London last fall. He settled the case this month before being extradited, agreeing to pay a \$7 million fine and to comply with tax laws in future.

Stanching the Flow

At the core of the problem, scholars say, are the high profits of tobacco smuggling, which rival those of narcotics, and the relative cheapness of conducting a terrorist operation. In many cigarette smuggling cases, millions of dollars are at stake. A shipping container containing 10 million cigarettes costs as little as \$125,000 to produce in China, but can bring as much as \$2 million in the United States. Cigarette smuggling bolstered the entire economy of Montenegro during the 1990s.

Contrast that with the small amounts it takes to conduct a terrorist attack. "Part of the problem is that it takes so little to finance an operation," says Gary LaFree, director of the University of Maryland's National Consortium for the Study of Terrorism and Responses to Terrorism. British authorities, for example, estimated the 2005 London subway bombing that killed 52 people succeeded on a budget of less than \$15,000. Al-Qaeda's entire 9/11 operation cost between \$400,000 and \$500,000, according to the final report of the National Commission on Terrorist Attacks Upon the United States.

To end the flow of criminal money to terrorist groups and insurgencies, experts say, will mean cutting off the flow of contraband — whether narcotics or tobacco. Terrorism and criminal finance investigator Larry Johnson, with BERG Associates, notes that it's much easier to crack down on the flow of legal products like tobacco. "You need to ensure that the products are being sold through legitimate channels through legitimate distributors — that they're not committing willful blindness," he says. "The contraband is fairly easy to deal with because it's in the power of the distributors and producers to control the process. This is actually one of those few problems that is fixable."



Tobacco magnate Tribert Rujugiro Ayabatwa has allegedly helped finance a guerrilla insurgency in the eastern Democratic Republic of Congo. Credit: *The New Times*.

The Taliban and Tobacco

Smuggled Cigarettes Give Boost To Pakistani Militants

By Aamir Latif and Kate Willson

Tumman Khan is a poor, aging farmer who tills another man's land in the restive northern tribal belt of Pakistan. For him and others in the Khyber Agency region, Sahib Ayub Afridi is considered an angel. The illiterate 70-year-old tribal leader finances construction of water pumps, streets and lighting, builds mosques and madrasahs, and supports the penniless and widowed.

But there's another side to Afridi.

A one-time notorious drug kingpin who in the 1980s armed the Afghan Mujahidin at the CIA's behest, Afridi churns out millions of counterfeit cigarettes to smuggle across central Asia, China and Africa, and splits the proceeds with the pro-Taliban militants who control the swath of mountainous borderland, according to Pakistani intelligence and customs officials. The leaders of some of these militant groups are on the U.S. most-wanted list in the region – among them, Baitullah Mehsud, who has claimed responsibility for bloody attacks in Pakistan and has sworn to strike Washington, D.C. U.S. officials have responded by putting a \$5 million price on Mehsud's head.

A Tax for Terrorism

As government sanctions restrict traditional sources of terrorist financing, Pakistani militant groups increasingly rely on proceeds from counterfeit cigarette production and smuggling, intelligence sources say. Although income figures are rough estimates at best, profits from the illicit cigarette trade account for as much as 20 percent of funding for these militant groups, second only to heroin production, according to terrorism experts in Pakistan. "Taliban and other militant groups do not have to do much," says Ikram Sehgal, a senior defense and security analyst who heads SMS Security, Pakistan's leading private security company. "They simply receive taxes on a regular basis from owners of illegal and legal cigarette factories and later for the safe passage they provide to the convoys."



Sahib Ayub Afridi, local philanthropist, convicted drug smuggler, and top cigarette counterfeiter in his native Pakistan.

The Afridi case is part of a broader trend of terrorism groups relying on contraband to finance their activities, experts say. Even if efforts to cut the region's booming heroin production are successful – an unlikely prospect – the lucrative tobacco trade suggests how hard it will be to stanch funding to terrorists and insurgents in areas far from government control. The world's longest-running civil wars are fueled by contraband according to a 2002 study by Stanford University's James Fearon. Cocaine smuggling has largely propelled FARC's 40-year insurgency in Colombia. Diamonds have funded civil wars in Sierra Leone and Angola. Opium has led to drawn-out conflicts in Afghanistan and Burma.

In the badlands of the Afghan-Pakistan border, the challenges are particularly daunting. U.S. President Barack Obama recently deemed the region "the most dangerous place in the world" for Americans. The growing power of the Taliban and other militant groups, combined with new waves of terrorism, has put Pakistan's weak government on the defensive. The risks are indeed high: as much as two-thirds of the nuclear-armed country is ruled not by a central government but by insurgents, militants, tribal leaders, or warlords.

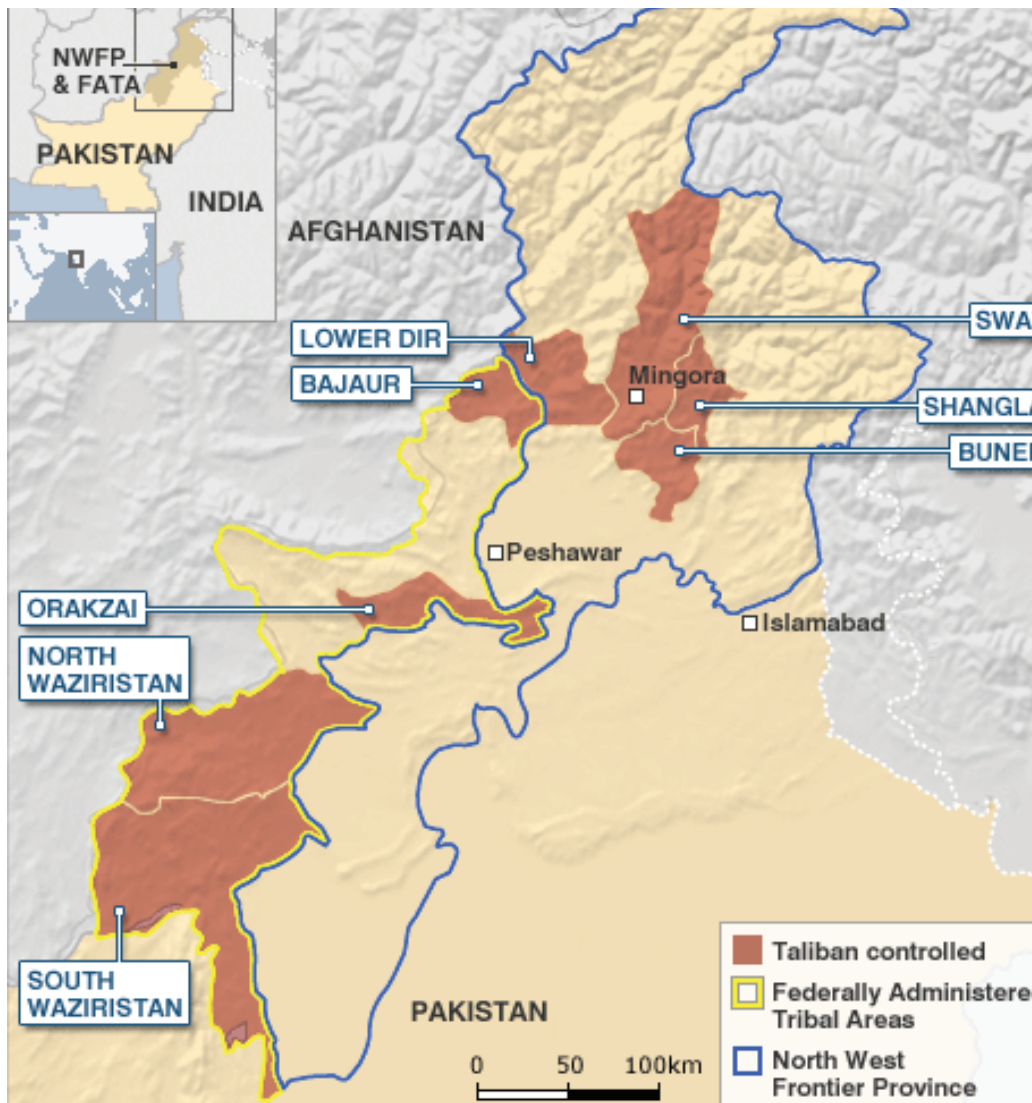
Overlooked in the Pakistan Taliban's growing power is the role of tobacco smuggling.

As U.S. and NATO forces attacked the Taliban in Afghanistan, the predominantly Pashtun fighters increasingly sought sanctuary along the ungoverned border of Pakistan. The Khyber Agency – a border province boasting the most-traveled trade route between the two countries – is also the hotbed of cigarette counterfeiting in Pakistan. And its renegade factories have become the region's largest employer, according to Pakistani intelligence sources.

Fateh Mohammed, a senior Pakistani tax official, said counterfeit cigarette production is on the rise, costing the government an estimated \$88 million annually in lost taxes. He said the excise department does what it can, but the factories are “out of reach.”

“It’s hard for us to curb the sale and production of counterfeit cigarettes as we neither have the manpower and other resources to do that,” Mohammed said. “Nor do we have any reach to the tribal belt where this business is flourishing.”

Illicit cigarette production in the strife-torn tribal belt, a semiautonomous region of Pashtun tribes bordering Afghanistan, accounts for an estimated 22 percent of all consumption in Pakistan, a country with cigarette taxes among the highest in the world – accounting for 87 percent of the cost per pack. Mohammad Khosa, who heads the anti-counterfeiting efforts for British American Tobacco in the region, estimated that the region's factories pump out some 15 billion cigarettes a year, a large portion of which end up smuggled to neighboring Afghanistan.



The Taliban control large swaths of western Pakistan. (Reprinted with permission from BBC News)

“Smuggling has long existed because of physical proximity to land routes going into Central Asia and beyond,” said Sumit Ganguly, professor and Pakistan expert at Indiana University. “On top of that, there are very poor people. The two dovetail very neatly.”

Trade routes between Afghanistan and Pakistan developed over thousands of years with no governmental controls. It wasn’t until the British drew a 1600-mile border between the two countries, in 1893, that a culture of illicit trade flourished. Today, Pashtuns pay little attention to the poorly marked borders that separate the rugged terrain between Afghanistan and Pakistan.

Following the October 2001, U.S.-led invasion of Afghanistan, smuggling contraband goods across to Pakistan provided the Taliban with a major source of financing. In his final story published in

the Wall Street Journal before his January 2002 abduction, Daniel Pearl reported on how the group “taxed” goods being smuggled across the border. The militants skimmed between \$35 million and \$75 million off exports of Marlboro cigarettes, Sony TVs and Gillette shaving cream, Pearl wrote.

Today, no figure is more deeply mired in the region’s contraband trade than Haji Ayub Afridi, a tribal leader of the region-ruling Afridi clan, which has long controlled trade routes into Afghanistan and whose name is synonymous with trade and transport throughout Pakistan.

Who’s Who of Militants

Afridi’s sweeping luxury estate near the Afghan border is enclosed by 20-foot high walls topped with concertina wire, guarded by a private army and protected by an anti-aircraft battery. Authorities point to a pair of lucrative, yet nameless, cigarette factories that Afridi owns, known locally as “One More Cigarette,” and to a number of cigarette-filled warehouses he is said to own near Peshawar – the region’s largest city, 25 miles east of his home. Because most of his business is in the names of associates, the full extent of Afridi’s assets is unknown, but officials believe he operates as many as six factories.

Afridi churns out copies of an array of Western brands – Marlboros, Camels, Benson & Hedges, and 555s, among them, officials say. The Marlboros and Camels are smuggled into Afghanistan and the central Asian countries of Turkmenistan, Uzbekistan and Tajikistan. Benson & Hedges is favored for shipment to South Africa, while counterfeit 555s are moved through the Khunjarab pass into China. Afridi also produces low-quality local brands One-Touch and Datchi, which are popular in Afghanistan.

Afridi pays protection money to a Who’s Who of the region’s militant leaders, according to Pakistani intelligence. In exchange for operating his factories in the Khyber Agency, sources say, Afridi pays \$36,000 a month – the average combined annual income of 47 Pakistanis – to Mangal Bagh, leader of the area’s ruling pro-Taliban militia.

A former bus token taker and fellow member of the Afridi clan, warlord Bagh commands thousands of heavily-armed Islamist militants through his group Lashkar-i-Islam (Army of Islam). In addition to collecting taxes from the likes of Afridi, the pro-Taliban group specializes in kidnapping for ransom. Early in his smuggling racket, Afridi refused to cut Bagh a percentage of his proceeds, instead paying protection taxes to a rival Taliban group, officials say. The two groups clashed in 2008, leaving 19 dead. Following the battle, Afridi agreed to pay Bagh.

Bagh may be the most moderate militant leader on Afridi’s payoff list. Afridi also pays a pair of rival Taliban factions in the neighboring tribal region of Waziristan, along the Afghan border to the south, who are actively fighting U.S. and NATO troops in Afghanistan. One of the men, Mullah Nazir, opposes fighting against Pakistan security forces. But his rival, Baitullah Mehsud – leader of Pakistan’s Taliban movement – has advocated attacks against the Pakistani government and is blamed by Islamabad for ordering the assassination of Benazir Bhutto.

Mehsud’s troops also provide a safe haven for al-Qaeda forces fighting in Afghanistan, and his militancy has made him a prime target for the Americans. But that has not deterred the Taliban leader; he recently joined forces with Nazir and a third warlord who, together, now control much of the region. The rival groups agreed to “fight the U.S. together, because we are concerned over the surge in American troops in Afghanistan,” Nazir told local tribal chiefs, according to the Daily Times, an English-language newspaper in the region.



The Torkham Crossing, a heavily traveled trade route between Pakistan and Afghanistan, is used to smuggle cigarettes and other goods between the two countries. *Credit: United States Agency for International Development.*

Afridi isn't the only counterfeit cigarette producer in the tribal belt. Smugglers also transport cigarettes from illegal factories in neighboring provinces of Kohat and Bannu into Afghanistan through the border town of Miramshah. The area is in the grip of an al-Qaeda militia of ethnic Uzbeks loyal to Mehsud. Pakistani intelligence sources say cigarette smugglers pay the militant groups up to 20 percent commission for each convoy. American and Japanese model trucks leave the sprawling, high-walls cigarette factories almost daily, while bigger convoys of five to seven trucks leave twice a week, local residents say.

On the Lam

Afridi is no stranger to the black market. During the 1960s he drove truckloads of smuggled gold through the Khyber Pass. His partner was a slightly older gold smuggler named Iqbal Baig. The two prominent tribal members would remain close business partners as they expanded into currency, hashish, and heroin smuggling.

In the 1980s, Afridi is credited with orchestrating the heroin trade between eastern Afghanistan, through the Khyber Pass, to the Afridi clan in Pakistan. Pakistani and Belgian authorities first sought his arrest in 1983, after tying the smuggler to 17 tons of hashish in a southwest Pakistan warehouse and another 6.5 tons in Antwerp, Belgium. But when 50 Pakistani police sought to arrest Afridi in 1990, they were met by an armed militia and quickly retreated, according to U.S. court records.

Despite his record as a narcotics trafficker, the CIA had its own uses for Afridi. In the 1980s, he was one of many Pashtun tribal leaders tapped by the agency to help finance and arm the Mujahidin struggle against the Soviet invasion of Afghanistan, according to *The New Dimension of International Terrorism* by former Harvard University fellow and U.S. Army Colonel Stefan M. Aubrey. After the Soviets pulled out of Afghanistan, Afridi turned his attention homeward. He was elected to Parliament in 1990 – reportedly after paying up to \$600 per vote to represent the Federally Administered Tribal Areas.

Through it all, Afridi never stopped dealing drugs, according to U.S. court records. He ordered subordinates to truck hashish to Karachi in Bedford trucks and old tanker trucks. Meanwhile, he and his partners made millions smuggling tons of heroin and hashish across the globe – through India to London, Paris, and Amsterdam, packed amid frozen fish into the Netherlands, through Singapore and Hong Kong, and across the Atlantic to the United States and Canada.

Afridi, through his longstanding contacts in the drug world, became the key supplier to the biggest narcotics ring in Pakistan, according to the U.S. Drug Enforcement Administration. The DEA branded Afridi's syndicate "the single most prolific heroin and hashish drug trafficking organization in Pakistan." The amounts were indeed impressive: 57 tons of hashish into the Netherlands in a single shipment; 30 tons of hashish to California; and massive amounts of heroin around the world.



Tobacco counterfeiter Afridi lives in a heavily guarded compound near the Afghan border.

At the center of the operation was the notorious Iqbal Baig—a respected, well-known businessman whose assets included cinemas, textile factories, commercial property, and a pizzeria. And at Baig's side was Tarik Butt, his brother-in-law. Butt took over a battery manufacturing plant in 1986 after its owner – smuggling heroin into Vienna on Butt's behalf – died from a drug-filled balloon exploding in his stomach. The factory became "a social club of misfits, thugs, murderers and dope dealers," said a New Delhi-based agent with the Drug Enforcement Administration.

By the 1990s, however, Afridi's criminal past was catching up with him. With authorities threatening prosecution, he went into hiding and was soon splitting his time between Pakistani tribal areas, Afghanistan, and the United Arab Emirates.

It was a trio of hash shipments – 58 tons in all – that finally led to Afridi's undoing.

Hidden amid fish, tires and sacks of rice, the drugs were sent to Long Island, New York and Newport News, Virginia, and led to the arrest of one Stewart Newton, Afridi's U.S. connection. Arrested in 1988, Newton was sentenced to 47 years in prison, but served only eight after agreeing to cooperate with prosecutors in the case against the Pakistani smugglers. Also indicted were Butt and Baig, whom Pakistan extradited to the United States in 1995.

Afridi stayed out of reach, hiding in the tribal zone. But fearful of arrest by Pakistani officials and concerned his now-arrested co-conspirators would turn against him, he negotiated with the DEA for a year before finally turning himself in.

Now-retired DEA agent Gregory D. Lee recalls fielding odd questions from Afridi's go-between during that time.

"He would ask crazy questions like, 'how many times a day will I be beaten by the Marshals?' and 'will I be able to stay at the Waldorf Astoria in Manhattan,'" Lee said during a recent phone interview. If he wasn't permitted to serve out his sentence at the four-star hotel, Afridi wanted to know if he could employ a personal cook at the prison. "He had no idea what to expect."

In 1997, Afridi pleaded guilty to smuggling hashish and was sentenced to five years in prison and a \$100,000 fine. But the Pakistani godfather served only two years in U.S. jail, paid just \$425, and in 1999 he was deported to Pakistan, where officials promptly arrested him for an earlier smuggling case.

Although sentenced in Pakistan to seven years in prison, Afridi was released without explanation shortly after 9/11. Soon after his release, he traveled to Afghanistan to unite anti-Taliban warlords, according to senior Pakistani intelligence and anti-narcotics officials. His attempts failed, they say, and the aging Afridi returned home.

It is back home, in the Khyber Agency, where Ayub Afridi has refocused his attentions. Gone are the hashish and heroin shipments, officials say. The old smuggler has found an easier racket to ply, with few penalties and easy profits – the untaxed cigarette trade. Reached by telephone, in English and Urdu, an elderly man at Afridi's home denied he was Afridi and declined to comment further.

Nor will others talk openly about Afridi in his native land. Journalists do not write about the man, and even law enforcement officials speak about him in hushed tones. But the poor of the Khyber Agency are not so reticent. Despite his years in Afghanistan, in jails and throughout his smuggling exploits, Afridi didn't forget the poor who surrounded him, farmer Tumman Khan told a visiting reporter. Even when Afridi was locked away in an American prison cell, the poor and widowed continued to receive monthly checks on his behalf.

"Haji Sahib is an angel for poor people like us," Khan said. "We don't know much about his business, whether legal or illegal. What we know is that he has helped us when no one was there to do that."



Children line up with lunch buckets at a refugee camp near Swabi, Pakistan, during spring 2009 fighting in the Swat valley. *Courtesy of Olaf Kellerhoff, published under Creative Commons licence.*

China's Marlboro Country

A Massive Underground Industry Makes China the World Leader in Counterfeit Cigarettes

By Te-Ping Chen

On first approach, Yunxiao seems like any other Chinese backwater caught in uneasy industrial transition. Faded advertisements line the streets downtown, where motorcyclists wearing bamboo-frond hats determinedly vie for passengers in a riot of honking. A cheerful red banner in the city center exhorts citizens to develop the local economy—and yet the message seems ironic. After all, since the 1990s, Yunxiao has already sprouted its own league of millionaires, famous throughout China.

But you won't find their activity downtown.

Ringed by thickly forested mountains, illicit cigarette factories dot the countryside: carved deeply into caves, high into the hills, and even buried meters beneath the earth. By one tally, some 200 operations are hidden in Yunxiao, a southwestern Fujian county about twice the area of New York City. Over the past ten years, production of counterfeit cigarettes in China has soared, jumping eightfold since 1997 and making China the world leader in fake smokes. Chinese counterfeit cigarette factories now churn out an unprecedented 400 billion cigarettes a year, enough to supply every U.S. smoker with 460 packs a year. Yunxiao—once famed for its bright yellow loquat fruit—is the trade's heartland: the source of half such production, officials say.

Today, China's fake cigarettes fuel a multi-billion dollar black market and are even more hazardous for smokers, yet the industry is little-known. From New York delis to London storefronts, China's brand rip-offs are now sold in cities around the world. While a pack of fake Marlboros costs \$0.20 to make in China, in the United States, it can fetch up to twenty times that amount, even when sold at cut rates. Spurred by global crime rings, the counterfeit trade has exploded, propping up addiction and robbing governments of billions in annual tax revenue. Officials can only guess at the size of the industry here in the United States, but to give a sense of scale, from 1999-2005, one ring smuggled a billion fake cigarettes into Los Angeles and New Jersey. Fully 99 percent of the U.S. counterfeit market is supplied by China, and up to 80 percent of that in the European Union. Meanwhile, Chinese government efforts to stop the trade are met by street riots, machete-armed manufacturers and retaliation killings.

"Most factories are underground," confides a Yunxiao cigarette broker in hushed tones. "They're under buildings, unimaginably well-hidden, with secret doors from the basements." Even the village temple—topped with a tilting red roof and twisting, frescoed spires—conceals a factory below, she says.



Much of China's counterfeit cigarette industry is literally underground, with many factories accessible only by trapdoor and ladder.

Sixty Versions of Marlboro

Though a nearly invisible industry, cigarette counterfeiting is an immensely lucrative one, with profits rivaling those of the narcotics trade, officials say. While one 40-foot container of cigarettes (containing 10 million sticks) can be produced in China for just \$100,000, the street value of such a container smuggled into the United States is up to \$2 million. And though a drug trafficker might land a life sentence if caught, a cigarette counterfeiter receives a comparative slap on the wrist—a handful of years in jail, or possibly a fine.

Interviews with law enforcement officials, tobacco industry investigators, and the smugglers themselves reveal the Chinese busi-

ness is booming, with no shortage of groups vying to enter the trade. The Chinese diaspora plays a major role in distribution, with groups particularly active around New York City, Vancouver, Rotterdam, Le Havre, Valencia and Hamburg. The industry has also attracted a sprawling network of middlemen and smugglers, notably from the Middle East and Eastern Europe.

“In the last few years, pretty much every market has been targeted,” says Andrew Robinson, who directs the brand integrity division for Philip Morris International (PMI). In 2001, Chinese manufacturers were producing eight different varieties of counterfeit Marlboros. As of last year, though, PMI reports, Chinese counterfeiters were manufacturing separate versions of Marlboro tailored for some 60 countries—down to the specific detail of tax stamps and regional health warnings.

“Ten years ago, [there were] almost no counterfeit cigarettes,” says Austin Rowan, who heads cigarette fraud investigations for the EU’s Anti-Fraud Office, known as OLAF. Last September, though, the tide of fake smokes flooding the European Union—most of them Marlboros from China—prompted OLAF to post its first-ever officer to Beijing. In the United Kingdom alone, the illicit trade costs the government nearly \$5 billion a year. “People are hungry for these products,” says Rowan.



To dodge official scrutiny, counterfeiters tunnel deep within the mountains to hide their workshops, which helps camouflage the tobacco scent

Inhaling the knock-off cigarettes, however, may do even more damage than their legitimate counterparts. Lab tests show that Chinese counterfeits emit higher levels of dangerous chemicals than brand-name cigarettes: 80% more nicotine and 130% more carbon monoxide, and contain impurities that include insect eggs and human feces. And by targeting smokers with cheap cigarettes, health authorities fear the counterfeit influx diminishes incentives to quit. (Centers for Disease Control studies show that every 10 percent increase in cigarette prices causes a 4 percent drop in consumption.)

Back in the 1990s, counterfeit packs from China often came riddled with easy giveaways: misspelled health warnings, blurred lettering. These days, OLAF reports that sophisticated industry forensics are needed to identify China’s counterfeits. In the United Kingdom, where authorities in some areas report that up to one-third of all cigarettes sold are fake, mostly from China, customs officers have deployed a trained dog to try and sniff out counterfeits on the streets.

When it comes to the source of top-quality fakes like these, all roads lead back to Yunxiao. The area’s cigarettes are so renowned that Yunxiao has become a watchword among China’s counterfeiters, with manufacturers from other regions even claiming their cigarettes originate in the area—a kind of double-layer decoy.

Last December, China’s Ministry of Public Security announced the bust of one of the largest international schemes in years, a network of 27 suspects that reportedly smuggled at least 600 million fake cigarettes around the globe. While the cigarettes—mostly counterfeit Marlboros and 555s—were shipped as far as South Africa, Greece, Indonesia and the United Kingdom, they’d all been manufactured in southwest Fujian, deep in rugged mountains.

Fujian’s cigarettes also lay behind a massive U.S. smuggling network the FBI busted in 2005. Two sting operations code-named “Operation Royal Charm” and “Operation Smoking Dragon” netted a group of 62 ethnic Chinese who smuggled one billion cigarettes into the Los Angeles-Long Beach and Newark ports, using false descriptions such as “wicker furniture” and toys. The counterfeits, largely Marlboros and Newports, were in turn sold on the streets of Los Angeles, Chicago, and New York City.

“Any brand or quality, Yunxiao can help you make it,” says a former cigarette smuggler from Fujian. “You just need to name your price.”

A Flood of Fakes

It’s hard to overstate the ubiquity of tobacco in China, a country home to one of the world’s most elaborate and entrenched smoking cultures. Here, the introductory exchange of cigarettes is as ritualized as a handshake, while expensive packs moonlight as everything from wedding gifts to bribes—even offerings on ancestors’ tombs.

As an official from the tobacco company Rothmans once put it, “Thinking about Chinese smoking statistics is like trying to think about the limits of space.” Every year, China’s smokers consume one-third of the world’s tobacco: an overwhelming 2.2 trillion cigarettes. Cigarette-related mortality levels, too, are equally staggering, with fully one-third of all Chinese men under age 30 predicted to die from the pandemic.

Like anything else related to tobacco in China, the number of counterfeits flooding the domestic market is similarly off the charts. “Each of us has come up with our own strategy to deal with it by now,” says one Beijing smoker, who personally refuses to buy at locations where he doesn’t know the owner. The problem is so bad that on trains, conductors roam the aisles, industriously hawking 75 cent keychain lights that purportedly reveal fake packs.

After all, while the West is the most lucrative counterfeit market, for smugglers, it’s also the riskiest. Inside China, local ties and protectionism afford some degree of control: a friendly \$10,000 tribute, one customs official confides, has been the going rate to bribe a container out of the Xiamen ports in recent years. (And even without payment, inspection rates at China’s ports are a low one to two percent) Beyond China’s borders, though, containers are more vulnerable to detection by outside law enforcement, many of them newly vigilant against the fake trade.

“We’re seeing seizures all the time,” says PMI’s Robinson. In May, UK authorities seized over 20 million counterfeit Regals (valued at \$8.6 million) imported from China into Southampton. Likewise that month, Spanish authorities grabbed 20 million fake Marlboros—falsely described as mattresses—imported from the Chinese ports of Chiwan and Shekou. Also in May, French customs intercepted more than 15 million made-in-China fake Marlboros outside Paris, some bearing Vietnamese as well as Arabic and French health warnings.

Nevertheless, says OLAF’s Rowan, such seizures are just “the tip of the iceberg.” Smugglers frequently ship cigarettes through an array of destinations such as Dubai and Singapore to mask a container’s origin, with some spending up to three months at sea before delivery. And even if a container is seized, given exorbitant per-container profits, the loss is a slim deterrent. “With nine containers seized in ten,” Rowan says, “[smugglers] still would not be losing money.”

For counterfeiters, the rewards are especially prodigious. According to manufacturers, state-of-the-art cigarette machines (available online from sites like Alibaba.com) can fetch a pricey \$1.5 to \$3 million. “But everyone knows that the invest-



ment can be recouped in just a few months of manufacturing,” says a Yunxiao broker. Some factories boast up to 500 workers and over \$100 million in annual sales.

With so much profit at stake, this underground industry has cultivated a notably violent set of players. Past factory raids have yielded semi-automatic rifles and met with armed resistance, and every year, several state and private investigators are killed in their efforts to penetrate the trade. The average raid is carried out by hundreds of Chinese police. During one 2003 operation, says a consultant for the security company ZIC, fully 5,000 officers were deployed. (ZIC no longer takes on cigarette cases, the consultant says, because the risks have become too great.)

In the 1990s, Chinese counterfeiters relied heavily on Macao, Taiwan, and Hong Kong for technical expertise, as well as high-quality packaging. These days, though, China’s counterfeiters source the majority of their supplies from the mainland: tobacco from Yunnan province in the west, packaging from Dongguan and Shantou in nearby Guangdong province, and cast-off machines bought online from underground manufacturers or recently shuttered state facilities. (Over the past decade, China’s legal cigarette industry has been consolidated, with the number of factories shrinking from 185 to 31 since 2001.) Counterfeiters have not only acquired the technology to mimic holograms used to distinguish real packs, but also the rounded-corner packaging the tobacco industry has introduced in recent years.

And as manufacturing technology has improved, so, too, has the speed with which counterfeiters respond to shifting markets. This December, when Irish authorities seized a shipment of 20 million counterfeit cigarettes, they found the made-in-China packs bore exact replicas of Ireland’s latest tax stamps, which had been in circulation only a few months.



China’s counterfeit cigarette factories are often dingy, musty facilities built underground. Tests show their products contain floor sweepings, rat droppings, and even human feces.

With the advent of the Internet, counterfeiters have become more brazen as well. Many openly court clients through online storefronts, touting quality guarantees and their equipment’s international caliber. One Yunxiao operation, established in 1993, assures customers of its experience exporting to Asia and Africa, and says it maintains its own tobacco leaf fields in Laos. The company—which churns out some 80 million cigarettes a week—promises a six-day manufacturing turnaround, door-to-door delivery for certain overseas clients, and impeccable customer service.

The tone is reassuring and gently instructive. For tentative buyers, the owners guarantee that for the U.S. in particular, it’s a “profit business.” Reads their website: “We strive to build and maintain a total honesty management culture, and will appreciate the chance to do business with you.”

James Bond and Pig Pens

In China, as elsewhere, a successful business relies on more than just technology—it requires serious support from investors and brokers. Men, for example, like Tony Tung.

Originally a fishmonger from Fujian, for the past 15 years, Tung—square-jawed, middle-aged, with a thick coil of black hair—has ranked among China’s most notorious cigarette dealers. Tung, though, didn’t start out smuggling fakes. In the early 1990s, he found gold in the genuine product: Marlboros and 555s smuggled into China from abroad.

For years, the Chinese government has worked strenuously to keep foreign cigarette companies at bay, capping imports and levying tariffs as high as 430%. That, though, didn't deter companies like British American Tobacco from smuggling their products into China—or Chinese enterprisers like Tung, who made millions smuggling legally produced cigarettes in the Philippines into China.

But when China cracked down on the trade in the 1990s, Tung turned his sights to the next industry bonanza: counterfeiting. Tung built up factories in Fujian, as well as in the Philippines (closed by authorities in 2005) and the free-trade zone of Rajin, North Korea. In recent years, his enterprise has reportedly shipped up to 50 containers a month—or 500 million cigarettes—to markets throughout the United States, Europe and Asia. Tung continues to elude authorities, shuttling between Singapore and nearby countries, according to a tobacco industry source familiar with Asia. Recently, his syndicate has started using fishing boats to smuggle its product around Asia, the better to dodge inquisitive customs officials.

Tung and his fellow counterfeiters employ an impressive bag of tricks to avoid scrutiny. One manufacturer (arrested in 2001) constructed a factory that masqueraded as a People's Liberation Army compound, complete with 20 laborers—dressed in cast-off military uniforms—who would conduct faux-army drills and sing the national anthem in the yard every morning. Other machines have been lodged on ships, inside concrete bunkers, and even under a lake.

"Finding these guys is like a James Bond movie," says Keith Tsang, a committee member of the China Association of Industry Security Professionals. "You'd never believe it was for real."

In Yunxiao, factories are frequently hidden in dim, bricked-in facilities underground, accessible only via trapdoor and ladder. The turf masks the tobacco scent, while nearby sentries are used to monitor passersby. Workers staff production lines in teams of six or seven, feeding tobacco into large, heavy machines anchored in concrete foundations. Above ground, manufacturers use other ploys to hide the tell-tale aroma: double-paned glass and cotton quilts tacked to the walls, with pig pens sited nearby. In Yunxiao, investigators say, the easiest way to find a factory is often by searching for signs of industrial power sources.

Like many industries, China's counterfeit operations are distributed: tobacco cutting and drying at one site, cigarette rolling at another location, and packing still elsewhere. These days, the packing—usually managed outside port cities, just prior to shipment—is the only process that hasn't yet been mechanized. In major distribution centers like the city of Guangzhou, 300 miles west of Yunxiao, laborers still fill and seal the branded packs by hand. In one city corridor crammed with wholesalers, teenage girls from Fujian stroll arm-in-arm in the quiet pre-dawn darkness, awaiting their next shift.

Twenty-five years ago when multinational tobacco companies' smuggling activities took off, Chinese smokers flocked to foreign brands. Now, cigarette vendors say fake Marlboro and 555s are so common that many Chinese simply choose to avoid them altogether. As one former cigarette smuggler from Shenzhen explains, "Nobody can tell anymore whether they're real."

The Mountains Are High

Since its accession to the World Trade Organization, China's lackluster efforts to protect intellectual property rights have attracted sharp criticism. But with regard to tobacco, Beijing has waged a more aggressive war. All legal manufacture and distribution of cigarettes is state-owned, and in a nation of 400 million smokers, that's big business. (Local governments are zealous about defending it, too: until this May, officials in Hubei were required to smoke a collective 230,000 packs of regional brands a year.) With cigarette sales accounting for



From his humble origins as a Fujian fishmonger, Tony Tung has become a top dealer in contraband cigarettes, financing counterfeit factories in China, the Philippines and North Korea. *Credit: Next Magazine*

nearly 8 percent of China's budget in 2007, the state has a strong motive to keep its supply counterfeit-free.

Certainly the relevant authority, the State Tobacco Monopoly Administration, has spared no resources in trying. By 1995, long before multinational tobacco companies had seriously mobilized on the issue, the STMA had already dedicated \$12 million to combating counterfeiters. The agency today fields 50,000 agents to fight the fakes, according to industry sources. Meanwhile, this year, according to a police officer in the Yunxiao region, the STMA has dispatched some 150 officers directly to the region for up to year-long postings.

Last year, officials say, the STMA raided 3,312 production sites throughout China, apprehending 7,128 people in the process and seizing 8.3 billion counterfeit cigarettes. The STMA also regularly holds public "destruction ceremonies" to demolish seized cigarette equipment, hoisting the machines up into the air by crane before dashing them onto concrete below.

"China devotes a huge amount to enforcement," agrees Martin Dimitrov, a professor at Dartmouth College who has studied the issue. "The puzzle is that there seems to be little effect."

It's not that manufacturers don't feel the pressure. One manufacturer reports that local counterfeiters are losing up to \$300,000 a day in seized materials, and phone calls to a handful of different counterfeiters suggest a number are currently laying low, hesitant to expose themselves to new buyers.

But when it comes to Yunxiao's factories, an old Chinese idiom seems particularly fitting: *The mountains are high, and the emperor is far away*. Yunxiao villagers, too, quote their own motto: "Any official can absolutely be bought within half a month." In some cases, a gift of just \$1,500 can buy a counterfeiter a license to operate and some official breathing room. Last year, 28 officials were reportedly detained in connection with cigarette counterfeiting on charges such as dereliction of duty, cover-ups, or actually participating in the trade.

From another perspective, the counterfeit industry is also a boon for local employment, which some officials are loath to suppress. "The question for authorities now, with the economic slowdown, is: Do you really want to shut these places down?" says Tim Trainer, who heads the Global Intellectual Property Strategy Center in Washington, D.C.

For some, it seems, the answer is no. Last year, though China's Administration of Industry and Commerce completed 13 percent more intellectual property raids than in 2007, the number of such cases transferred for criminal prosecution dropped 40 percent. This January, the Guangdong prosecutor's office instructed prosecutors to "cautiously choose whether cases should be brought," and with less serious criminal cases, "postpone enforcement where appropriate." Likewise in December, the deputy minister of Shandong's public security bureau (recently arrested for corruption) pressed police to avoid "aggravating" businesses' production problems, for fear of "increas[ing] the likelihood of mass protests."

No matter Beijing's intentions, national priorities can only filter down so far. One police officer based just outside Yunxiao, who asks to remain anonymous, reports that his superiors deliberately downplay fighting those in the trade, and that an arrest is an anomaly. Most workers caught will "just pay some fines," and even if arrested, their bosses will bribe or bail them out. As for catching production bosses, he says, it's "impossible." They're too deeply insulated, he says, and too adept at hiding: some hold as many as 100 fake identity cards from China's 22 different provinces.

Even if caught, the maximum sentence a cigarette counterfeiter can expect is just seven years. Three years is the minimum and more common sentence, says the ZIC security consultant. To put someone in jail for even that long, authorities have to seize over \$36,800 in contracts or goods, a threshold counterfeiters try to duck by scattering storage and production efforts.

"It's impossible to root out this business," says the police officer. "Even though there are crackdowns, I don't see any long-term plan to eradicate the industry." While the STMA pays any police division up to 15 percent of the

retail price of any goods seized, those incentives, he explains, are useless in nabbing those involved. “When cars [with cigarettes] are stopped, the drivers run away, but the police don't care, because they'll get a reward anyway,” he says.

In the last five years, one multinational tobacco company has altered its tactics on the mainland, choosing to focus its efforts on seizing goods as they leave China, rather than on identifying production sites. “In an ideal world, we'd be able to go after them, but that became too hard,” says a tobacco industry official. There are simply too many—and besides, as he asks, “At the end of the day, are we really going to convince the provincial authorities in Fujian to crack down?”

The Shanghai Professor

Few in Yunxiao will talk openly about the village's main industry. One knowledgeable resident, a 30-year-old woman and sometimes cigarette broker, tried to explain why the trade flourishes so well in her community. The counterfeiting industry, she told visitors, is more than just a business, it's a brotherhood. Only those whose entire family tree can be traced to the area are permitted to work in production. Regional markets are divided by family, and once established, firmly respected—spurring others, in turn, to develop their own new markets. Unity is fierce, she says: that's why Yunxiao is so well-protected.

Surveillance is heavy in Yunxiao's narrow side streets and in its hotels, and outsiders are frequently tailed. Though authorities offer rewards of up to several thousand dollars for information, few residents dare to take them, she says. “Even if you get the money, you won't have any life left to enjoy it in afterwards.”

But when it comes to production, she adds, Yunxiao people are nothing less than business-minded “professionals.” She tells the story of one Shanghai chemistry professor, who manufacturers collectively enlisted five years ago to help them better mimic the popular Chinese cigarette brand Hongtashan. Counterfeiters paid him \$15,000, and have rewarded him with royalties ever since. Similarly, in years past, she says, local counterfeiters have invited retired workers from the state-owned Shanghai Cigarette Factory—home to some of China's top brands—to tour Yunxiao for a month, helping fine-tune local recipes.

As they battle with Beijing, Yunxiao's manufacturers show no signs of backing down. Some have stepped up investment in new factories outside the area, including the cities of Pinghe and Zhangpu. Others are shifting production outside of China altogether, as far away as Vietnam and Burma. Meanwhile, overseas law enforcement facing the counterfeit influx is baffled by the trade: tracing a seized container to its producers, industry officials say, is “almost impossible,” given that the majority of company names used on accompanying records are also fake.

Yunxiao might someday change, but such a transition would take many years, says the broker. One manufacturer she knows invested \$2.5 million to start another legitimate business elsewhere, but recently quit and returned—disappointed, she reports, because “the profits could never match counterfeit.”

Still, though, she hopes the industry will make a shift: “We locals hope we can work together to build up a real factory someday.”



Cigarette stalls like these are ubiquitous within China, where one third of the world's smokers consume 2.2 trillion cigarettes a year. Credit: Te-Ping Chen

Smuggling Made Easy

Landlocked Paraguay Emerges as a World Leader in Contraband Tobacco

By Marina Walker Guevara, Mabel Rehnfeldt, and Marcelo Soares

Guaíra sits on the edge of the sluggish, muddy, mile-wide Paraná River that cuts a natural border between Brazil and Paraguay. Here the soil is red, the terrain is flat with ample soybean and mate leaf plantations. On its face, Guaíra is a well-kept Western Brazilian city of 30,000. Men chatter among themselves sitting in small plazas and barber shops. The streets downtown are clean, the houses are freshly painted and pay phones are decorated with natural motifs — you can call from the gut of a fish or the chest of a parrot.

Beneath this surface, however, the city shows a more disturbing element. Last September, Guaíra made headlines across Brazil when 15 people were murdered at a makeshift riverside warehouse. The killings were the result of a vendetta among drug smugglers and, officials here say, they weren't all that unusual. Just 150 miles north from the notorious Tri-Border Area, where Brazil, Paraguay and Argentina meet, Guaíra is today a major weapons and drugs corridor in the region. But no product, police say, is more widely smuggled through this city, and more profitable to smugglers, than Paraguayan cigarettes.

Dozens of motor boats crammed with tobacco cross the Paraná River daily from the neighboring Paraguayan city of Salto del Guairá. The smugglers feed an illicit trade that injects billions of cigarettes into Sao Paulo, Rio de Janeiro, and other large Brazilian cities, where the cheap, untaxed Paraguayan sticks account for 20 percent of the entire cigarette market. Guaíra sits at the heart of this trade, a strategic gateway and a place where many residents — up to half its population, locals say — rely directly or indirectly on smuggling for their livelihood. A few reap millions from the illicit trade. Guaíra's most famous criminal son, Roque Fabiano Silveira, made a fortune and a name, trafficking Paraguayan cigarettes thousands of miles away.

Silveira, 44, nicknamed Zero Um ("The Kingpin"), is a larger-than-life border boss who fled to Paraguay after being charged in Guaíra with orchestrating the 1996 murder of a businessman. In Paraguay his cigarette business took off, and in 1999 he opened a sizable cigarette factory on the outskirts of the country's capital, Asunción, which soon became the operational base for a smuggling network that spanned two continents and reached deep into the United States. Starting in 2003, Silveira cut deals with tobacco traders in Arizona and smoke shop owners in Indian reservations in Washington state to smuggle millions of Paraguayan-made contraband cigarettes through the ports of Miami, Norfolk, and Baltimore. The sticks were then distributed across the country and the profits were laundered to bank accounts in Paraguay and the United States. Silveira not only manufactured the cigarettes, U.S. prosecutors said, but also greased political and law enforcement hands in South America that guaranteed swift passage north for the cargoes. His former associates describe him as smart and cold, with an eye for fine suits.



The sluggish, muddy Paraná River is widely used by smugglers to move contraband cigarettes from Paraguay to Brazil. *Credit: Marina Walker Guevara*

The tale of Roque Silveira is emblematic of the criminal nature and global reach of the teeming Paraguayan cigarette industry, one that experts and law enforcement officials say is, largely, set up for and devoted to transnational smuggling. Fifteen years ago cigarette manufacturing was minimal in Paraguay, one of South America's poorest countries and a place notorious for corruption and trading in counterfeit goods. Today Paraguay, a landlocked, California-sized country, ranks among the world's top producers of contraband cigarettes, responsible for 10 percent of the world's contraband tobacco, experts estimate.

Paraguay's factories churned out 68 billion cigarettes in 2006, more than 20 times what the country consumes, according to a study by the Centro de Investigación de la Epidemia de Tabaquismo (CIET), a Uruguay-based NGO that tracks the economics of the region's tobacco market. The vast majority of the cigarettes — up to 90 percent of production, worth an estimated \$1 billion — disappear in the black market, law enforcement officials say. The cigarettes are flooding Brazil and Argentina, where taxes are much higher than in Paraguay, and have turned up as far away as Ireland.

Fidel, Hamlet, and Opus Dei

Once dominated by multinational tobacco companies, the global illicit cigarette trade today involves an array of crime syndicates which, much like the Silveira network, rob governments of billions of dollars in much-needed tax money, fuel organized crime, and help spread addiction by placing cheap cigarettes in the world's black markets. The steep growth of Paraguay's cigarette industry alarms law enforcement agencies and health officials alike, who fear that the South American nation could become be the next nightmare in global cigarette trafficking. Industry sources say manufacturing cigarettes in Paraguay today is cheaper than in China — the top producer of contraband smokes — while the quality of the product is far superior.



Roque Fabiano Silveira pleaded guilty in 2005 to smuggling Paraguayan cigarettes into the United States.
Credit: ABC Color

"There is a real danger that this situation could escalate very rapidly," says Austin Rowan, head of the anti-tobacco smuggling operations at the European Union's Anti-Fraud Office (OLAF). What's distinctive about Paraguay, investigators say, is the massive number of obscure, cheap brands its factories produce — more than 2,600 brands have been registered with the Ministry of Industry and Commerce, including the likes of "Dirty," "Fidel," "Hamlet," and "Opus Dei" — which makes it harder for investigators to track the trade. In contrast, only a handful of local brands are sold in the domestic market, where smokers pay some of the lowest cigarette taxes in the world.

Multinational tobacco firms are alarmed at the size and speed at which the Paraguayans have built up an off-the-books industry. Investigators for Big Tobacco say Paraguayan cigarettes are shipped to known Caribbean smuggling hubs like Aruba and Panama, where they believe the shipments enter the black market. In 2006 Irish customs seized a container loaded with five million Paraguayan cigarettes concealed in bales of plywood. While making inquiries about the case among his EU peers, David Godwin of Irish Customs says he was told: 'If you think you have problems with China, the Middle East, and the rest, brace yourself because you haven't seen anything. ... The capacity is just endless in South America.'

Tobacco factories in Paraguay range from sprawling, state-of-the-art manufacturing plants that boast cutting-edge technology to miniature "mobile" factories — also called submarines — which are assembled inside of trucks. Paraguayan government officials say that if all cigarette-making machines in Paraguay were to work at maximum output, the country could produce up to 100 billion sticks annually — enough to supply about two-thirds of the

Brazilian market.

Smuggling is made easy in Paraguay, officials confide. There is virtually no industry regulation, and illegal manufacturers and traffickers are often insulated from prosecution by those in power. Bankers, politicians, and soccer club barons are themselves involved in the business and make hefty campaign contributions. Although the administration of President Fernando Lugo — a former Catholic bishop who in 2008 unseated the powerful Colorado Party after more than 60 years in power — has pledged to change the country's reputation as a smuggling haven, there already have been some mishaps. In February, the president named a convicted cigarette smuggler as his Air Force intelligence chief. Lugo later backed off amidst intense criticism.

A Smuggler's Paradise

Cigarettes are just another commodity peddled through Paraguay's decades-old underground economy, which flourished during the 35-year dictatorship of Alfredo Stroessner. Before he was forced from power in 1989 in a military coup, Stroessner made the country a sanctuary for Nazi war criminals, deposed dictators, and smugglers.

The Tri-Border Area of Paraguay, Brazil, and Argentina is the epicenter of this contraband culture. A corridor for drugs, weapons, stolen cars, and any imaginable knock-off — from CDs to Viagra — this region of thick, green rainforests and spectacular waterfalls has also become the backdrop for the booming trade in smuggled and counterfeit cigarettes made in Paraguay.

"The only thing that flourishes here is illegality," says Humberto Rosetti, a prosecutor in Ciudad del Este, the commercial center of the Tri-Border Area, often regarded as one of the most lawless places on earth. The city's downtown is a bustling labyrinth of narrow streets cluttered with thousands of street stands, money exchange houses and shops, where anything from exotic pets to AK-47s can be obtained with almost equal ease. Late-model Mercedes and BMWs sporting polarized windows rush by and scores of motor scooters, some of them transporting entire families, weave through the ubiquitous traffic jams. In the Calle de los Cigarrilleros, as locals have christened one of the city streets, boxes of Eight, Te, Rodeo, Calvert — the smugglers' favorite brands — are stacked high along the sidewalk. "Our hands are pretty much tied," says Rosetti, who has directed several cigarette seizures in recent months, only to see judges and customs officials promptly return the loads to smugglers.

U.S. officials regard Paraguay as a principal money laundering center for the proceeds of drugs, arms, and cigarette trafficking in South America — and Ciudad del Este sits at the core of that trade. Cigarette factories are often linked to money exchange houses where profits of the contraband are laundered, according to former factory managers and court records. So impenetrable is Ciudad del Este's financial system that American undercover agents who infiltrated Roque Silveira's U.S. smuggling ring were unable to find the money they helped the group launder. "We tried to track the proceeds," says Assistant U.S. Attorney James Warwick. "Did we succeed? No."

Several Paraguayan cigarette firms have conveniently built factories in Ciudad del Este and nearby Hernandarias. From there, cigarettes for years were smuggled to Brazil in vans, trucks, and buses through the shabby Friendship Bridge that connects Ciudad del Este with its Brazilian counterpart, the city



This Brazilian Customs machine pulverizes about 500,000 seized cigarette packs a day. *Credit: Marina Walker Guevara*

of Foz do Iguaçu. Brazilians stepped up controls at the border in 2005, so smugglers switched from the road to the water. Starting at dusk, motor boats leave through any of the more than 300 makeshift piers fashioned along the nearby Lake Itaipú, formed by the dam of one of the world's largest hydrological power plants, built on the Paraná River. To reach some of these illicit piers, one must navigate a maze of tortuous and narrow red-dirt paths through dense underbrush. One afternoon in March, ICIJ reporters visiting the seemingly deserted Codorso Pier came across a government worker smoothing out the smugglers' trail with the help of his tractor. Reporters were told the smugglers were taking the day off to mourn one of their own, a former policeman, who had died in a car accident the day before.

"We close one pier, and two more pop up overnight," says Gilberto Tragancin, chief of Brazil customs service in Foz do Iguaçu. With a shoreline of nearly 1,000 miles, Lake Itaipú is almost impossible to patrol in its entirety, Tragancin explains. A few yards outside of Tragancin's office, a 'cigarette trashing' machine was in motion. The loud contraption pulverizes about 500,000 seized cigarette packs every day — the remains of which are used in fertilizers and to build roads. The flow of Paraguayan contraband cigarettes to Brazil is 20-30 billion sticks annually, experts estimate. In contrast, says Tragancin, legal exports of cigarettes to Brazil are zero.

Besides the public health threat it poses, cigarette smuggling is also bolstering violent organized crime groups that operate complex networks along the border with Brazil. Tragancin says these groups are now using the cigarette smuggling channels to supply weapons and munitions to some of Brazil's most dangerous syndicates, including the First Command of the Capital (PCC), the leading criminal gang in Sao Paulo prisons.

The Trade Goes Global

International smugglers quickly spotted an opportunity in the booming Paraguayan illicit tobacco trade. Washington state-based cigarette wholesaler Stormmy Paul, a Tulalip Indian, flew to Paraguay in 2003 to cut a deal. He had been buying Chinese cigarettes, including counterfeit Marlboros, and re-selling them tax-free to smoke shops in his state, but he wanted a better combination of price and quality. A business partner from Brazil offered to make some introductions south of the border.



In Paraguay, Paul visited a handful of cigarette factories. One facility stood out: the heavily guarded Tabacalera Central in the outskirts of Asunción. The visitors were greeted by owner Roque Silveira and feted with a lavish barbecue. By the time dinner was completed an agreement had been sealed. Paul would pay \$2 for each carton of cigarettes manufactured at Silveira's facility and an additional \$2 per carton to a middleman in Maryland who altered customs forms to avoid controls, and taxes, at U.S. ports. The deal still left Paul a \$2 per-carton profit.

"I loved it down there," said Paul, an enterprising, voluble fellow who leads a weekly ritual at a sweat lodge on the

Tulalip reservation, north of Seattle. He found Silveira impressive. “He is a really sharp business guy,” said Paul of Silveira. “There is a certain class about him — Roque looks successful.”

Starting in late 2003, the ring of 11 people, most of them American tobacco traders, smuggled into the United States more than 120 million Paraguayan cigarettes, for distribution from California to North Carolina, according to court records. The ring was brought down in spring 2005 as the smugglers convened in Las Vegas. Silveira, Paul, and the others were indicted on a total of 50 counts of conspiracy, smuggling, trafficking, and money laundering. U.S. officials jailed Silveira for two months after his arrest at the Miami airport, but the Brazilian pledged to cooperate with authorities and was handed a probationary sentence. Silveira paid a fine and, to the amazement of Paraguayans, was let go.

River of the Dead

Around the same time the Americans gave Silveira a slap on the wrist, Brazilian prosecutors indicted him in one of the largest-ever cigarette smuggling investigations in that country. Codenamed Operation Fireball, the sting rounded up more than 90 people in 11 Brazilian states. In the indictment for the case, Silveira was fingered as a major supplier of contraband cigarettes who allegedly controlled three different networks that delivered the sticks to the populous Rio Grande do Sul state. Silveira managed to evade the law simply by staying in Paraguay, where, Brazilian prosecutors alleged, he has “a vast network of contacts and the financial capability to live underground.”

Silveira had become the top dog in the traffic of cigarettes from Paraguay to Brazil following the 2003 arrest and subsequent conviction of legendary cigarette smuggler Roberto Eleuterio “Lobão” Da Silva, a Brazilian who wore plenty of bling and looked like Mr. T, Brazilian police say. From that point on, in smuggling parlance, Silveira “owned” the routes that led to millions of smokers in Brazil’s largest cities.



Tulalip Indian Stormmy Paul sold contraband Paraguayan cigarettes to smoke shops in Washington state.
Credit: Darren Breen/ The Herald

Two weeks after Operation Fireball, a Brazilian customs agent was murdered in a bleak, sparsely populated region of the border called Rio do Morte — River of the Dead. An anonymous caller tipped local police to a burned-out SUV on the road. So charred was the corpse in the passenger’s seat that police couldn’t readily identify the victim, who had been burned alive. Forensic experts eventually said the dead man was Carlos Renato Zamo, a resident of Mundo Novo, a city just north of Guaíra. He was one of thousands of customs agents working Brazil’s porous borders. Throughout the years, however, Zamo reportedly had grown far richer than most on a typical border agent’s salary. He accumulated real state investments in Sao Paulo and Mato Grosso do Sul. He even owned a plane.

Brazilian police discovered that Zamo had worked for Silveira and other cigarette smugglers, who allegedly paid the agent \$8,000 a month to assure their cigarette cargoes passed uninspected through border checkpoints. But Zamo had begun to fear discovery and finally backed out of the ring, police said. In a meeting, the smugglers allegedly offered to raise his payment, but he refused and tipped off customs about the group’s shipments, according to Brazilian police.

Four men were eventually arrested in connection to Zamo’s murder, but not Silveira, who was wanted by Brazilian authorities but remained at large in Paraguay. The day Brazilian police officials announced the arrests, they addressed Silveira directly, calling him “the big head” of cigarette smuggling in the region. “Everything happens under his orders,” they said.

Through his attorney in Asunción, Silveira declined to comment for this article.

579 Smokes a Second

Paraguayan cigarette manufacturers like to point out that they are just filling a void created by large multinational tobacco companies. In the 1990s, British American Tobacco and Philip Morris ran independent schemes in which their subsidiaries in Brazil and Argentina legally exported billions of cigarettes to Paraguay. The sticks were then smuggled back to these two higher-tax countries and sold on the black market. The practice ended in 1999 when the Brazilian government raised the cigarette export taxes dramatically to discourage the illegal trade. Following the tax increase, dozens of cigarette factories opened in Paraguay, many of them owned fully or in part by Brazilians. Within three years, Paraguay was home to more than 30 cigarette manufacturing plants, some of which counterfeited well-known international brands.

The local counterfeiting business has dropped markedly in recent years as cigarette makers realized that there was a market — in Brazil and around the world — for the cheap Paraguayan brands. The practice also carries less risk of being pursued by Big Tobacco companies for trademark violation. Today the number of manufacturing facilities has more than halved, but not so production.

Tabacalera del Este (Tabesa) is Paraguay's top cigarette factory, a modern, sprawling 183,000 square-foot facility that can pump out up to 1.5 billion cigarettes a month — or 579 cigarettes per second. The factory, located a short drive north from Ciudad del Este in the city of Hernandarias, supplies almost half of the Paraguayan market with its two flagship brands, Kentucky and Palermo. But at the same time as it serves a legitimate market, the company allegedly supplies large quantities of cigarettes that end up smuggled to Brazil and Argentina. Customs officials in those two countries told ICIJ they seize more contraband cigarettes from Tabesa than any other Paraguayan company. In 2006, Tabesa was mentioned in Operation Fireball as one of the factories whose cigarettes were allegedly smuggled to Brazil.

Paraguayan businessman Horacio Manuel Cartes is widely reported to be the owner of Tabesa, and is listed as a top shareholder and director by Informconf, a Paraguay business database. Cartes started as a cigarette distributor two decades ago. Since then he has built an empire that includes a bank, a soccer club, and several agricultural ventures — some of these formally owned by family members and business associates.

Tabesa's CEO José Ortiz talked to ICIJ reporters about the company's business.



Tabacalera del Este, Paraguay's largest cigarette factory features state-of-the-art machinery imported from Germany. Credit: Marina Walker Guevara

"We don't know where our cigarettes are consumed, and it's not our problem," said Ortiz when asked about the presence of Tabesa's cigarettes in Brazil and Argentina, two markets to which the company does not legally export. "We sell our products in Paraguay and pay all local taxes," he added, sitting in his office at Tabesa's manufacturing plant, which features high-end German cigarette machinery. What happens once the cigarettes leave the factory is not Tabesa's responsibility, said Ortiz, a view shared by other cigarette makers in Paraguay. "My job is to supply the market."

Ortiz said that Tabesa does not sell directly to vendors but rather to four or five wholesale distributors. He named two wholesale firms, one of which, Tabacos del Paraguay, is affiliated with Tabesa. "The rest, I don't re-

member,” he said, reclining on his large black leather office chair and switching the focus to multinational tobacco companies: “They are the parents and the grandparents of the creature,” said Ortiz of BAT and Philip Morris’ smuggling in the 1990s. “We are replacing that market they abandoned.”

Last year, the company broke into the U.S. market with its Palermo brand and is now certified to sell in at least eight states, including Maryland and California. Palermo is also available online through websites selling cigarettes from Indian reservations in New York, but Ortiz denied that Tabasa is selling to Native Americans directly. U.S. officials have identified New York reservations as major hubs for cigarette smuggling.

Guaíra: No Man’s Land

Brazilian prosecutors and police place the Paraguayan factories at the top of the “criminal enterprise,” which they say runs high-volume cigarette smuggling in the region. Érico Saconato, head of the Brazilian federal police in Guaíra, said that the factories work hand in hand with “managers” on both sides of the border who acquire trucks and boats, bribe public servants, and hire scores of youths, fishermen, and farmers to transport the cigarette loads. In one of the cases involving Silveira, prosecutors said in court documents that the ring acquired large quantities of contraband cigarettes “directly from the Paraguayan factories” for distribution in Rio Grande do Sul and border cities of Argentina.

“All the smugglers, big-time traffickers, in this region are businessmen and politicians, who have good lawyers, fancy cars, family,” says Saconato. “Some even are leaders of evangelical churches.”

Roque Silveira’s hometown of Guaíra gained prominence in the cigarette trade when controls tightened in the Tri-Border Area, starting in 2005. Today large portions of the population there, Guaíra officials say, rely on smuggling for their livelihood, whether it’s renting space in their homes for the smugglers to store their loads, working as lookouts, or passing cigarettes across the Paraná River. The “paseros,” or crossers, make about \$300 a week, one and a half times the minimum monthly wage in Brazil.

Police in Guaíra say they feel overwhelmed. Saconato says 700 people were arrested in 2007 in connection with smuggling, yet only two men were convicted. When the district attorney shut down a riverside bar, Tininha’s, which allegedly was widely used by smugglers to plan their business, a federal prosecutor reversed the order and sued the city. That night smugglers celebrated by launching fireworks on the riverside, officials say.

“Guaíra is practically abandoned,” says Saconato, who anticipates record cigarette seizures this year due to the global financial crisis and a recent rise in cigarette taxes in Brazil. In the kiosks of Sao Paulo or Rio de Janeiro, the cheapest Brazilian cigarette pack (valued at roughly \$1.50) costs three times as much as the contraband Paraguayan brands.

”A Big Duty Free Store”

No policeman in Guaíra has seen Silveira in recent years, Saconato says. He has become a mythical character of sorts, with town residents claiming from time to time to have spotted him. His 1996 murder case is still meandering through Guaíra’s courts. After Operation Fireball, Silveira became a ghost, Bra-



zilian police say, but no one believes he has retired from the cigarette trade. Some of Silveira's former associates now manage large portions of the smuggling on both sides of the border, according to Brazilian police.

The latest traces of Silveira in Paraguay's courts are from July 2007, when he beat the legal system again. On that occasion, Paraguay's Supreme Court denied an extradition request by Brazilian prosecutors who accused him of conspiracy, cigarette smuggling and money laundering.

Just the mention of Silveira's name in Paraguay's tobacco circles raises eyebrows and causes interviewees to clear their throats repeatedly before offering a noncommittal "His name sounds familiar," or "Didn't he own a cigarette factory around here?"



Paraguayan manufacturer Sidronio Talavera says he doesn't care if his cigarettes end up being sold on the black market. "I care that I sell," he says.

Credit: Marina Walker Guevara

One man in Salto del Guairá, a Paraguayan city located just across the river from Guairá, is not hesitant to talk about Silveira. Sidronio Talavera, a professional harpist who once played with one of Paraguay's most famous bolero bands, sits in a small office from where he manages his cigarette factory, Cosmopolita S.A. The facility is rather old and the cigarette-making machines are housed in a warehouse across a dirt yard from Talavera's office. A truck was picking up cigarettes at the factory the afternoon ICIJ reporters visited in March. Talavera says he not only knows Silveira, he is also his business associate. "He is one of the nicest people I have ever met," beams Talavera, who was convicted last year of tax evasion. Paraguayan prosecutors accused Talavera of reporting fake cigarette exports to Brazil in order to avoid paying taxes on imported cigarette manufacturing supplies. He has also been fingered by Paraguayan officials as a counterfeiter, a charge he denies.

Talavera says he sells to anybody who knocks on his factory's door, and he's well aware that some of the buyers are smugglers or work with smugglers. "Good for them if they send the cigarettes to Brazil," he says slapping his hands down on his desk. "If I have too many requirements, I will starve." Talavera boasts that his Latino cigarettes have found a market as far away as Dubai. He says that wholesalers based in Panama buy from him and then ship the cigarettes overseas. "I don't know if from Panama they are smuggled elsewhere or re-sold legally, and I don't care. I care that I sell."

As for Silveira, Talavera says he is still the trade's big intermediary, the middleman who acquires large quantities of cigarettes from the Paraguayan factories and arranges the deliveries in Brazil. "He works with everybody!" he says when told that other cigarette makers seem oblivious these days to Silveira's whereabouts. "He is smart, the Mafioso. He fooled the Americans," says Talavera.

As things stand, the Paraguayan government, which says it's determined to bring the cigarette industry under compliance, has its work cut out for it. Ortiz, Tabesa's CEO, put it simply. "Paraguay is like a big duty free store," he said. "And it's a great deal."

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When Cracking Down Seems Impossible Paraguay's Corruption Fuels a Criminal Economy

By Marina Walker Guevara and Mabel Rehnfeldt

Paraguay's Customs chief, Carlos Rios, knew he would get a lot of heat from the tobacco industry, but he decided to move forward with the raid regardless. After all, he was part of a new administration that had pledged to end the country's deeply rooted smuggling culture. So on February 6, 2009, Rios coordinated the largest cigarette bust in Paraguay's history: 46 million "sticks," stored in a shabby, illegal warehouse located one block away from the border with Brazil, in the desolate area of Pindoty Porã. As officers burst onto the scene, seven cigarette-laden trucks idled, preparing to cross into Brazil. Police opened fire as one driver revved his engine and sped across the border.

It was an enforcement operation that wouldn't raise eyebrows in most countries. But the raid proved an exceptional event in Paraguay, a country that for decades has been branded *paraíso de contrabandistas* — a smugglers' paradise. Cigarette seizures rarely occur in Paraguay, where tobacco factories are owned by some of the country's richest and most influential. The country produces far more than the 3 billion cigarettes its residents consume; 68 billion cigarettes were manufactured in 2006, the bulk of which ended up smuggled to neighboring countries and beyond, according to law enforcement officials. After the Pindoty Porã seizure, even President Fernando Lugo — a former Catholic bishop who in 2008 was elected on a reform platform — congratulated the customs agents who took part in it.

The celebrations did not last long. As the press coverage faded, Rios quietly replaced the core of the anti-contraband unit that had conducted the cigarette raid, a section of Paraguayan customs that receives financial assistance from the U.S. government. He scrambled to explain that the agents had not effectively stopped the influx of contraband seeping into Paraguay from neighboring countries. Meanwhile, a vociferous chorus of prominent cigarette manufacturers — whose smokes were caught in the seizure — worked behind the scenes, enlisting influential politicians to lobby for their products' return. In May, after a local wholesaler paid a bond of almost \$300,000, customs returned all 46 million seized cigarettes.



Paraguayan Customs conducted that country's largest ever cigarette raid in February 2009: 46 million smokes were seized at an illegal warehouse, located one block from the Brazilian border. *Credit: Dirección Nacional de Aduanas (Paraguayan Customs)*

An Unaccountable Industry

The raid had reaffirmed a precedent for an industry accustomed to minimal accountability. "The seizure was a media show," said José Ortiz, CEO of Tabacalera del Este (Tabesa), the top cigarette factory in Paraguay. Tabesa is reportedly owned by Horacio Manuel Cartes, a high-powered businessman whose holdings include a soccer club. The company's cigarettes are routinely seized from smugglers in Argentina and Brazil, according to customs officials in those countries. But the cigarettes in Pindoty Porã were legal, Ortiz said, as long as local cigarette taxes had been paid and the sticks were on the Paraguayan side of the border.

The investigation remains open and customs

may ultimately fine the wholesaler for attempted smuggling. But the case illustrates the virtually impossible task of cracking down on crime and contraband in a country where law often takes a back seat to power and cash. Paraguay ranked near the bottom — 138th among 180 countries — of Transparency International’s 2007 Corruption Perception Index.

The tobacco industry in Paraguay is virtually unregulated. Government agencies involved in its oversight cannot even seem to agree on the number of factories operating in the country. The minister of taxation, Gerónimo Bellasai, told ICIJ that tax evasion by tobacco factories is “very high,” but in March his team was still trying to figure out how to track company sales. A basic step to improve traceability, officials say, is to update the country’s arcane cigarette tax stamp system. Currently tax stamps — square pieces of white paper that are easily photocopied — are affixed on master cases of 10,000 cigarettes rather than on individual packs. But even this can be hard to accomplish. “When there’s a lot of money on the other side, the tax authority always loses,” Bellasai said.



José Ortiz, CEO of top Paraguayan tobacco manufacturer Tabesa. “We don’t know where our cigarettes are consumed, and it’s not our problem,” he says. *Credit: Marina Walker Guevara*

Back in customs headquarters overlooking the Paraguay River, Rios, the customs chief, spoke of his daily “titanic fight” for resources to run his agency. Paraguay operates only 10 check-points along more than 800 miles of border with Brazil, he said. And for customs agents who earn as little as \$300 a month the temptation to accept bribes is overwhelming. “We are defenseless,” he said. Rios has been criticized by the media, however, for not using the resources he does have, including a fleet of speedboats donated last year by the United States, some of them reportedly kept for months at the manufacturer’s plant while smuggling soared.

In a country where the cigarette industry carries such clout, those who actively pursue smugglers can find themselves out of a job. Prosecutor Eber Ovelar was suspended in March from his post, and he said he had no doubt the move was politically motivated, linked to his anti-contraband work. During his tenure, sentences for counterfeiting and contraband in Ciudad del Este — a commercial city at the heart of the notorious Tri-Border Area of Paraguay, Argentina and Brazil — increased six fold, Ovelar said. More often than not, the prosecutor said, customs officials refused to classify smuggling cases as a crime, opting instead for the lesser category of infrac-

tion. To Ovelar’s dismay, local judges often sided with customs when he attempted to prosecute smugglers. “Today cigarette [makers] in Ciudad del Este have become the pressure and money group,” said the prosecutor. In contrast, he added, traffickers of narcotics have never personally applied pressure to him.

No Lone Rangers

Former prosecutor Eduardo Petta got a taste of the politics behind cigarette smuggling back in 2005, while pursuing contraband cases in the southern city of Encarnación. One morning he saw suspects in a small plane preparing to take off from a municipal runway. Acting without police backup Petta drove his car across the airstrip and blocked the airplane’s way. Inside the plane, Petta reportedly found 8 million contraband cigarettes. Lacking equipment to search for drugs in the aircraft, he requested assistance from Argentine border agents,



The chief of the Brazilian federal police in Guaíra, Érico Saconato, says there is little political will in his country to fight smuggling. *Credit: Marina Walker Guevara*

who provided a drug-sniffing dog. Shortly after the seizure, Petta was accused by his superiors of having violated Paraguay's sovereignty by seeking help from the Argentine officials, and he was removed from his post by a judicial review board. He later told reporters that he had no doubt the tobacco industry had urged his dismissal. "You can't play lone ranger," Petta told the Argentine newspaper *La Nueva Provincia*.

Brazilian and Argentine customs and police officials say they are frustrated by Paraguay's lack of commitment to stop cigarette smuggling. But they also acknowledge faults in their own governments' enforcement. Trucks loaded with Paraguayan cigarettes are supposed to pass through several Brazilian check-points along their more than 600-mile journey to Sao Paulo and other large cities. "There's no [political] will to combat this sort of crime," said Érico ato, the head of the Brazilian federal police in the border city of Guaíra, which in recent years has become a major corridor for the smuggling of cigarettes from Paraguay. "We know smuggling is one of the sources for campaign financing in Brazil. So, there's not much interest in messing with it," added Saconato.



Smugglers use illicit piers like this one, along the Paraná River, to load contraband cigarettes onto motor boats. Credit: Marina Walker Guevara

Meanwhile, Paraguayan cigarette manufacturers are earning stunning profits while denying any involvement in smuggling or counterfeiting (Brazilian law enforcement officials, however, link the Paraguayan factories directly to the illicit trade). Those who pursue civil charges against factory owners face endless judicial battles. British American Tobacco has repeatedly sued a tobacco company owned by former presidential candidate Osvaldo Domínguez Dibb for counterfeiting several of its brands. Some lawsuits have slogged through courtrooms for as long as 11 years.

Tabesa's CEO Ortiz was blunt when asked about Paraguay's quid pro quo: "We give them money," he said of politicians during election time. "And all we ask is to be left alone."

Ukraine's "Lost" Cigarettes Flood Europe

Big Tobacco's Overproduction Fuels \$2 Billion Black Market

By Vlad Lavrov

The hang glider pilot insisted it was a routine flight, and that strong winds had blown him over the border from Hungary into Ukraine. But the man arrested by Ukrainian authorities last July, with his flight suit and night-vision gear, looked suspiciously like other hang-gliding smugglers along the border – smugglers who take off from Ukraine, fly into Hungary, and each drop as much as 100 cartons of contraband cigarettes.

Ukraine is home to some of the world's cheapest cigarettes – at \$1.05 per pack – making the country a bonanza for smugglers, whether by glider or more mundane pathways on the ground. Cars and trucks filled with Ukrainian-made Marlboros and Viceroy's get waved through border checkpoints by customs guards who seem more than eager to accommodate, for a price. Loads also move by bus and train, bound for other European countries where high taxes raise a pack's cost to as much as \$5 (Germany) or \$10 (United Kingdom).

The backbone of this underground commerce – the acquisition of the cigarettes themselves – is by far the easiest part of the entire operation. The world's four leading multinational tobacco companies, Philip Morris International, Japan Tobacco International (JTI), Imperial Tobacco, and British American Tobacco (BAT), have produced billions of excess cigarettes in Ukraine, fueling a teeming black market that reaches across the European Union. Today, Ukraine is rivaled only by Russia as the top source of non-counterfeit brand cigarettes smuggled to Europe, EU officials say.

The booming trade in tobacco smuggling has major consequences, industry experts say. The growing traffic pushes huge supplies of cheap, untaxed, and unregulated cigarettes into the rest of Europe, undercutting otherwise successful attempts to curtail smoking. Worse, officials say, the trade is boosting organized crime gangs, who find the soft penalties and big profits hard to resist.

The numbers tell the story. Each year, Ukraine's cigarette consumption and legal exports top 100 billion sticks, according to Ukraine's Ministry of Health. Yet in 2008, tobacco companies manufactured and imported nearly 130 billion cigarettes – 30 percent in excess of what the local market can consume. These "extra" cigarettes disappear in the market, feeding an illicit trade that is worth, conservatively, \$2.1 billion annually. Ukrainian cigarette production, meanwhile, has steadily risen since 2003, according to an analysis by ICIJ of data compiled by SOVAT, a tobacco and alcohol industry association, and Ukraine government statistics. In fact, cigarette production in Ukraine increased one-third between 2003 and 2008 – from 96.8 to 129.8 billion – with JTI and Philip Morris leading that trend.

Smuggled Smokes: Ukraine's 30 Billion "Missing" Cigarettes

Led by Philip Morris International, Big Tobacco in 2008 produced 130 billion cigarettes in Ukraine. Officials estimate nearly a quarter of those were smuggled abroad, fueling black markets across Europe.



30 Billion Smuggled

10 Billion
Legally Exported

90 Billion Consumed

Sources: State Statistics Committee of Ukraine; Customs Service of Ukraine; SOVAT, a tobacco and alcohol industry association in Ukraine; World Health Organization

What happens to those 30 billion “lost cigarettes”? The huge surplus has reached such proportions that it has become a parallel industry, experts say, with all sides benefiting from it, from manufacturers to organized crime gangs who control the black market. In addition, hundreds of thousands of Ukrainians, Romanians, Hungarians, and Poles along the border rely on the trafficking of cigarettes for their livelihood, buying the cheap smokes in Ukraine and unloading them tax-free in European countries where prices are far higher.

Distribution of smuggled “discount cigarettes” with Ukrainian excise stamps is also flourishing on the Internet through numerous Moldova-based online stores, which deliver them to customers worldwide.

“Tobacco companies are benefitting from selling to smugglers,” says Kostyantyn Krasovsky, head of the tobacco control unit of the Institute of Strategic Research at Ukraine’s Ministry of Health. “They sell it to them at the same prices they sell to legal wholesalers.” Krasovsky adds that in dealing with smugglers, tobacco companies can potentially gain extra profits when a batch is confiscated by customs and destroyed. “It’s even better for them; another smuggler will come and buy the same quantity.”

Even after recent hikes, cigarette taxes in Ukraine remain among the lowest in Europe. The low price of Ukrainian cigarettes means high profits for smugglers, who have pushed the product all over Europe. Enforcement is lax at best; most big seizures of smuggled Ukrainian smokes take place not in Ukraine but in neighboring Romania, Poland and Hungary.

Blame Game

Attracted by high smoking rates and the potential for rapid returns on investments, multinational tobacco companies rushed to acquire the state-run cigarette factories after the Soviet regime collapsed in 1991. Today, the big four tobacco companies – Philip Morris, BAT, JTI, and Imperial – control 99 percent of the Ukrainian cigarette market.

“The former Soviet Union, particularly the most populous countries such as Russia and Ukraine, represented a massive opportunity for the tobacco companies. Men were already smoking in large numbers but the companies knew they could push many more women to smoke, and they did,” said Dr. Anna Gilmore, a senior public health researcher at the University of Bath, in the UK, who has written extensively about the tobacco industry in the former Soviet Union. “As a result, Eastern Europe is now one of only two regions in the world where both numbers of cigarettes sold and profits are increasing (the other region is Asia), and this makes it extremely important to the industry.”



The Tobacco Atlas, published by the American Cancer Society and the World Lung Foundation, identifies Ukraine as one of the countries with the highest annual rates of cigarette consumption per person

The tobacco companies, for the most part, acknowledge that they are churning out more cigarettes than the local market can absorb, but they say they sell only to licensed distributors and periodically reduce the output of certain brands that are popular among

smugglers. Beyond, that, they claim, it’s up to law enforcement to prevent smuggling. “Objectively, we know that our brands produced in Ukraine are found in Europe,” said Dmytro Redko, JTI’s director of corporate affairs in Ukraine. “We do our best to prevent such shipments, although we can’t halt them completely. That is the function of the [Ukraine] government.”

JTI, which is owned in part by the Japanese government, manufactures some of the brands that smugglers cherish the most, including Ronson. Redko says his company is constantly decreasing production of Ronson, though he would not disclose the exact figures of this brand's output. In 2008, JTI manufactured roughly 37 billion cigarettes in Ukraine, roughly 30 percent of the nation's total production. According to Redko, when JTI bought British manufacturer Gallaher in 2007, it also inherited what he called Gallaher's "outflow" issue – smuggled cigarettes – and the company has since tried to correct it.

BAT also has had its share of troubles in Ukraine despite the fact that the company's output in Ukraine has declined 30 percent since 2003. In a 2007 corporate report the company acknowledged that it had to cease production of its Pall Mall brand in the country after an audit showed that "local production was not proportionate to local demand," and cigarettes were widely being smuggled to Germany. BAT stated in the report that the company's actions helped reduce the smuggling of its products from Ukraine by 3 billion cigarettes in 2005 and 2006. "It is our belief that if all manufacturers took this approach, outflows from Ukraine could be significantly reduced," BAT's chief of anti-illicit trade, Pat Heneghan, told ICIJ in an e-mail.

Philip Morris, maker of Marlboro, is the top producer of cigarettes in the Ukraine, with 44 billion sticks manufactured in 2008 – an increase in production of more than 85 percent since 2003. Marlboro, EU officials say, remains the number one brand seized in Europe. Ukrainian law enforcement officials say that Philip Morris' brand L&M is routinely seized at the border. Philip Morris International's director of brand integrity, Andrew Robinson, told ICIJ that the country does indeed have "an ongoing problem of diversion of genuine products from Ukraine into the EU," but, he stressed, the company's production is commensurate with demand. Robinson added that Philip Morris has implemented a sophisticated system of product tracking and tracing in Ukraine, and that it actively cooperates with law enforcement to prevent smuggling.

Imperial Tobacco officials declined to comment for this story. In 2008, Imperial manufactured more than 30 billion cigarettes in Ukraine, according to industry and government statistics, the third largest production after that of Philip Morris and JTI.

Everyone's Windfall

The big tobacco multinationals in Ukraine are not strangers to the smuggling business – in the 1990s the firms colluded with criminal networks to smuggle cigarettes and gain market share around the world. Since 2004, Philip Morris have settled lawsuits brought by the EU and publicly committed to fight smuggling. The agreements require both companies to make substantial payments to the member states every time their brands are seized.



Dmytro Redko, Japan Tobacco International's director of corporate affairs in Ukraine, says it is the government's responsibility to stop smuggling. *Credit: Novynar magazine.*

Experts say, however, that only a tiny portion of all contraband cigarettes are caught by Ukrainian customs. In 2008, customs officials seized about 66 million cigarettes – less than one percent of what they believe was smuggled out of the country.

Then there's the problem of corruption. Several of the more than 120 criminal smuggling cases prosecuted in 2008 in the picturesque region of Chernivtsi, on the border with Romania, involve customs agents who aided the smugglers, Ukrainian police say. In just the first two months of this year, three cases have been prosecuted in Chernivtsi in which customs officials "overlooked" the smuggling of 10.3 million cigarettes – more than half of them JTI's

Ronsons.

Tobacco companies say they monitor their wholesalers for suspiciously large sales of cigarettes. Smugglers, in turn, have started to split large purchases into many smaller purchases to avoid detection. “We don’t know really who is buying from the wholesalers, as these are small batches” said JTI’s Redko.

Krasovsky, of the Ministry of Health, says tobacco companies are doing little to stop smuggling. By checking the seized packs’ production dates, he said, manufacturers could monitor where cigarettes have been bought and cut off wholesalers who deal

regularly with smugglers. Instead, he adds, “tobacco companies supply cigarettes to a wholesaler that has a huge warehouse in the border with Poland – it’s obvious where those cigarettes are going to go.”



These seized L&M cigarettes, manufactured by Philip Morris International, were slated for shipment to the Czech Republic. *Credit: Ukrainian Customs.*

Internet merchants also making a windfall from Ukraine-made cigarettes. A Web search for “cheap Ukrainian cigarettes” yields about two dozen online stores, most of them located in neighboring Moldova. The sites offer all the well-known brands, from Marlboro to Winston, with Ukrainian tax stamps and health warnings. The price is \$22 for a carton (10 packs) of Marlboro –about three times cheaper than prices in the EU. The sellers claim that they will skip customs inspections at the destination country. If customs does try to charge a duty tax, customers are advised to reject the package and ask for their money back. Also plentiful on Ukrainian Internet sites are classified ads offering Ukrainian cigarettes delivered to the EU “in large quantities,” “on constant basis” and “without any paperwork.”

One such ad, posted on January 9, 2009, offered delivery of cigarettes from Ukraine to Europe. In response to an online inquiry, a person who introduced himself as Oleh Dmytruk responded by saying that delivery of red Marlboro can be made to Germany at 18 Euros (about US\$25) per carton. The minimum purchase: 1,000 cartons.

In Krasovsky’s view, the only way to halt smuggling is to make the trade unprofitable for manufacturers. He and other tobacco control advocates propose that, much like in the Philip Morris-EU agreement, tobacco companies in Ukraine be forced to buy back their seized cigarettes at market prices.

But the economics of smuggling may be too sweet for at least some tobacco companies to stop. Asked whether the tobacco industry loses money to the illicit trade in Ukraine, JTI’s Redko responded candidly: “What do you mean by loss? From the point of view of a company operating on the market, production of extra goods means extra profits.”

About ICIJ

The International Consortium of Investigative Journalists (ICIJ) was launched in 1997 as a project of the Center for Public Integrity to globally extend the Center's investigative style of journalism in the public interest. Based in 50 countries, ICIJ's global network includes 100 of the world's top investigative reporters who produce collaborative, cross-border reports on major global issues around the world.

About CPI

The Center for Public Integrity is a nonprofit, nonpartisan, and independent digital news organization specializing in original investigative journalism and research on significant public policy issues.

Since 1990, the Washington, D.C.-based Center has released more than 475 investigative reports and 17 books to provide greater transparency and accountability of government and other institutions. It has received the prestigious George Polk Award and more than 32 other national journalism awards and 18 finalist nominations from national organizations, including PEN USA, Investigative Reporters and Editors, Society of Environmental Journalists, Overseas Press Club, and National Press Foundation.

In 2007, the Society of Professional Journalists recognized three Center projects with first-place online awards—the only organization that year to be recognized with three awards. The Center has been honored with the Online News Association's coveted General Excellence Award, and a special citation for the body of its investigative work from the Shorenstein Center on the Press, Politics and Public Policy at Harvard's Kennedy School of Government.

About This Project

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