

How does organised crime hurt legitimate business and society?

An industry perspective

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**Pat Heneghan - Global Head Anti Illicit Trade
British American Tobacco**

Illicit tobacco in the EU: latest estimates



BRITISH AMERICAN
TOBACCO

- 10% of market is illicit = 65 billion cigarettes
- €1bn lost in tax for EU & €1bn lost profit for industry
- Profits for organised crime are +/- €5bn
- Illicit share has grown for 5 consecutive years



The market in illicit tobacco – demand



Price differentials are the main driver of demand

- Huge disparities within EU & along EU borders
- Lower disposable incomes mean many smokers are looking for more affordable alternatives



Other factors

- Growth of 'illicit whites'
- Wide availability – markets, bars, workplace etc.
- Normalisation of illicit consumption – no longer socially unacceptable



200 JOHN PLAYER BLUE 8/10
200 MG 8/35
200 GOLD CLASSIC 8/35
200 MARLBORO RED 8/35
200 PRIDE 8/35
200 RYANSON + HURONS 8/45
200 PALACE 8/35
200 GOLDEN EAGLE 8/35
200 S+K BLUE 8/35
200 C+K 8/35
200 SAVARIN 8/35
500G GOLDEN VIRGINIA 4/10
500G AMBER LEAF 8/10
SMILN OFF VODKA 1 LITRE 8/18
BAILEYS 1 LITRE 8/14
D HG HAIR STRAIT DOWNSET 8/80
CALL Mick 0851341006

The market in illicit tobacco - supply

Potential profit on product purchased in Ukraine but sold in Ireland:

€1,500 per case
Qty 10,000



€8,700 per car
Qty 50,000



€87,000 per white van
Qty 500,000



€1,300,000 per container
Qty 7,500,000

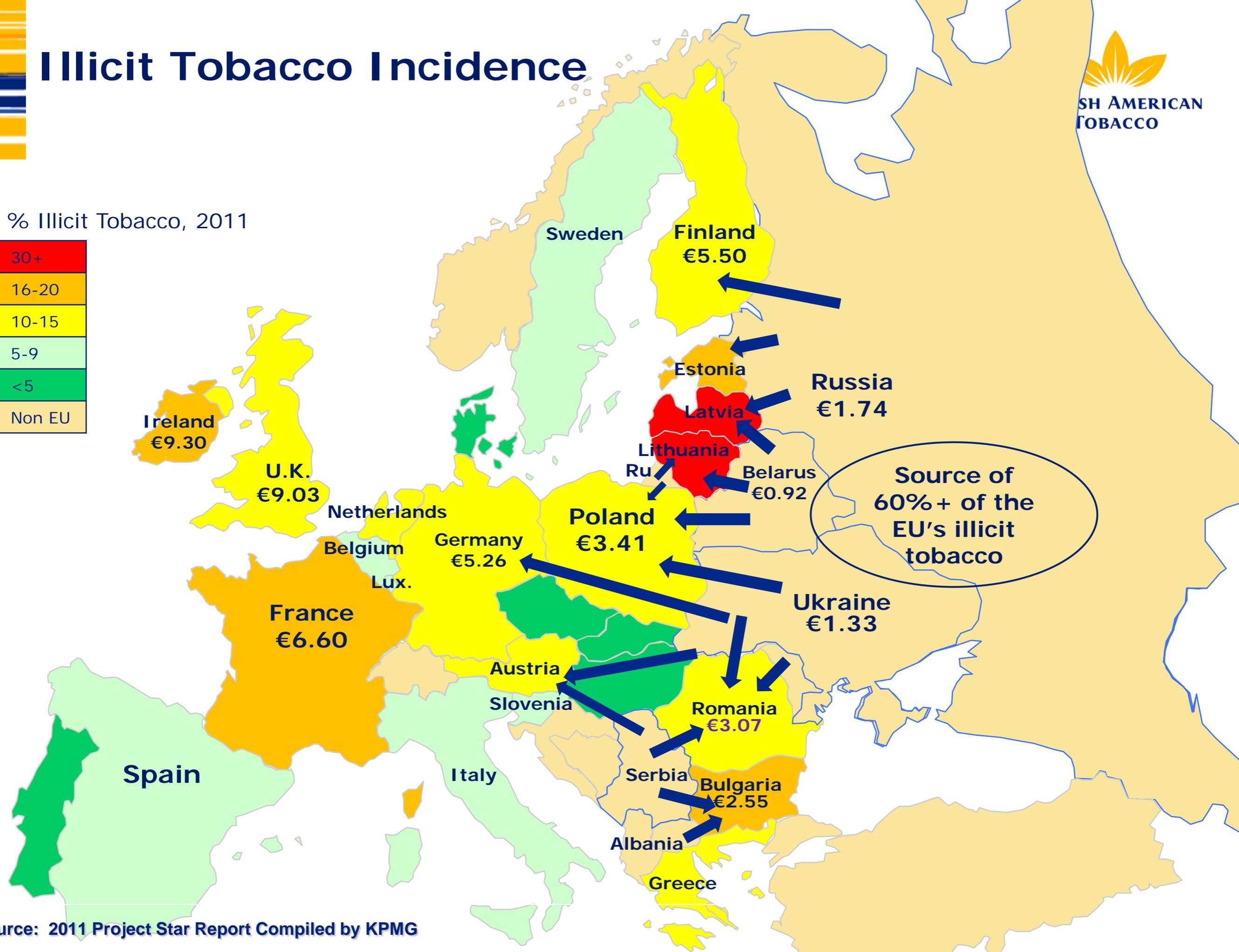
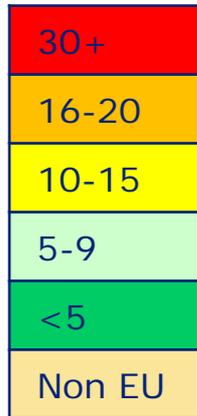


- Some non-EU Governments turn a blind eye to smuggling
- Variable border control on Eastern Border – 50% of illicit cigarettes enter EU here
- Inadequate penal sanctions & lenient judiciaries make cigarette smuggling low-risk

Illicit Tobacco Incidence



% Illicit Tobacco, 2011



Source of 60%+ of the EU's illicit tobacco

Who's involved in illicit tobacco?



➤ ***“Cigarette smuggling is almost exclusively the domain of organised crime groups that make substantial financial gains from their illegal activities”***

OLAF, 2011 Annual Report

➤ ***“Counterfeit and smuggled tobacco products are sold on open markets and customers are often unaware that they are buying illegal products. The money they pay goes directly to criminal groups, funding other areas of serious organised crime and terrorism”***

EUROPOL, 2010 General Report

- Finances criminal lifestyles; provides cashflow for other crimes
- From 'ant smugglers' to sophisticated, industrial-scale operations
- Methods/routes of smuggling replicate those for drugs, arms and people

Illicit tobacco smuggling methods



Addressing the trade in illicit tobacco

What can be done?

- Manage excise levels: reduce the price incentive
- Disrupt supply chains: push criminals' costs up
- Pursue, catch & punish major operators
- Communicate negative aspects of illicit tobacco to users



What is BAT doing?

- Supply Chain Controls
 - Know Your Customer, Standards of Business Conduct
 - Track and Trace system (tracks every carton)
- Redundant machinery destroyed
- Intelligence Unit works with law enforcement agencies
- Vigorous defence of intellectual property rights
- Awareness raising
- Support international organisations to combat illicit trade
- EU Co-operation Agreement; Memoranda of Understanding



Addressing the trade in illicit tobacco



How can EU legislation and policy help?

1. EU Action Plan on combatting cigarette smuggling in the EU

- Tougher penalties and seizure of cigarette smugglers' assets
- Directive on protection of the financial interests of the EU by criminal law – DG JUSTICE / OLAF
- Directive on confiscation and recovery of criminal assets in the EU - DG HOME

2. Pressure on illicit source markets via Association Agreements (e.g. Moldova / Ukraine)

- Include obligations to control cigarette smuggling

3. All cigarette smuggling covered by the EU's new internal security strategy for 2013-2017

- Smuggling in containers is now a relatively small part of the problem

Thank You

**Pat Heneghan
Global Head Anti Illicit Trade
British American Tobacco**

Slide 1

- Thank you, Nick. Good morning ladies & gentlemen.
- My name is Pat Heneghan and I'm the Global Head of Anti Illicit Trade at British American Tobacco. I'll be speaking for a few minutes about the involvement of organised crime in the illicit trade in tobacco – mainly cigarette smuggling - and the impacts on our business and society
- My role at BAT is seeking to prevent the illicit trade in cigarettes but, despite all I and many others do, the problem is continuing to grow.

Slide 2

- Cigarette smuggling into and across the EU is a huge problem, illustrated by these numbers.
- Work carried out annually by KPMG shows that in 2011 **one in ten** cigarettes smoked in the EU was illicit – that is to say **65 billion** counterfeit or contraband cigarettes
- As a result EU Member States lost over **€11 billion** in tax revenues whilst legitimate tobacco companies **lost €1 billion in profits.**
- Meanwhile criminals make or buy very cheaply, typically at €0.50 a pack. Because they pay little or no tax they can then

sell at an average of €2.50 a pack – a huge discount over the honest retailer. Our estimates show that the criminal fraternity **makes around €5 billion annually.**

- Finally, illicit tobacco volumes have risen for each of the last **5** years, and by over a billion cigarettes last year. The illicit market is now bigger than the combined legal markets of France and Portugal.
- With these profits and a minimal chance of being caught or prosecuted it is little wonder organised crime wants a big piece of the action.

Slide 3

- The price differences for tobacco products both within the EU, and between the EU and its near neighbours are often huge. You can buy a pack of premium brand cigarettes in **Belarus** for the equivalent of **€0.92**. Over the EU border in **Lithuania**, the same pack would cost **€2.00**. Into **Poland** and the price is almost **€3.50**. In **Germany** over **€5.00 Euros**. And in the **UK and Ireland** it's over **€9.00**.
- This makes it very attractive for smokers in high-priced countries to look for lower-priced cigarettes from elsewhere – particularly at a time when real incomes are stable or even

falling as a result of the **austerity** conditions in most EU economies.

- Alarmingly **one in every four** cigarettes smuggled into the EU has been specifically manufactured for that purpose. These are 'illicit whites' - brands you've probably never heard of and that were never meant to be sold in a normal retail shop.
- Smuggled cigarettes are easy to find. There's no need to go to a shop. At the street market, at the house down the road, under the table at the pub, even delivered if you call a mobile phone number.
- The criminals don't care who they sell to and even use underage persons to make the sale, as they're too young to be prosecuted. They also don't care if their cigarettes don't have the right health warnings or comply with legislated tar and nicotine ceilings.
- Perhaps most worryingly, there is growing social acceptance of the use of illicit product. It is no longer a thing of shame to be seen smoking contraband product or to offer an 'illicit white' to your smoking friends.

Slide 4

- The disparity in prices between EU markets and states outside the EU creates the opportunity for criminals to make big money.
- If you were to buy some legitimate tax paid cigarettes in **Ukraine** and sell them in **Ireland** at 50% of the retail price of the same cigarettes there, the profits are huge. If you fill your **car, nearly €9,000**. If you fill a **van, nearly €90,000**. And if you successfully organise a **containerful, over a €1 million**.
- It's not hard to find the cigarettes. Ukraine's neighbour, **Belarus** – where cigarettes cost less than a Euro a pack - has a quota for the production of cigarettes in its factories: **33 billion** cigarettes. But domestic consumption of cigarettes in Belarus is only **18 billion** per year and there are no legitimate exports! The remaining 15 billion is designated as 'peoples export' and the population is encouraged to sell it on outside Belarus to bring in much-needed foreign exchange.
- **Over half** of all illicit cigarettes in the EU come across the EU's Eastern Border from Belarus, Ukraine, Moldova and Russia, directly or via the Baltic States. Some do get seized but the sheer volume of smuggling – by road, over the 'green border', by rail and by boat creates pressure on already **overstretched customs and police officials**.

- Even if smugglers do get caught the **sentences available to judges are often wholly inadequate**. Cigarette smuggling is often treated as an administrative offence with local judges **imposing a lenient punishment** on offenders.
- Because there is huge **disparity across EU States** as to the severity with which cigarette smuggling is treated the **criminals naturally respond** by being most active in those states where the punishments are most lenient.

Slide 5

- The colour code on this map relates to the **proportion** of the cigarette market in EU states which is made up of illicit products. Also shown is the **price** of cigarettes in source and main destination markets and some of the main smuggling **routes** that the criminals use.
- The picture is pretty clear. Almost all the **states along the EU Eastern Border** have a big problem with smuggling from their neighbours, where cigarettes are sold at half the price or less. In the Baltics in particular, as many as three in ten cigarettes are illicit.
- It's a similar picture in other **Member States with high prices** - notably Germany, France, the UK, Ireland and the Netherlands.

- The **UK alone is losing £2 billion** a year in tobacco tax to the illicit market, money that could be used to reduce tax bills or to increase spending on much needed public services and infrastructure. But it's not just the government and taxpayer who are losing out – as well as lost profits legitimate manufacturers see their significant investment in building distribution networks and brands undermined. Retailers, wholesalers and distributors see a key contributor to their business disappearing to the informal channels causing huge damage to them and those who rely on them for employment.

Slide 6

- Tobacco products are light, portable and have a high volume to value ratio. Link this with the high profit potential; a ready market; a low risk of detection and low sanctions compared with other crimes and it's of little surprise that organised crime has increasingly turned its attention to tobacco smuggling.
- It is now a **cash-cow that bankrolls their other trafficking activities** - in arms, drugs, people, as well as the counterfeit business involving so many products from fake car spare parts to pharmaceuticals.
- The **links to drugs and arms smuggling** become even clearer when we look at the **methods** used to traffic the cigarettes into the EU. The use of 'coverloads' - concealing cigarettes in voids

and false floors and ceilings in vehicles or inside other goods is well-established as a method of transporting drugs and is now commonplace for cigarettes. But the variety of methods used to smuggle cigarettes is **as long as it is inventive**.

Slide 7

- As you can see they range from a few packs in clothing or hollow loaves of bread through the use of the postal service to fast speedboats and, on a larger scale; false ceilings in lorries and hollowed out concrete sections.
- The last photo shows a **tunnel** discovered last year, running between two small towns in Ukraine and Slovakia. It was **700 metres long, ran 3 to 6 metres underground and was fitted out with a small railway** with trucks to transport smuggled cigarettes into the Slovak Republic. The Slovak finance minister has estimated that the amount of cigarettes smuggled through the tunnel could have equated to 50 million Euros in lost excise
- **What you don't see on this slide is a container.** Five years ago, container smuggling was the norm. Nowadays, as criminals know, containers are more vulnerable to being seized. Polish Customs last year made **168,000 seizures** of cigarettes – only **2** were in containers, representing only 5% of the total cigarettes seized. Criminals have moved on to the more versatile, flexible methods you see depicted here.

Slide 8

- So, what can be done about this serious problem? Price differences clearly aren't going to be eradicated or even reduced anytime soon. But Governments must realise that significantly increasing excise every year and hoping that it won't foster illicit trade is unrealistic. Look at Ireland, where **despite €2.50 a pack being added in excise between 2000 and 2010 , the Government was taking less revenue at the end of the decade than at the start.** Governments need to **consider their excise policy carefully**, taking into account the current illicit market and the prices in neighbouring states and beyond.
- Acting to **improve enforcement and to break up criminal networks** disrupts the supply chain; meaning the customers can't get their tobacco products and prices are higher. Making sure that the **punishments available reflect the seriousness of the crime – and using them** - is also important. Even when caught too many are getting away with too light sentences.
- And it's possible to try to push smokers away from illicit tobacco by informing them of some of its downsides – as these images show.
- At BAT we are determined to play our part and are actively doing so. We do as much as we can to control our supply chain and are always looking for new ways to improve this. Recently

we have installed Track and Trace technology in PL, UKR, BEL, UK. We ensure that all our used machinery is destroyed so that it can't be bought and used for illicit manufacture. Our AIT Intelligence Unit works with national and international law enforcement agencies to share information on criminal activity. We work with our industry partners and a number of multi-sectoral bodies to both raise awareness and make policy proposals. In 2010 we signed a Cooperation Agreement the EU and the Member States committing \$200 million over 20 years. In addition we have signed in excess of 35 Memoranda of Understanding with government agencies worldwide.

Slide 9

- Finally I'd like to move on to some of those policy recommendations I mentioned earlier.
- We are very much looking forward to the announcement by Commissioner Semeta of the **new EU Action Plan**.
- In the meantime, we have **three ideas** on how EU regulation and policy could really help combat cigarette smuggling into the EU.
- Firstly, we need **tougher penalties and deterrents** – EU Member States and the European Parliament are currently working on two pieces of legislation. The **directive on the**

protection of the financial interests of the EU would introduce **truly dissuasive prison sentences** right across the EU. The **directive on confiscation and recovery of criminal assets** in the EU would make it far easier to hit criminals where it really hurts – **in their pockets**. The inclusion of cigarette smuggling within the scope of both directives would be a powerful addition.

- Secondly, all too often, source countries such as Moldova and Ukraine have little real incentive to prevent cigarette smuggling because they make money from the excise taxes paid in their country before the smuggling takes place. But **they do care about Association and Trade Agreements with the EU** – inclusion of obligations in such agreements for 3rd countries to control illicit trade would also be very beneficial.
- Finally, the EU is about to set its **internal security priorities** for the next four years. Cigarette smuggling **in containers** is included in the current priorities but as we have seen this is only a small part of the problem. **Inclusion of all types of cigarette smuggling in the new priorities would be a significant step forward.**

Thank You