

FINANCING OF ORGANISED CRIME



CENTER FOR
THE STUDY OF
DEMOCRACY

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The report *Financing of Organised Crime* contributes to a better understanding of the financial aspects of organised crime. The analysis explores topics such as the sources and mechanisms for financing organised crime, settlement of payments, access to financing in critical moments, costs of business and the management of profits. Drawing on the results of the analysis, the report also suggests possible new approaches to tackling organised crime.

The report has been produced with the joint efforts of the Center for the Study of Democracy, the University of Trento and Teesside University and in close collaboration with the State Agency National Security in Bulgaria, the State Police in Latvia and the French National Institute for Advanced Studies in Security and Justice.

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With the financial support of the Prevention of and Fight against Crime Programme European Commission – Directorate-General Home Affairs

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ISBN: 978-954-477-234-5

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LIST OF ABBREVIATIONS

API	active pharmaceutical ingredient
BGN	Bulgarian leva
Brå	The Swedish National Council for Crime Prevention
C&C	counterfeit and contraband
CDGEFID	Central Office for Combating Organized Economic and Financial Delinquency, Belgian Federal Police
CSD	Center for the Study of Democracy, Bulgaria
CSEW	Crime Survey for England and Wales
CTIF – CFI	Belgian Financial Intelligence Processing Unit
CZK	Czech crowns
DCPJ	Direction Centrale de la Police Judiciaire (French national judicial police)
DCSA	Direzione Centrale Servizi Antidroga – Ministero dell’Interno (Central Antidrug Bureau, Ministry of the Interior), Italy
DDA	Direzione Distrettuale Anti-mafia (Anti-Mafia District Directorate), Italy
DGDDI	Direction Générale des Douanes et des Droits Indirects (Directorate-General of Customs and Indirect Taxes), France
DNRED	Direction Nationale du Renseignement et des Enquêtes Douanières (National Directorate of the Intelligence and Customs Investigations), France
EBM	Ekobrottsmyndigheten (Swedish Economic Crime Authority)
EGF	excisable goods fraud
EMCDDA	European Monitoring Centre for Drugs and Drug Addiction
EMCS	Excise Movement and Control System
EU	European Union
EU-15	Austria, Belgium, Denmark, Germany, Greece, Finland, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom
FATF	Financial Action Task Force
FYROM	The Former Yugoslav Republic of Macedonia
GHB	gamma hydroxybutyrate
gr	gram
HMRC	Her Majesty’s Revenue and Customs, UK
HRT	hand-rolling tobacco
HUI	Swedish Retail Institute
INHESJ	Institut National des Hautes Etudes de la Sécurité et de la Justice, France
ITP	illicit tobacco products
ITT	illicit tobacco trade
kg	kilogram
LEA	law enforcement agents

LFO	light fuel oil
MinFin	Ministry of Finance
MTIC	missing trader intra-community fraud
NCA	National Crime Agency, UK
NRA	National Revenue Agency, Bulgaria
NTE	night-time economy
OCG	organised crime group
OCS	Support Cell Carousel Fraud, Belgium
OCTA	Organised Crime Threat Assessment
OCTF	Organised Crime Task Force
OFDT	Observatoire Français des Drogues et des Toxicomanies (Monitoring Centre for Drugs and Drug Addiction), France)
OIVO	Onderzoeks en Informatiecentrum van de Verbruikersorganisaties (Research and Information Centre of Consumer Organisations), Belgium
pcs	pieces
PMI	Philip Morris International Inc.
RAF	Royal Air Force
RUC	Swedish Regional Intelligence Centre
SANS	State Agency National Security, Bulgaria
SEK	Swedish Krona
SKV	Swedish Tax Agency
SOCA	Serious Organised Crime Agency, UK
SODN-EMP	Central Anti-drug Coordination Unit – National Intelligence Unit, Greece
THC	tetrahydrocannabinol
TMA	Tobacco Manufacturers' Association, UK
UK	United Kingdom
UKBA	United Kingdom Border Agency
UNODC	United Nations Office on Drugs and Crime
VAT	value-added tax
WDF	World Duty Free
xtc	Ecstasy

UNDERSTANDING CRIMINAL FINANCES: POLICY AND METHODOLOGICAL FRAMEWORK

Enhancing the knowledge of the financing of organised crime is an indispensable component of more effective and smarter approaches to prevention and investigation. Accessing capital is a significant constraint for some criminals when they seek to become big players in illicit markets for goods and services,¹ yet the processes and structures involved in the financial investment of criminal markets are largely under-researched. Whilst there is general information available regarding the level of financing required for a criminal group's operations in specific illicit markets – for example, the illicit drugs market is relatively well documented and there is a reasonably sound understanding of the pricing available along the entire value chain of operations, from production prices, smuggling and wholesale prices, middle-level dealing, to retail distribution,² as well as with costs of the business³ – this is not the case with a number of other illicit markets such as organised VAT fraud, illicit excisable goods, smuggling/trafficking in human beings, counterfeiting of goods and money, payment card fraud, and trafficking in stolen vehicles, etc.

To enter a criminal market at the wholesale level, organised criminals may need significant financial resources including, but not restricted to, credit facilities. Their need for financing concerns every level of organised crime. However, while millions (upfront and/or on credit) may be needed to enter the cocaine market at wholesale level, participation at the retail level requires only modest resources. The same applies to manifestations of organised crime that do not require entrepreneurial characteristics and are based on predatory activities. For example, small criminal groups may need only several tens of thousands of euros to launch an international banking fraud.⁴ The entry costs for many e-crimes are insignificant.

Various financial mechanisms and opportunities are available for criminal actors to fund new or existing illicit activities. However, fairly little has been done in terms of systematically analysing or targeting individuals or processes that are mainly involved in the financing of criminal structures and organised criminal activities. The financing of organised crime is the type of horizontal issue that several analyses as well as threat and strategic assessments – analyses and assessments that have been previously criticised as unreliable sources of information on organised

¹ G. Dean, I. Fahsing, and P. Gottschalk, *Organised Crime: Policing Illegal Business Entrepreneurialism* (Oxford: Oxford University Press, 2010).

² See Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom* (Home Office Online Report, London, 2007). P. Kopp, *Economie de La Drogue* (Paris: La Découverte, 2006).

³ J.P. Caulkins et al., "What Drug Dealers Tell Us About Their Costs of Doing Business", *Journal of Drug Issues* 29(2) (1999): 323-40; K. Moeller, "Costs and Revenues in Street Level Cannabis Dealing", *Trends in Organised Crime* 15, no. 1 (2012): 31-46.

⁴ See R.T. Naylor, "Towards a Theory of Profit-Driven Crime", *British Journal of Criminology* 43, no. 1 (2003): 81-101, for a deconstruction of profit-driven crime into its inherent characteristics.

crime⁵ – often skip, focusing instead on the proceeds of crime, criminal assets and/or money laundering.⁶ Official and informal financial services may all be used to finance organised criminal operations in one way or another.

Previous research has shown that financiers are often behind the financing of large-scale trafficking of commodities such as cigarettes or drugs.⁷ Yet despite the influence of these financiers, they remain outside the scope of analysis of organised crime being done at EU level, where such information is largely omitted. Although considerable research has been conducted on the proceeds of crime and the financial management of several organised criminal activities, the financing of terrorism⁸ and money laundering, little has been done in terms of analysing or targeting individuals, structures and processes that are involved in the “proceeds” of crime,⁹ especially on crimes unconnected with the financing of terrorism. Little has also been done in terms of analysing whether criminal entrepreneurs engage in a process that disguises a *legitimate* source of funds that are to be used for illegal purposes, a process that has been defined as “reverse money laundering.”¹⁰

Following these observations, a number of academics and law-enforcement officials from across Europe were contacted in order to gather information regarding the respective situations in their countries. It was established that many faced a similar situation, where some operational knowledge on the issue existed, yet (excepting the Netherlands) analytical units had not given much specific attention to it. Therefore, an interest was expressed to gather this knowledge at the EU level, as well as to exchange knowledge and experiences with partner countries where this issue has been paid more attention.

⁵ P.C. van Duyne, “OCTA 2006: The Unfulfilled Promise”, *Trends in Organised Crime* 10 (2007): 120-28; P.C. van Duyne and T. Vander Beken, “The Incantations of the EU Organised Crime Policy Making”, *Crime, Law and Social Change* 51 (2009): 261-81.

⁶ See UNODC, *The Globalisation of Crime* (Vienna: UNODC, 2010); UNODC, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organised Crimes* (Vienna: UNODC, 2011); Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment* (The Hague: Europol, 2013); NCA, *National Strategic Assessment of Serious and Organised Crime* (London: NCA, 2014); R. Dubourg and S. Prichard, *Revenues, Economic and Social Costs and Criminal Assets* (London: Home Office, 2009).

⁷ See, for example, K. von Lampe, *Provisional Situational Report on Trafficking in Contraband Cigarettes*, 2005, <http://www.organized-crime.de/AOC-DLV18-vR3.pdf>; J.P. Caulkins, B. Gurga, and C. Little, “Economic Analysis of Drug Transaction ‘Cycles’ Described by Incarcerated UK Drug Dealers”, *Global Crime* 10, no. 1/2 (2009): 94-112; CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011* (Sofia, 2012); A. Rusev, P. Gounev, and T. Bezlov, “European Lessons from the Bulgarian Serious Organised Crime Threat Assessment”, in *Human Dimensions in Organised Crime, Money Laundering and Corruption*, ed. P.C. van Duyne et al. (Nijmegen: WLP, 2013), 95-120.

⁸ A. Silke, “Drink, Drugs and Rock’n’Roll: Financing Loyalist Terrorism in Northern Ireland – Part Two”, *Studies in Conflict and Terrorism* 23, no. 2 (2000): 107-27; M. Levi, “Combating the Financing of Terrorism: A History and Assessment of the Control of ‘threat Finance’”, *British Journal of Criminology* 50, no. 4 (2010): 650-69.

⁹ M. Levi, “Proceeds of Crime”, *Criminal Justice Matters* 81, no. 1 (2010): 38-39.

¹⁰ S.D. Cassella, “Reverse Money Laundering”, *Journal of Money Laundering Control* 7, no. 1 (2003): 92-94.

LEGITIMATE BUSINESS AND CRIMINAL ENTERPRISES: KEY DISTINCTIONS IN FINANCIAL MANAGEMENT

Criminal enterprises, regardless of whether they operate in an entirely illegal market (drugs) or compete in a market with numerous legal players (cigarettes), at some point of their life cycle face many of the same dilemmas and financial limitations that are typical for legal businesses. Criminal entrepreneurs may need external financing under any of the following circumstances:

- to start their business, launch new products or cover new areas;
- to meet recurring financial needs (e.g. purchase of goods, payments to “employees” and contractors, bribes to political or law-enforcement authorities);
- to cover any incidental or, on some occasions, regular expenses (legal expenses, fines, loss or confiscation of goods, restructuring of debts, securing collaterals for certain deals);
- to support the potential vertical or horizontal expansion of their enterprise.

Access to financing in the world of legitimate businesses is directly dependent on the risk associated with each particular enterprise. In an open market in which there is no risk *per se* to either party from participation in commerce, the estimated risk determines the cost of financing and the variety of financial investment and other “resource mobilisation” options available.¹¹ For instance, outside of fashionable advance technology sectors where huge gains are possible, mature and established companies with proven quality products and services enjoy a lower cost of capital and a greater choice of financial resources in comparison to start-up businesses or businesses without proven track records. Risk is also driven by a number of macroeconomic factors: overall economic stability in a country, reliability of the national financial and legal system, and development prospects for a certain market or industry – all of which may translate into lower costs of capital. For example, manufacturers in Romania or Greece may find it much more difficult and expensive to finance their businesses than similar manufacturers in France or Germany. At a micro level, the cost of financing and variety of sources available are driven by the *expected* ability of creditors and investors to secure the return of their funds – these guarantees include the quality of collateral that businesses can provide and their leverage ratio, but also the efficiency of the respective legal and administrative framework.¹²

In the world of criminal entrepreneurs, the same correlation between risk and cost of financing may exist, but risk assessment is much more difficult to implement and verify. Financing options are affected by factors such as:

- **Differences in the level of hostility of the environment** in which criminal entrepreneurs operate. In some less economically developed

¹¹ Dean, Fahsing, and Gottschalk, *Organised Crime: Policing Illegal Business Entrepreneurialism*, 8.

¹² BDO, *Ambition Survey* (Brussels: BDO, 2012).

countries with high levels of corruption it is not easy to determine whether it is the licit or the illicit businesses that operate in a more hostile environment.

- The **relative illegality of the product** sold and service provided. For instance, cigarettes constitute a commodity for which there is a very large, receptive market, which involves “voluntary transfers” and “an implicit notion of fair market value”,¹³ and is, therefore, received well (compared to heroin, for example) by large parts of the population. Similarly, the entrepreneurs operating in the sex market are more widely accepted by the public and the authorities than are entrepreneurs specialising in contract killings.
- Consequently, the **level and extent in which a criminal enterprise is embedded** in the so called “upperworld”¹⁴ – the sphere of legitimate transactions – is also a factor. The more embedded a criminal market is in the upperworld, the easier it is for financial sources to be found (e.g. VAT fraud vs heroin).
- The relative **inability of the illegal entrepreneur to advertise** their business and compete openly.
- **Difficulties in recruiting talent.** Except where there is a plausible lawful rationale for the activity (like for boiler room salespeople or for “money mules” through whose accounts money is laundered), criminal entrepreneurs (unlike legal entrepreneurs) cannot legitimately advertise positions and recruit the best employees or collaborators; something that may affect the success and profitability of the enterprise.¹⁵
- The **range of skills required** create barriers to entry which do not exist in other markets (for example, producing counterfeit DVDs, which is a relatively easy task, as opposed to hunting tigers or elephants for their body parts).¹⁶
- The **degree of transparency/opacity of operations** (e.g. excise goods vs. the illegal arms trade).
- **Information leaks** by actors related or unrelated to the criminal enterprise (employees, disillusioned and sacked employees, customers/clients, competitors, family members, etc.). The possibility of information leaks increases the bigger and more successful the enterprise becomes. Thus, criminal entrepreneurs can be the victims of their own success, which is generally not the case with legal entrepreneurs, unless they expand beyond their ability to judge and control their environments, or are unable/unwilling to delegate.
- The **level of violence** of a given criminal market (e.g. though still not as common as popularly believed, Class A drugs trafficking is generally associated with more violence than credit card fraud or the illicit cigarette trade);

¹³ Naylor, “Towards a Theory of Profit-Driven Crime”, 85.

¹⁴ E.R. Kleemans and H. van de Bunt, “The Social Embeddedness of Organized Crime”, *Transnational Organized Crime* 5, no. 1 (1999): 19-36; K. von Lampe, “Organised Crime Research in Europe: Development and Stagnation”, in *European Crime-Markets at Cross-Roads: Extended and Extending Criminal Europe*, ed. P. van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2008), 17-41.

¹⁵ P.C. van Duyne, “The Organisation of Business Crime”, in *The Organisation of Crime for Profit*, ed. P. van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2006), 177-205; Brå, *Where Did All the Money Go?* (Stockholm, 2007).

¹⁶ B. Moyle, “The Black Marker in China for Tiger Products”, *Global Crime* 10, no. 1/2 (2009): 124-43.

- The **priority given by law enforcement** to those participating in a particular market (for instance, hard drugs), and the respective penalties – both perceived and actual – which affect expected and real risks. Real risks affect incapacitation via imprisonment; expected risks affect general and special deterrence via willingness to participate.
- **Differences in the visibility** of the criminal activities themselves. For example, the street-selling of cigarettes vs the street-selling of heroin.
- The **willingness of victims or affected bystanders of a criminal market to take action** and/or report criminal enterprise-related activities to the authorities. For instance, victims of fraud are generally more willing to report criminal activities to the authorities than are individuals living in an area in which the trade of cannabis is rife.
- The **degree of centralisation of markets** – more centralised markets command better financing options than fragmented markets. This is related to the ability of the criminal entrepreneur to have an overview of the operation and several financial aspects. Skinnari, in her study on the financial management of drug crime in Sweden, for example, found that some drug dealers found it difficult to make financial management of drug trafficking more efficient because, in many instances, they were not aware of what all business-related expenses in their scheme were.¹⁷
- The **ability of the illegal entrepreneurs to use information and communication technologies** (ICTs) to facilitate their business (for example, offline trade in counterfeit medicines vs online trade in counterfeit medicines). Online entrepreneurs require less financing than offline entrepreneurs.¹⁸
- The **strategies and efforts made by law enforcement authorities**, including frequently mutating technologies against illegal enterprise, and their intended and unintended consequences accounting for the “shifting terrains”¹⁹ that criminal entrepreneurs respond (or attempt to respond) to. Such strategies can have substantial financial implications.²⁰

In general, it can be expected that capital in criminal markets is readily available when the potential for profit is high and the perceived risk is low. However, the nature of the criminal enterprise follows from the requirements of continuous criminal transactions,²¹ and these transactions depend heavily on how economic, social and cultural relations are articulated in particular national and local contexts.

¹⁷ J. Skinnari, “The Financial Management of Drug Crime in Sweden”, in *Cross-Border Crime Inroads on Integrity in Europe*, ed. P. van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2010), 189-215.

¹⁸ A. Hall and G. A. Antonopoulos, “License to Pill: Illegal Entrepreneurs’ Tactics in the Online Trade of Medicines”, in *Economic and Organised Cross-Border Crime in Times of Crisis*, ed. P. van Duyne, P.C., Antonopoulos, G., Harvey, J., Maljevic, A. & von Lampe, K. (Nijmegen: Wolf Legal Publishers, forthcoming).

¹⁹ D. Hobbs, “The Firm: Organisational Logic and Criminal Culture in a Shifting Terrain”, *British Journal of Criminology* 41 (2001): 549-60; M. Levi, “Breaking the Economic Power of Organised Crime Groups. Paper Presented at the CIROC (Centre for Information and Research on Organised Crime)” (Amsterdam, October 16, 2002).

²⁰ J. Caulkins and P. Reuter, “How Drug Enforcement Affects Drug Prices”, *Crime and Justice: A Review of Research* 39 (2010): 213-71; see also Brå, *Where Did All the Money Go?*

²¹ D.C. Smith, “Illicit Enterprise”, in *Handbook of Organised Crime in the United States*, ed. R.J. Kelly, K-L. Chin, and R. Schatzberg (Westport, CT: Greenwood Press, 1994).

Generally, licit enterprises secure external capital through borrowing, equity financing, or reinvestment of past internal profits. This raises the question about whether such options also exist in criminal markets. Are there black market banks and investors? And, if so, how do they differ from their legal counterparts? Peter Reuter has conceptualised the key distinctions existing between legal and illegal enterprises in accessing credit.²² The most important difference arises from the separation of the ownership from the management in the modern (large) firm, which provides for the independence of the organisation from its owner and, therefore, can contribute to a legal entity's survival and longevity. This is because independence from the owner creates the necessary conditions for establishing the existence of external credit markets. These credit markets are then able to rely on the fact that even if the individual owner is not in a position to repay his debt, they can claim their payments or collateral from the firm itself – if it still remains solvent. Moreover, though it is important not to overestimate the integrity of accounting rules and compliance levels, existing legal regulations assure some standardised and detailed record keeping, which provides the lenders with evidence about the assets and financial flows of the borrower. Though this does not offer immediate protection from fraud, legal requirements for detailed record keeping also ease access to equity financing because the investor can monitor the expenditure and profits. Detailed record keeping also means that establishing the market value for the ownership of an enterprise is easier. Further on, in legal markets, lenders can rely on the legal institutions to recover their claim in case borrowers fail to meet their contractual obligations, provided that there are sufficient assets remaining and that the money has not been laundered elsewhere or simply spent recklessly.

In contrast, many illegal enterprises are inextricably linked to individual criminal entrepreneurs and, therefore, an entrepreneur's disappearance, imprisonment or death can easily deprive the lender or equity shareholder from his claim or share of the profit; such was the case of Dutch "underworld banker" Willem Endstra where his alleged lack of repayment and collusion with police led to his death.²³ Wholly illegal enterprises are thought seldom to keep detailed records as this carries risks if they are raided and searched.²⁴ Some individuals, however, sometimes do keep records, especially if they may be looking for something to trade with prosecutors²⁵ or if they need to satisfy their superiors who may

²² P. Reuter, *The Organisation of Illegal Markets: An Economic Analysis* (Washington, D.C.: National Institute of Justice, 1985); see also L. Paoli, "The Invisible Hand of the Market: The Illegal Drugs Trade in Germany, Italy, and Russia", in *Criminal Finances and Organising Crime in Europe*, ed. P. van Duyne, K. van Lampe, and J. Newell (Nijmegen: Wolf Legal Publishers, 2003), 19-40.

²³ P. Gottschalk, *Entrepreneurship and Organised Crime* (Cheltenham: Edward Elgar, 2009). An infamous gangster, Willem Holleeder, served 6 years in prison for blackmailing him, and a Dutch tycoon, Paarlberg, was jailed for 4.5 years and ordered to pay a fine of €25.7 million to the state for tax fraud and laundering the proceeds of Endstra's blackmail (<http://www.nltimes.nl/2013/03/19/e25-7m-fine-after-holleeder-cohort-convicted-of-fraud/>).

²⁴ See, however, S. Levitt and S. Venkatesh, "An Economic Analysis of a Drug-Selling Gang's Finances", *Quarterly Journal of Economics* 115, no. 3 (2000): 755-89; M. Soudijn and S.X. Zhang, "Taking Loansharking into Account: A Case Study of Chinese Vest-Pocket Lenders in Holland", *Trends in Organised Crime* 16 (2013): 13-30; S. Barley, "The £50m Drugs Gang", *The Gazette*, September 13, 2014.

²⁵ M. R. Soudijn and P. Reuter, (in preparation) "Cash and Carry: The High Cost of Currency Smuggling in the Drug Trade between the Netherlands and Colombia".

take extra-legal actions if they consider themselves cheated.²⁶ Setting aside any cynicism about the quality of audits in the licit sector, this fact means lenders do not have access to reliable public information about the *capacity* of the criminal entrepreneur to repay his debt, or about the accurate disbursement of profits, creating the scope for tension between lenders and operators. Furthermore, the lack of justice institutions that can guarantee protection of the contractual agreements for the lenders and the shareholders raises the uncertainty and risk in collecting back their money. The exception is where Mafia-type associations are able to perform this function (at a cost) or even combine it with financing crime as a vertically integrated firm – something that makes sense primarily when they can also guarantee freedom from criminal process and confiscation, without which the downside risks of integration become substantial.²⁷

Furthermore, due to the need for most criminal enterprises to have several links in the chain, their reliance on trust and the problems associated with networking means starting new business opportunities is more difficult than in the licit sphere – even if the rewards are more lucrative. The need within the sphere of criminal entrepreneurship to select partners carefully, and for those that are selected to prove their position further – either by cost-discriminating signals (those that are costly for an impostor to supply/show their commitment beyond question) or through previous credentials – increases the costs and difficulties even further.²⁸

All of the above constraints are supposed to substantially decrease the criminal enterprise from accessing external capital and, therefore, Reuter²⁹ argues (based on the evidence collected of thirty years ago) that they must rely exclusively on the reinvestment of profits in order to grow. Having said that, social network analysis of criminal networks has identified “black” investors as key nodes in criminal operations.³⁰ However, these analyses tend not to elaborate on their specific roles or the mechanisms of financing involved. Furthermore, research in various European countries suggests the existence of a specific **overlapping between legitimate and criminal entrepreneurship**, when, for example, so called “oligarchs” move money between their legal and illegal businesses.³¹ How common this legal-illegal

²⁶ With organised VAT fraud there is even “legitimate” accounting although this does not, of course, mean that such “black” accounting records are available for external audit.

²⁷ *Obchak* is the mutual fund to which all members of a criminal organisation (in Russia and Baltic Sea Region) must donate part of their earnings, performs such functions. See I. Abramova, “The Funding of Traditional Organised Crime in Russia”, *Economic Affairs*, March 2007, 18-21; R. Pullat, “Criminal Hierarchical Structures: Models of Organised Crime in the Baltic Sea Region”, *SIAC-Journal – Zeitschrift Für Polizeiwissenschaft Und Polizeiliche Praxis* 2 (2009): 24-30. *Obchak* is discussed in more detail in the chapter on drug trafficking in Estonia in this report.

²⁸ D. Gambetta, *Codes of the Underworld: How Criminals Communicate* (Princeton, NJ: Princeton University Press, 2009).

²⁹ P. Reuter, *Disorganized Crime: Illegal Markets and the Mafia* (Cambridge, Ma: MIT Press, 1986).

³⁰ C. Morselli and C. Giguère, “Legitimate Strengths in Criminal Networks”, *Crime, Law, and Social Change* 45 (2006): 185-200; M. Kenney, “Architecture of Drug Trafficking: Network Forms of Organisation in Colombian Cocaine Trade”, *Global Crime* 8, no. 3 (2007): 233-59.

³¹ CSD, *Organised Crime in Bulgaria: Markets and Trends* (Sofia, 2007). for discussions of the relationships existing between legitimate and criminal entrepreneurship see also Ruggiero V., “Criminals and Service Providers: Cross-National Dirty Economies”, *Crime, Law and Social Change* 28, no. 1 (1997): 27-38; G. A. Antonopoulos and N. Tagarov, “Greece: The Politics of Crime”, in *Corruption and Organized Crime in Europe: Illegal Partnerships*, ed. V. Gounev, P., & Ruggiero (Oxford: Routledge, 2012), 125-43; P. van Duyne et al., eds., *Corruption, Greed and Crime Money: Sleaze and Shady Economy in Europe and Beyond* (Nijmegen: Wolf Legal Publishers, 2014).

business interconnection is within different regions of Europe and beyond is unknown: but to the extent that some crime entrepreneurs with interests in drugs, clubs and the sex trade may find common attitudes and values among some financial services “wheeler-dealers” with surplus wealth, it would not be surprising to find such investment access there too.

Finally, it is important to note the degree to which the availability of internal re-investment funds is likely to be affected by lifestyles and the profitability of different segments of particular crime trades. Drawing on 150 cases from the Dutch Organised Crime Monitor, Kruisbergen *et al.*³² note the following:

“The skewness of the profit distribution differs per drug market and is related to the logistic nature of the trade chain. In the case of cocaine there is a big distance between the production locations on the one hand and the markets on the other. The successful bridging of that distance constitutes the most important and lucrative step within the total chain of the cocaine market. Therefore, the person who has the contacts and/or the ability to arrange for a successful importation of this drug is the top earner.

“Contrary to the production of coca leaves, the production of synthetic drugs is not restricted to one...region.³³ In addition, in the case of synthetic drugs the distance between production and the (European) market is much smaller. With respect to the synthetic drug trade, the trade chain consists of the following three links: the raw materials, which are much harder to obtain now than in the early days of xtc production; the production, which requires equipment and knowledge; and (international) market channels.

“The relation between these links is more equal, making the profit distribution less skewed than it is in the case of the cocaine trade (although the export of for instance xtc is far more profitable than the domestic market is).

“The distribution of criminal profits is not a static fact; actors may try to increase their own share at the cost of others. In the context of the drug trade, increasing one’s share of the profits often seems to boil down to shutting out, deceiving or robbing one’s ‘business partners’. In the context of human trafficking and extortion, however, the profit is chiefly added to by increasing the pressure on the victims... Thus, we almost never encountered collective ‘business reserves’ or a collective kitty, while both investments and profits are extremely individualised.”

These Dutch research observations are, of course, subject to changes in market demands and in techniques of production. For example, artisanal

³² E.W. Kruisbergen, H. Van de Bunt, and E.R. Kleemans, *Georganiseerde criminaliteit in Nederland. Vierde rapportage op basis van de Monitor Georganiseerde Criminaliteit [Fourth Report of the Organized Crime Monitor]* (Den Haag: Boom Juridische Uitgevers, 2012), 300-301.

³³ Nor, actually, is the production of cocaine restricted to one region. See e.g. F. Thoumi, *Illegal Drugs, Economy and Society in the Andes* (Baltimore: John Hopkins University Press, 2003).

drugs and 3D printing reduce transportation requirements and thus both costs and certain types of risks. The growth of generic online markets like Silk Road and specific product markets like DarkMarket (for “stolen” or rather duplicated financial and personal data) has reduced search time for offenders, and the development of Bitcoin and suchlike cryptocurrencies has offered risk-mitigation strategies for the identifiability of financial transfers (though value volatility creates other risks, and they are not as untraceable as some may believe). Thus, analyses of the financing of crime are always provisional.

OBJECTIVES OF THE REPORT

The broad aim of the present report is to examine the sources, mechanisms and approaches behind the financing of organised crime, through collecting and analysing empirical data in order to enable more effective investigations of organised crime and money laundering. Bearing in mind the time and financial (as well as evidential) limitations that prevent the authors from offering an exhaustive account of every organised crime activity, a decision was made to analyse three manifestations of organised crime: **an illegal market of an illegal commodity (cocaine); an illegal market of a legal commodity (tobacco products); and VAT fraud**. The study is based on the assumption that the aforementioned illegal markets are part of the body of knowledge widely defined as “organised crime”, and are empirical manifestations of such crime.³⁴

The aim of the study presented in this report includes the following specific objectives:

- Take stock and examine the various forms and sources of financing of organised crime activities/markets;
- Identify the criminal and legal structures behind financing;
- Examine the possible interlocking relations between criminal structures and business and legitimate financial institutions;
- Examine cash flows in criminal enterprises;
- Examine the logistics and processes with which organised crime structures settle their payments and manage financial transactions;
- Examine the costs of doing illegal business;
- Examine profits from organised criminal activities, profit sharing among participants in illicit businesses, and the areas in which these profits are invested and re-invested;
- Examine access to capital in critical moments.
- Examine specifics related to financing of OC activities across the EU countries;
- Examine specifics related to financing of organised criminal activities across the different criminal markets;
- Examine the possible cross-financing issues and other financial interplays related to terrorism;

³⁴ See von Lampe, “Organised Crime Research in Europe: Development and Stagnation”.

- Examine the role of loan sharks as well as other forms of underground banking as a possible source of criminal capital.

The study covers financing and financing-related aspects of organised crime in 27 EU member states.³⁵ Forms of organised crime financing outside the EU were also taken into consideration to an extent, in the context of the cross-border reach of organised crime networks operating in the EU (e.g. source and transit countries for illicit commodities). Specific markets in 10 member states (Belgium, Bulgaria, Czech Republic, Estonia, France, Greece, Italy, Spain, Sweden, and the UK) were explored through detailed case-studies. The methodology section that follows explains in more detail the sampling approach and logic employed.

METHODS AND DATA

Overall approach

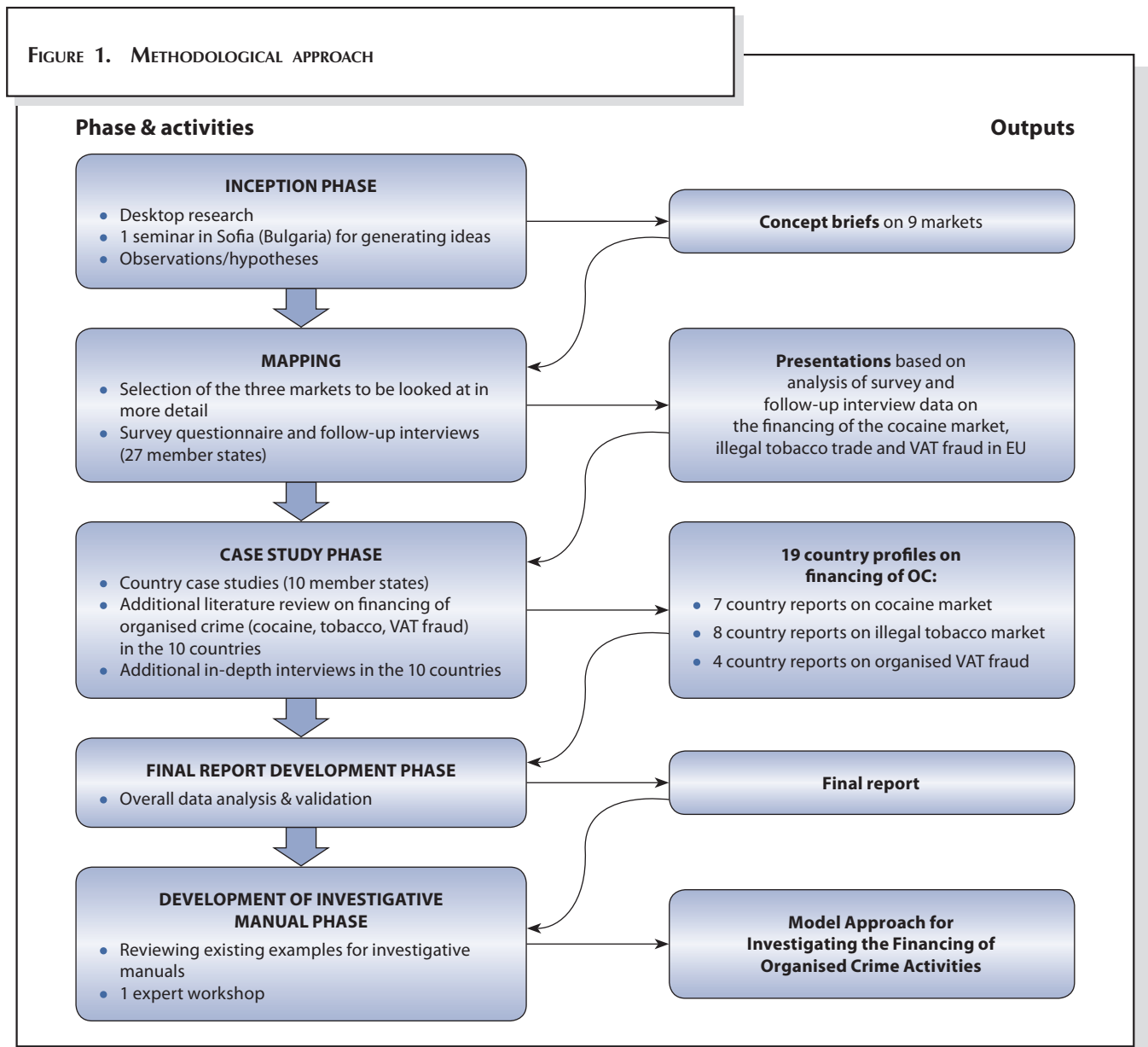
The overall methodological approach of the study presented in this report includes a broad collection and use of a diverse set of both secondary and primary data. The data collection for the study was based on four key elements:

- **Published literature:** this included research reports by academics, research institutes, governments, national and international law enforcement reports (EUROPOL, INTERPOL, National Crime Agency, etc.), reports by international organisations (UNODC, FATF), professional associations, and/or private companies that are either affected by specific manifestations of organised crime (e.g. British American Tobacco, national tobacco companies) or commissioned to conduct research on a specific market by a client (e.g. KPMG). The available literature reviewed was in a variety of languages such as English, Bulgarian, Italian, Dutch, Greek, French, Spanish, Russian, Estonian, Swedish, and Czech.
- **Media** sources in almost all member state languages were consulted.
- **Survey and follow-up interviews with officials:** a survey was carried out with law-enforcement, judicial, and other government officials in all 27 member states. The follow-up interviews, which were conducted in order for clarification and additional information about issues mentioned in the survey to be obtained, were done over the phone or in person where this was possible.
- **Country studies (case studies)** were carried out for Bulgaria, UK, Italy, Greece, France, Belgium, Estonia, Czech Republic, Sweden and Spain. The countries were selected based on the preliminary data obtained in the earlier stages of the study. For some countries more than one market was examined. Each case study was based on interviews, official and unofficial data, a literature and media review. In addition, the data collected in the survey and follow-up interviews phase of the study were used. The help of locally based academics and researchers

³⁵ All EU member states minus Croatia which joined the EU after the commencement of the project.

was solicited for all country case studies. The respondents involved in interviews as part of the country case studies included law-enforcement, judicial, and other government officials, academics and researchers, criminal entrepreneurs and other knowledgeable experts such as investigative journalists. In total, 206 interviews were conducted. The average length of the phone interviews was approximately one hour, and for the face-to-face interviews roughly two hours.

The methodological approach followed led to the production of the current report. The report also utilises the overall research in developing practical guidelines for investigation and tackling of organised crime financing. The guidelines have been compiled into a specialised manual, developed via collaboration with law enforcement and judicial experts. In order to facilitate the process, a specialised workshop was organised in Trento (Italy) in September 2014 to collect additional opinions and feedback. The overall methodological strategy followed is summarised in Figure 1.



Inception phase: desktop research and expert meeting

Desktop research

The relative lack of specific studies examining the financing of organised criminal activities forced the research team to broaden the scope of the review. The initial desktop research was utilised to gain a better understanding of the business models *in general* of the 9 pre-selected illicit activities that cover a relatively wide range of manifestations of organised crime. These organised criminal activities included:

- Heroin market
- Cocaine market
- Amphetamine-Type Stimulants (ATS) market
- Illicit tobacco market
- VAT fraud
- Human trafficking for sexual exploitation
- Facilitated illegal immigration
- Loansharking
- Counterfeiting of commodities

Key sources of information for the desktop research included the existing academic research dealing with issues such as the size, structure and social organisation of criminal markets. Reports by institutions including the UNODC and EUROPOL, reports by governmental institutions in the EU member states relating to organised crime (e.g. OCTA reports), annual situation reports on specific organised crime activities (e.g. the trafficking of human beings or drugs), and reports under specific projects and initiatives and policy analyses published by non-governmental organisations were also used as sources of information. Such documents, where available and accessible, were also a source of some data about revenues and costs of doing business. Reports from non-governmental institutions were also reviewed within the desktop research phase of the project.

In addition to the above grey and academic literature reviews, a review of available internationally comparable official statistics and surveys relevant to financial aspects of organised crime were used (e.g. drug supply indicators, money laundering statistics, etc.). Given data limitations, they were reviewed for insights and validity. Finally, media sources from all member states were consulted. Media sources are a very convenient and highly accessible source of the purely “technical” information they provide, which assisted the researchers in making inferences about an organised crime-related issue. Given the possibilities of legal action for defamation if they are mistaken, some (non-tabloid) media sources, especially stemming from an investigative journalistic context and/or dealing with a social issue or phenomenon, are very useful and fairly reliable for research of this nature.

The result of this initial desktop research were 9 briefs with the purpose to present how different criminal enterprises function, the typical cash flows of the criminal enterprises at each level (production, wholesale, retail) and where possible the expected need for financing of new and existing activities. The development of the concept briefs captured a wide possible spectrum of specifics such as:

- Illicit goods/services markets (drugs) vs markets for goods that are not *per se* illegal (tobacco);
- Commodity markets (drugs) vs service markets (facilitated illegal immigration);
- Markets (illicit tobacco) vs predatory profit driven OC activities (VAT fraud).

Expert meeting

The data gathering process, which began with observations based on the review of the available literature and media sources, provided the concept framework for further data collection. This was also supplemented by an expert seminar that was organised in Sofia (Bulgaria) in May 2013. The expert seminar included all project partner experts, as well as experts from law enforcement agencies and prosecution services from different EU countries. The seminar's aims included:

- probing the recurring statements in the media that the financial crisis has turned organised criminals into major financiers;
- testing whether there is much evidence that loan-sharks have become more powerful and active in financing crime as a result of the economic downturn;
- probing the role of organised crime in financing business enterprises (as substitutes to banks) in order to conceal proceeds and earn more money to finance its activities;
- testing whether asset confiscation and anti-money laundering legislation have made it more difficult for criminals to invest the proceeds of crime in legitimate economies, therefore making criminals more willing to re-invest in illicit businesses.

Overall, the seminar was utilised as a tool for collecting preliminary data, generating ideas about the topic, as well as about the instruments used towards the collection of additional data, and identifying suitable interviewees for the next phases of the project. Most importantly, the seminar assisted the research team in selecting 3 manifestations of organised crime that the next phases of the research study would focus upon, given the time and resource limitations that prevented us from researching all organised criminal activities. As mentioned, these markets are: the cocaine market; the illicit trade in tobacco; and VAT fraud.

Mapping phase: survey and follow-up interviews

The main goal of this phase was to map the existing official knowledge and information on the financial aspects of the three aforementioned markets. The scarcity of existing data pre-defined the explorative approach of the current study which was undertaken in two stages: (a) a survey and (b) follow-up interviews.

Building on the initial desktop research, the concept briefs produced and the expert seminar, the questionnaire for the survey was developed and appropriate participants in all 27 member states were selected. The raised observations were used as a starting point when developing the interview questionnaires, as they would also outline the existing gaps in

knowledge regarding the financing of organised crime (and specifically the three selected markets). The survey questionnaire had specific sections devoted to collecting additional information about the financing of OC crimes related to the 3 market case studies and addressed some of the following issues:

- Business models and cash flows in criminal enterprises;
- Size and source of capital needed for entering or operating in a given market and market level;
- Costs of operating in a given market and market level – costs for purchasing illegal commodities/maintaining service provision, costs for specialised services (transport, store, financial, law, protection and violence services, etc.), corruption fees;
- Profits and reinvesting in criminal businesses – how often and how much?;
- Profile and number of financiers/investors in each country;
- Known sources for acquiring financing for entering a criminal market, expanding activities (e.g. entering a higher level of the market), closing a big deal on the black market (e.g. smuggling a container of illicit cigarettes) or coping with cash flow problems (due to emergencies such as police interception, competition, etc.);
- Mechanisms and logistics behind the financing of OC activities;
- Legitimate businesses investing in criminal enterprises;
- Role of loan-sharks and underground banking in providing finances to OC enterprises;
- Possible links of OC activities to terrorism.

Each research partner was responsible for covering 9 EU member states and identifying potential respondents through their informal networks and official communication with the relevant governmental and law enforcement institutions. The research partners also coordinated and facilitated the completion of the survey questionnaire by sending reminders and providing support to the respondents when needed:

University of Trento	Teesside University	Center for the Study of Democracy
Italy	UK	Bulgaria
Spain	Sweden	Romania
Portugal	Denmark	Slovakia
Malta	France	Czech Republic
Austria	Ireland	Poland
Germany	Cyprus	Slovenia
Luxemburg	Finland	Estonia
Belgium	Greece	Latvia
The Netherlands	Hungary	Lithuania

Approximately 8-10 participants from the authorities were approached in each EU member state. These were individuals who were members of

intelligence analysis units (of the police, financial police, border agencies, tax and customs authorities, etc.), public prosecutors or officials with a strategic oversight of the phenomenon of organised crime in a country. Of the 252 questionnaires that were sent to the authorities, 83 were returned (33% response rate).

The second step of the data collection in this phase was the follow-up interviews. The interviews were done via telephone because this was the most effective and cost efficient approach, bearing in mind the number of countries and experts to be covered. The goal of the follow-up interviews was to enhance and broaden the information collected via the survey. The respondents were approached and invited to clarify and elaborate on the details provided, as well as to illustrate the information with cases from their practice. Of the 83 participants who returned the questionnaire, 19 agreed to provide fuller accounts in a follow-up interview (approximately 23%).

Country case studies

In 10 countries (Belgium, Bulgaria, Czech Republic, Estonia, France, Greece, Italy, Spain, Sweden and United Kingdom) more in-depth research was carried out on at least one of the selected markets. These countries and the specific markets were determined by the initial stages of the research, as well as evidence from the literature review and the availability of locally-based researchers who could perform face-to-face interviews with knowledgeable actors involved in the criminal businesses and beyond. Each country study was based on:

- Review of the existing official and unofficial literature, and media sources;
- Analysis of the available national official statistics;
- Analysis of the data obtained from the survey and the follow-up interviews (these types of data were made available to the country researchers by the research partners);
- In-depth interviews with country officials and other knowledgeable actors such as investigative journalists and business people, as well as criminal entrepreneurs. These interviews – apart from issues relating to the structure of the markets focused upon and market entry – covered the sources of organised crime financing, settlement of payments, costs of doing business, profits and profit-sharing, access to capital in critical moments, loansharking and its links to organised crime, as well as the possible link between organised crime and terrorism.

In-depth interviews with 225 participants were conducted in all 10 countries. For this phase of the study, the team identified the respondents in three main ways. Firstly, during the course of the literature review and media research when specific officials from neuralgic posts of law enforcement agencies and the judiciary who appeared in reports or media accounts were approached. Secondly, a number of potential participants – both officials and criminals in prisons – were identified through official correspondence with government, judiciary and law enforcement bodies. Through a method of snowballing sampling, respondents working for the authorities recommended other potential

interviewees. Thirdly, in the planning of seminars/workshops that were part of the study, personal contacts and trust, especially with law enforcement officers, was established in order to be able to gather sufficient information. Three of the project partners are law enforcement agencies with sufficient contacts and relations that we took advantage of when this was deemed necessary. Finally, a number of participants (and this is primarily the case with active criminal entrepreneurs) were identified from previous work in the field of organised crime and/or financial crime in which the country researchers were involved. On some occasions these criminal entrepreneurs introduced acquaintances or collaborators to the researchers.

The main objective of the research team at this phase of the study was to develop a sample that could provide **detailed accounts and information on the financing of organised crime** specifically relating to the three selected markets. The list of respondents included:

- Government and law-enforcement officials – e.g. officers from counter organised crime units (analytical units, drug units), officers from financial crime units, customs officers, tax officers;
- Representatives of the judiciary;
- Actors from legitimate businesses;
- Investigative journalists;
- Academics and/or independent researchers;
- Criminal entrepreneurs specialising in the cocaine market, the illegal tobacco market, and/or VAT fraud.

TABLE 1. BACKGROUND OF INTERVIEWEES

Background	Number of interviewees
Government and law enforcement officials	148
Representatives of the judiciary	25
Legitimate business people	12
Investigative journalists	2
Academic and independent researchers	5
Criminal entrepreneurs	33
Total	225

The introduction of semi-structured interviews protocol used during this phase of the study was identical for all interviewees. Specific modules for the different types of interviewees (experts vs. criminal entrepreneurs) were developed. Experts with broader or more general knowledge, such as academics and journalists, were interviewed on several sections of the questionnaire, while other interviewees felt comfortable answering only specific questions. All questions were open, and interviews lasted between 1 and 2 hours, some even longer depending

on the amount of information a participant could provide as well as the talkativeness of the participant.

Limitations of the study

The methodological approach outlined above, and in particular the reliance on qualitative measures and opinions of a non-representative sample of interviewees is a significant drawback to the methodology which the authors are well aware of. In addition, official data including data derived from interviews with members of the authorities is the result of law enforcement activity, which in turn depends upon resource restrictions, the competency of agents, organisational priorities, and wider political priorities.³⁶ Very often – as this study also revealed at all phases – **information and details about financial aspects of organised crime are irrelevant to the prospect of successful prosecution**, and as such are not collected, excluded or ignored. In addition, official accounts limit the scope of an organised criminal's identity to that of a one dimensional "criminal" drained of cultural context; something that might have numerous implications in terms of the important financial information that is available.³⁷

Similarly, as reflected upon by almost all researchers who have conducted interviews with organised criminals, such interviews have numerous limitations. There are issues of generalisability, and one can never be absolutely certain about validity, although cross-checking and member checking significantly contributed towards eliminating untruthful accounts. In addition, there is also the issue of representativeness of the sample. In many instances researchers used a method of snowballing sampling to identify participants, thus limiting the sample to the researcher's own personal network and, as a consequence, the scope of the findings.³⁸

Finally, although media sources are used as sources of technical information about organised crime, they should be treated very cautiously for a variety of reasons. Not only do they most often refer to those cases which the authorities came across, thus ignoring cases of successful (non-apprehended) organised criminals and/or uninterrupted schemes, but they also tend to present the issues relating to the actors of organised crime or the activity/market itself in a sensational and morally charged manner; something that has limited analytical value. Finally, sources like *Lexis-Nexis* (and other search engines) from which material is drawn, depend on the researcher providing keywords, a process which may lead to the exclusion of reports that are peripherally relevant but extremely important for the wider context of the study.³⁹

Nevertheless, the **methodological triangulation** throughout the phases of the study, and the consultation of both official and unofficial sources of information has created a net that has captured what was identified as

³⁶ See J. Kinzig, *Die rechtliche Bewältigung von Erscheinungsformen Organisierter Kriminalität* (Berlin: Duncker & Humblot, 2004); M. Levi, "The Making of the UK's Organised Crime Control Policies", in *Organised Crime in Europe: Concepts, Patterns and Control Policies in the European Union and Beyond*, ed. C. Fijnaut & Paoli, L. (Dordrecht: Springer, 2004), 823-51.

³⁷ D. Hobbs and G. A. Antonopoulos, "How to Research Organised Crime", in *The Oxford Handbook of Organised Crime*, ed. L. Paoli (New York: Oxford University Press, 2014), 96-117.

³⁸ See S. Zhang and K.-L. Chin, *Characteristics of Chinese Human Smugglers* (Washington, D.C.: U.S. Department of Justice, 2004); M. Levi, "Qualitative Research on Elite Frauds, Ordinary Frauds and 'Organized Crime'", in *Handbook of Qualitative Criminology*, ed. M. Miller and Copes, H. (New York: Routledge, 2015), 215-35.

³⁹ See Y. Jewkes, "The Media and Criminological Research", in *Doing Criminological Research*, ed. P. Davies, P. Francis, and V. Jupp (London: Sage, 2011), 245-61.

the most important aspects of organised crime financing, at least within what is plausibly known and verified.

The findings of the study have informed two levels of analysis presented in this report:

- a general overview of the financing of the cocaine market, the illegal tobacco market, and organised VAT fraud in Europe;
- national-level analyses of the three criminal markets in a number of countries. Specifically, the cocaine market and its financial aspects are covered in Bulgaria, Estonia,⁴⁰ France,⁴¹ Greece, Italy, Spain, and the United Kingdom. The illegal tobacco trade is examined in Belgium, Bulgaria, Czech Republic, France, Greece, Italy, Sweden, and the United Kingdom. Organised VAT fraud is covered in Belgium, Czech Republic, Bulgaria, and Spain.

⁴⁰ The reports on Estonia and Bulgaria have a bigger scope and focus on the drugs market in general.

⁴¹ The report on France focuses on cocaine and cannabis markets.

1. COCAINE TRAFFICKING IN THE EU: COMMONALITIES IN FINANCING

1.1. DEMAND FOR COCAINE: CONSUMERS AND TRENDS

Consumption and supply of drugs are topics directly linked to both security and health issues at the European level. Both impact on EU relations with third countries directly (i.e. drug trafficking throughout Europe) and indirectly, in regard to the link between drug use and broader issues such as social stability, development, and the involvement of organised crime groups (OCGs). In regard to the latter, it has been estimated that about one third of all OCGs active in the EU are engaged in illicit drugs production and distribution; whereas the multi-billion drug markets remain particularly competitive and profitable for criminal entrepreneurs.⁴² For example, though this figure could not be tested, it has been argued that the income of the 'Ndrangheta on a yearly basis is around €44 billion, 62% related to drug trafficking.⁴³

In particular, the cocaine market is central to the global drug problem, representing one of the largest and most profitable markets, requiring an assessment of its patterns and dynamics. Thus, analysing the financing mechanisms behind cocaine trafficking could constitute a step further for counter action and prevention carried out by law enforcement and relevant institutions in the EU.

Cocaine powder (a hydrochloride salt, HCl) is manufactured from coca cultivated in the Andean-Amazonian region of South America, while the global production of coca is concentrated in three countries: Bolivia, Colombia and Peru. "Most indicators, including cultivation of coca bush, manufacture of cocaine, seizures of cocaine and prevalence estimates in the major consumer countries, suggest that in recent years the cocaine market has, on a whole, been declining. The finding reflects the situation in North America where the cocaine market declined significantly over the period 2006 – 2012, and, to a lesser extent, in Western and Central Europe, where the cocaine market appears to have stabilized following many years of growth."⁴⁴

Data available on coca bush cultivation and manufacture show a declining trend starting from 2010 and continuing up to 2012, driven mainly by declines in coca bush cultivation in Colombia (25% less in 2012 compared to 2011) and in the estimated production of cocaine (309 tonnes in 2012, the lowest level since 1996).⁴⁵

⁴² Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

⁴³ Europol, *Threat Assessment. Italian Organised Crime* (The Hague, 2013).

⁴⁴ UNODC, *World Drug Report 2013* (Vienna, 2013), 37.

⁴⁵ UNODC, *World Drug Report 2014* (Vienna, 2014).

For a time, North America, and Western and Central Europe have represented the two major consumer markets for cocaine and at present they account for about half of cocaine users globally. Nevertheless, in more recent years, “the extent of cocaine use seems to have been contained in both of these well-established markets.”⁴⁶

Comparisons with estimates for previous years (2004 – 2005), underline an increase of the prevalence of cocaine consumption also in other EU and non EU markets such as Africa, Asia, Oceania, Latin America, Caribbean, Eastern and South-eastern Europe. In 2012, data show a stable trend in cocaine use which “remained high in North and South America (1.8% and 1.2% respectively), Oceania (1.5%) and Western and Central Europe (1%). While there has been an increase in cocaine use in North America (between 2011 and 2012) [...], prevalence of cocaine in Western and Central Europe declined from an estimated 1.3 per cent in 2010 to 1.0 per cent in 2012”⁴⁷, due mainly to a slight decline in the largest consuming countries: Spain, Italy and the United Kingdom.

TABLE 2. COUNTRIES WITH HIGHEST PREVALENCE OF COCAINE USE IN THE EU

Country	Prevalence estimates – General population	
	Lifetime, adult (15-64),%	Last 12 months, young adults (15-34),%
United Kingdom	9.0	3.3
Spain	8.8	3.6
Ireland	6.8	2.8
Denmark	5.2	2.4
Netherlands	5.2	2.4
Italy	4.2	1.3
France	3.7	1.9
Germany	3.4	1.6
European Union	4.2	1.7

Source: Authors' elaboration on EMCDDA, *European Drug Report 2014. Trends and Developments*, 2014.

These estimations are in line with data provided by EMCDDA⁴⁸ at the European level. Generally, cocaine is considered to be the most commonly consumed illegal stimulant after cannabis, with prevalence in use of 14.1 million or 4.2% of adults (15-64) during their lifetime; 3.1 million or 0.9% of adults (15-64) in the last year and 2.2 million or 1.7% of young adults (15-34) in the last year. With reference to the same young adult population (use in the last year) and the countries with the highest prevalence, a reduction in cocaine consumption is registered, after a peak in 2008, in countries such as Denmark (2.4%), Italy (1.3%), Spain (3.6%) and the United Kingdom (3.3%). Conversely, an increase is underlined for

countries such as France (1.9%) and Sweden (1.2%), especially starting from 2000.

⁴⁶ UNODC, *World Drug Report 2013*, 38.

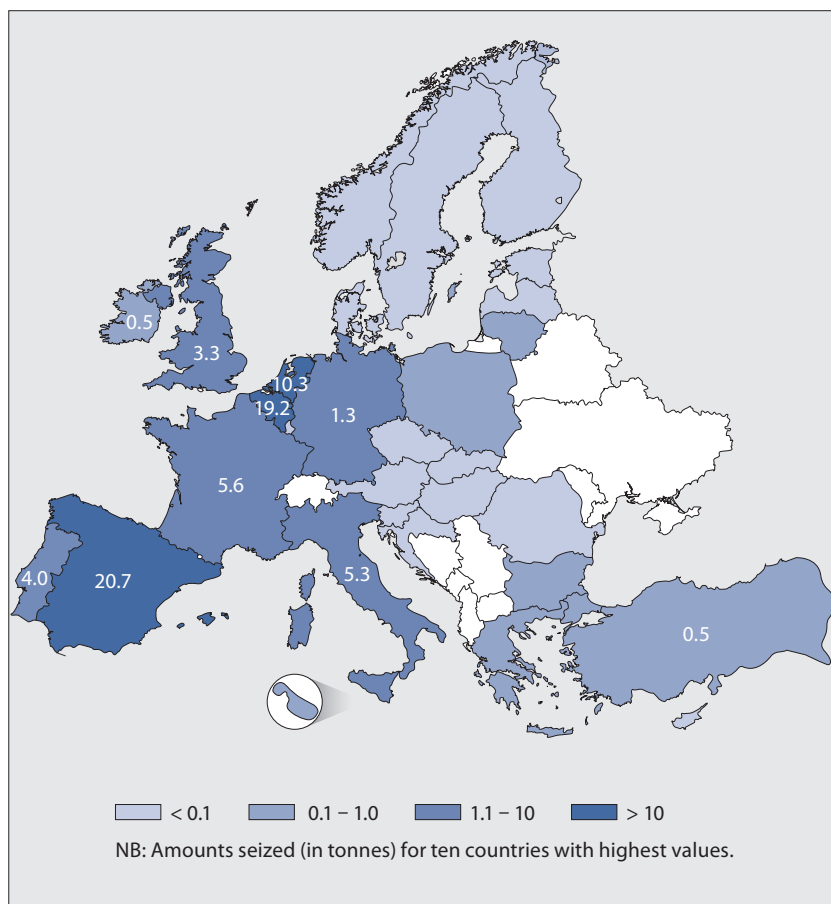
⁴⁷ UNODC, *World Drug Report 2014*, 35.

⁴⁸ EMCDDA, *European Drug Report 2014. Trends and Developments*.

1.2. MAIN ENTRY POINTS TO EUROPE: SEIZURES AND FLOWS

In many cases, cocaine entering Europe is smuggled by sea using container shipments, or through deliveries by air or postal services, as well as using drug couriers (i.e. swallowers). A high percentage of the total volume of cocaine seized on the way to Western Europe was detected on board boats or vessels, hidden in freight or in vessels structure. While most cocaine arrives by sea, a large number of smaller shipments are detected at airports or in the post.

FIGURE 2. QUANTITY OF COCAINE SEIZED IN SOME EUROPEAN COUNTRIES, 2012



Source: Authors' elaboration on EMCDDA, *European Drug Report 2014. Trends and Developments*.

The number of interceptions of cocaine directed to Europe has increased since the mid-1990s, growing faster from 2004 to 2007 and 2009, but declining since then. After a peak in seizures in 2006 (120 tonnes) – reflecting confiscations in Spain and Portugal – the total amount dropped to lower levels in 2009, while stabilising around half of the amount of 2006 in the period 2010 – 2011.⁴⁹

Cocaine seizures are higher in North America and in Western and Central Europe. In the latter regions, the amount of cocaine seized increased starting from 2009, reaching 71 tonnes in 2012. Declines in the quantity of cocaine seized are higher in the Iberian Peninsula, particularly in Portugal (period 2006 – 2007), and more gradually in Spain (2006 and 2011), while higher seizures of cocaine are reported in Belgium in 2012 (19 tonnes) (Figure 2).

The quantity of cocaine seized in countries such as Finland, Latvia and Lithuania remained

limited during the period 2010 – 2012, since they seem to serve as entry points for cocaine directed to the Russian Federation. In contrast, larger individual seizures were registered in the ports of Bulgaria, Romania and Greece.⁵⁰

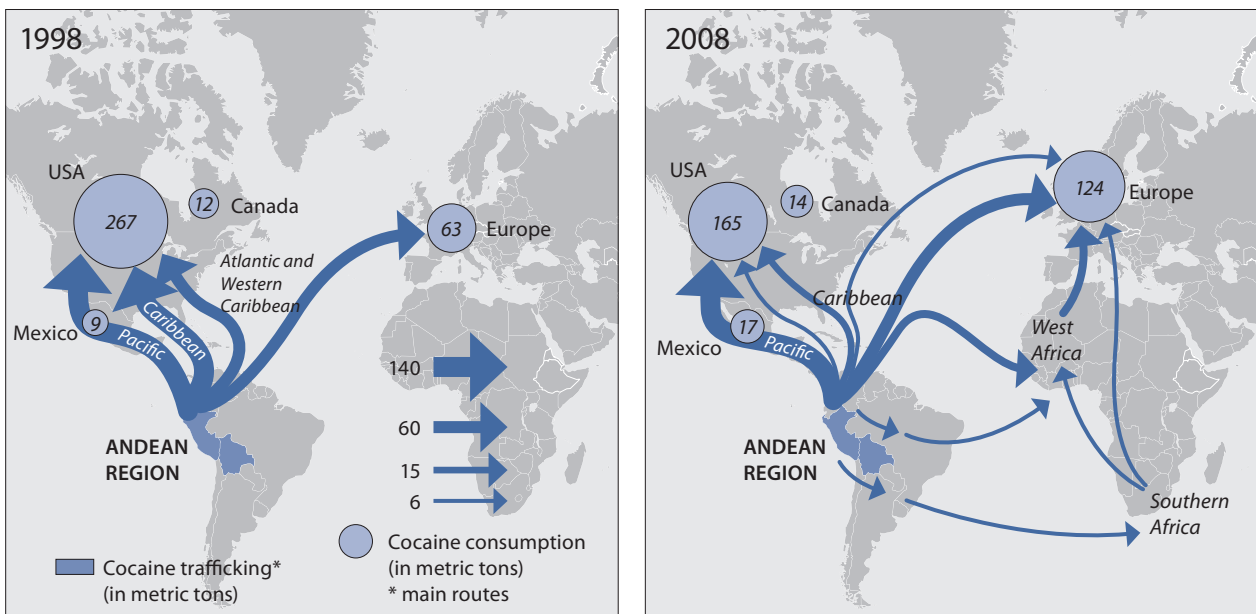
⁴⁹ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis* (Luxembourg, 2013).

⁵⁰ UNODC, *World Drug Report 2014*; EMCDDA, *European Drug Report 2014. Trends and Developments*.

Although, due to the lack of data, accurately mapping the routes of cocaine trafficking is challenging, three main sea routes used by traffickers to import cocaine from South America to Europe have been identified:

- Northern route that crosses the Caribbean and the Azores to reach Portugal and Spain;
- Central route from South America through Cape Verde or Madeira and the Canary Islands;
- African route starting in South America and reaching West Africa to direct cocaine mainly to Spain and Portugal (Figure 3).⁵¹

FIGURE 3. GLOBAL COCAINE FLOWS, 1998 AND 2008



Source: Authors' elaboration on UNODC, *The Transatlantic Cocaine Market* (Vienna, 2011).

Besides the more traditional entry points of cocaine into Western and Central Europe (i.e. Portugal, Spain, the Netherlands and Belgium, acting also as countries for further distribution of cocaine), the Black Sea and the Balkans have become places for the diversification of cocaine trafficking routes. The slightly increasing number of interceptions in some countries of this area (i.e. Estonia, Latvia, Lithuania, Poland, Bulgaria, Hungary, Romania, Greece, Slovakia and Turkey) during the period 2001 – 2011 (from 0.1% to 1.8% respectively) underline the possibility of a diffusion of cocaine in countries previously almost unaffected.⁵²

Greece represents a key entry point for cocaine directed to South-eastern Europe, and has some of the largest port seizures among all the countries

⁵¹ UNODC, *The Transatlantic Cocaine Market*.

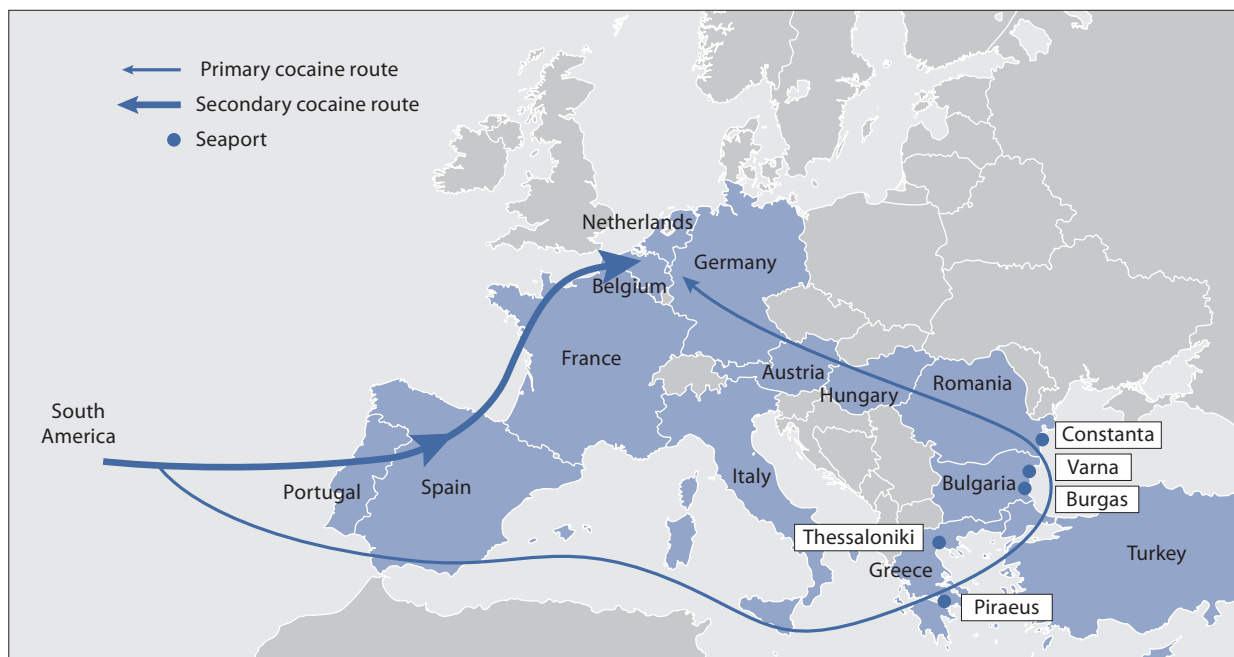
⁵² EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*.

in the region. Although, seizures have been on the decline (from 1 tonne in 2004, to 500 kg in 2011 and 200 kg in 2012), this trend does not correspond to a decline in cocaine trafficking due to the detection of laboratories for second extraction and the impact of the financial crisis. From Greece, traffickers have different options but official data suggest that they tend to follow a northward route through FYROM and Bulgaria. From Bulgaria, cocaine transits through Romania and Hungary to be further directed to Western and Central Europe. Indeed, trucks and personal cars transporting cocaine from Thessaloniki reportedly cross Bulgaria with the logistical support of local organised crime groups.

Cocaine also arrives at ports of the Black Sea (via transshipments) directed to Western Europe, as indicated by seizures in Constanta (Romania), Varna and Bourgas (Bulgaria) as well as at the Bulgarian port of Rousse on the Danube river. As for the South-eastern European countries on the Adriatic coast, as reported by international bodies and law enforcement in Italy, a key role seems to be exercised by the ports of Montenegro, Croatia and Slovenia which are used as hub for cocaine trafficking to Western Europe.⁵³

Recent trends indicate that former communist countries around the Baltic Sea are becoming central points for cocaine trafficking as well, with seizures of cocaine in 2010 in the port of Riga (Latvia), port of Klaipeda (Lithuania) and Tallinn airport (Estonia). Although being occasional seizures,

FIGURE 4. GENERAL COCAINE TRAFFICKING ROUTES IN WESTERN AND CENTRAL EUROPE



Source: Authors' elaboration on UNODC, *The Illicit Drug Trade through South-Eastern Europe* (Vienna, 2014).

⁵³ UNODC, *The Illicit Drug Trade through South-Eastern Europe* (Vienna, 2014).

the indication is that this area is already used for cocaine smuggling. Another feature of this recent development is the increasing use of Eastern Baltic nationals as couriers at the local level and in other areas of Europe and Latin America. The same trend has been registered in regard to the employment of Polish, Estonian and Lithuanian nationals for trafficking cocaine both in Europe and the Americas.⁵⁴

1.3. MARKET STRUCTURE AND KEY ACTORS

The European cocaine market is dynamic and fragmented, involving the interplay of various OCGs that, in most cases, collaborate in a more or less stable way, as to carry out cocaine trafficking operations, sharing at the same time loads, risks and costs. The few studies conducted so far⁵⁵ as well as the data from the country studies in the current report (Bulgaria, UK, Italy, Estonia, Spain, France, Greece) consistently underline the presence of **fluid, horizontal and loose criminal networks** within the European cocaine market that have replaced the traditional hierarchical organisations. The former, having **high levels of flexibility and adaptability** in regard to business opportunities and contingencies, are structured into independent nodes – connected by key individuals (brokers) – with specific roles and duties along the trafficking chain: managers coordinating group activities, persons organising logistics (recover and purchase of vehicles and equipment) or dealing with the recovery of drugs/money. Brokers are crucial, since in charge of connecting potential partners, buyers and suppliers, employees and employers and having skills of networking extremely functional to the cocaine business.⁵⁶

Depending on the OCGs involved, relationships within networks may be based on ethnic, family, kinship, or friendship ties, useful to create business partnerships and acting at the same time as a guarantee of trust. The latter is fundamental for the smooth running of cocaine trafficking operations (Italy, Greece). Family bonds for example, are particularly important within Albanian and Italian OCGs; while friends and acquaintances can be either acquired during periods of detention

⁵⁴ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*, 47.

⁵⁵ J.S. Benson and S.H. Decker, "The Organisational Structure of International Drug Smuggling", *Journal of Criminal Justice* 38 (2010): 130-38; Kenney, "The Architecture of Drug Trafficking: Network Forms of Organisation in Colombian Cocaine Trade"; F. Calderoni, "The Structure of Drug Trafficking Mafias: The 'Ndrangheta and Cocaine'", *Crime, Law and Social Change* 58 (2012): 321-49; P. Kostakos and G. A. Antonopoulos, "The 'Good', the 'Bad' and the 'Charlie': The Business of Cocaine Smuggling in Greece", *Global Crime* 11, no. 1 (2010): 34-57; D. Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)* (London: Springer, 2002); D. Zaitch, "From Cali to Rotterdam: Perceptions of Colombian Cocaine Traffickers on the Dutch Port", *Crime, Law and Social Change* 38, no. 3 (2002): 239-66; N. Dorn, M. Levi, and L. King, *Literature Review on Upper Level Drug Trafficking* (Home Office Online Report 22/05, 2005); Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*; G. Pearson and D. Hobbs, *Middle Market Drug Distribution*, Home Office (London: Home Office, online report, 2001); F. Desroches, "Research on Upper Level Drug Trafficking: A Review", *Journal of Drug Issue* 37 (2007): 827-44.

⁵⁶ Kostakos and Antonopoulos, "The 'Good', the 'Bad' and the 'Charlie': The Business of Cocaine Smuggling in Greece"; Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*; Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

or encountered in the establishments of the “night-time economy” (Italy, UK, Greece, Estonia).

At present, several OCGs are involved in cocaine trafficking from the countries of origin in South America to Europe, resulting from the increased liberalisation of the cocaine market. Indeed, if on one side Colombian OCGs have become more fragmented into different partnerships, on the other some European groups have been able to settle as main importers and wholesalers serving both their national territories and other European countries.⁵⁷ At the same time, the retail level, as underlined by some country study reports (France, Italy, UK) is more fragmented and is managed by both native and foreign criminal entrepreneurs. The same OCGs can act as importers and wholesalers and also sell cocaine as a retailer. Nevertheless, it is more common that the retail part is managed by foreign individuals that can be either competitive to local OCGs or recruited by them.

In regard to importation and wholesale (the high level of the trafficking business), three main factors have contributed to the involvement of certain European OCGs, which over time have become competitive actors to the more traditional importers such as the Colombians:

- the **geographical position** of the countries (in terms of trafficking routes) allowing the importation of cocaine almost directly, as well as the proximity to key cocaine markets;
- the establishment of **trusted relationships with suppliers** in South America (i.e. Colombians and Mexicans);
- the availability, ownership, and/or the **control of strategic infrastructures and transit points** (e.g. import-export companies, sea ports, customs) facilitating large-scale cocaine trafficking (Spain, Italy, Bulgaria).

In particular, Spanish and Italian OCGs have nowadays a well-established relationship with Colombians, who have been active in importing huge quantities of cocaine to countries such as Spain, the Netherlands, France and the United Kingdom.⁵⁸

In Spain, alliances have existed between Colombian and Spanish (i.e. Galician) OCGs since the initial phase of cocaine trafficking to Europe, facilitated by the similarity of language and culture and the expertise of Galician groups in other illegal smuggling activities (e.g. illicit tobacco trade). Colombians were used to import cocaine in shipping containers from Venezuela, Brazil or the Caribbean countries, being in charge of production, while Venezuelans took care of transportation and Spanish groups of transferring the cocaine to the coast. Nowadays the situation has changed and Colombians are well settled into the local cocaine market, controlling the global supply chain (Spain).

Similarly, Italian organised crime groups (especially the ‘Ndrangheta and Camorra) hold trusted and stable relationships with South Americans

⁵⁷ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*.

⁵⁸ Ibid.

(Colombian and Mexican cartels) to import huge quantities of cocaine (from several kilos to tonnes via container shipments) to be further distributed to other European countries and throughout the territory of Italy. "In 2007, the Camorra located in Naples, was reported to have begun trafficking cocaine to Italy from Spain, as well as directly from South America. [Both Camorra and the 'Ndrangheta] are most heavily involved in the Italian cocaine trade. More recently, the Sicilian Mafia has also got involved, getting support from [these groups] to bring cocaine into the areas under its control."⁵⁹ Nevertheless, among Italian OCGs, the 'Ndrangheta is considered to be the strongest and most competitive group, since benefitting from ramifications almost worldwide (due to the presence of family members and affiliates), exercising a quasi-monopolistic position within the European and international cocaine market (Italy).

Serbian-Montenegrin OCGs have a similar role as they have recently started to be involved in large-scale cocaine trafficking operations at the EU level. Cocaine is imported from the Southern Cone countries in South America to the Balkans, exploiting legal commercial routes, and from there throughout Europe. In particular, these groups have established contacts in the supply countries, managing their own trafficking networks and investing profits in the legal economy of the Western Balkans and other EU countries. Among Eastern OCGs, the Bulgarians have turned more recently into large-scale cocaine importers from South America to Western Europe, and in some cases through joint ventures with Spanish, Italian, Colombian and Greek criminal entrepreneurs.⁶⁰

The main transportation method in large-scale cocaine trafficking operations is in shipping containers followed by road transportation, especially within EU. This way, cocaine is hidden in various commercial products or in the structure of containers or trucks. In many cases, OCGs own legitimate businesses associated with logistics, transportation, import and export of various commercial products (France, Bulgaria, Italy, Greece, Spain).

On a smaller scale, cocaine is trafficked with commercial flights from South America reaching major airports within EU. In this case methods include either hiding cocaine in luggage, as it occurs for example with Estonian couriers, or transporting it via drug mules (i.e. swallows).⁶¹ The latter are particularly used by African OCGs (i.e. mainly Nigerians), that import lesser quantities of cocaine employing numerous drug mules. West Africans have settled in several EU cocaine markets (UK, France, Germany, Switzerland, Spain, Italy and Portugal), while managing importation of cocaine in virtue of contacts with South Americans and links with European groups (e.g. Balkan and Italian OCGs) located in West African countries.⁶²

⁵⁹ UNODC, *The Transatlantic Cocaine Market*, 40.

⁶⁰ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*.

⁶¹ See also J.P. Caulkins, H. Burnett, and E. Leslie, "How Illegal Drugs Enter an Island Country: Insights From Interviews with Incarcerated Offenders", *Global Crime* 10 (2009): 66-93.

⁶² UNODC, *Transnational Organized Crime in West Africa: A Threat Assessment* (Vienna, 2013).

1.4. FINANCING AND FINANCIAL MANAGEMENT

Although the cocaine market at the EU level is fragmented into the interplay of different actors, common financing patterns can be underlined. First, the need in most cases is to have some **start-up capital to enter the cocaine business**; second, the coexistence of legal and illegal sources of financing that are invested to arrange cocaine trafficking at all levels of the operation (high/medium/low segments); third, the importance of social capital, in other words the relations with trusted individuals acting as guarantors of cocaine transactions on the side of buyers and suppliers; finally, the presence, especially at the high level, of **financial joint ventures**, in which different criminal groups participate in cocaine trafficking operations providing part of the total amount needed (Italy, Bulgaria, UK, Spain).

Sources of capital

Sources of capital to initiate and sustain cocaine trafficking operations are flexible, diverse and mutating, and depend on the circumstances, quality of contacts and the level of operation of criminal entrepreneurs. In the majority of cases, entering the market is facilitated by **social capital**. This way, it is possible to gradually acquire credibility, and money to be reinvested into subsequent cocaine deals.

Trusted contacts or intermediaries in virtue of ethnic ties, family or friendship bonds are of higher importance at the lower levels of the trafficking chain as they allow entrepreneurs to receive cocaine on credit. This seems also to be valid in particular circumstances involving large scale cocaine smuggling (Italy, UK). It is the case, for example, of the 'Ndrangheta which at first exploited previous contacts gained through heroin trafficking during the 1990s, and built their credibility as reliable and solvent traffickers at the national and international level, thus being able at present to import huge quantities of cocaine without any payment in advance.

Nevertheless, the **most common source of financing is illegal capital** acquired either from cocaine trafficking or other criminal activities, with the latter related to the level at which criminal entrepreneurs operate. In particular, lower segments usually finance cocaine deals through minor crimes such as robberies, thefts, burglaries; while medium/high segments perpetrate more risky and highly profitable activities ranging from extortion racket, loansharking, sexual exploitation and prostitution to tobacco smuggling and human trafficking (Italy, UK, Estonia, France, Greece).

In both cases, acquired capital is reinvested into subsequent cocaine trafficking operations as well as into the legal economy. Indeed, especially high level criminal entrepreneurs run legitimate businesses that may represent a source of financing of cocaine trafficking as well as means to launder the profits gained (Italy, UK, Spain, Estonia, France, Greece). For instance, a criminal group involved in the importation of large amounts of cocaine into the UK via Spain and Amsterdam relied not only on

cocaine trafficking but also on manufacturing and supplying amphetamine, cannabis cultivation, with some individuals holding legitimate companies such as fitting centres, fruit and vegetable shops, hotels, public houses. As a result, a net differentiation among sources of financing of cocaine trafficking appears particularly difficult, as underlined by the country reports (Italy, Bulgaria, UK).

At the same time, legitimate and illegal funds loaned by external financiers represent another source of capital to enter the cocaine business. Legal entrepreneurs investing capital for a share of the profits but remaining outside the trafficking operations, individuals using personal savings, or money borrowed from friends are just some examples (Bulgaria, Estonia, Greece, UK).

Raising capital is, in most cases, managed among more OCGs or families/clans of a same OCG in the form of financial joint ventures present at all levels of the cocaine market, although more common in regard to high level criminal entrepreneurs dealing with the importation of huge quantities of cocaine. The reason for such practices is in the opportunity to share among partners the risks related to cocaine trafficking operations, but also to secure additional financing if needed (Italy, Bulgaria).

Settlement of payments

In addition to functioning as a start-up means for entering the cocaine business, social capital is also fundamental when settling payments by allowing cocaine deals to go ahead even if criminal entrepreneurs have at their disposal less money than needed (Estonia, Italy, Bulgaria, UK, Spain, France).⁶³

Cash up-front appears to be the preferred way to settle cocaine payments (e.g. purchase prices are lower), especially at the initial phase of business relationships among criminal entrepreneurs since trust has yet to be built. This way, cash functions as a guarantee of the deal (cocaine is delivered after the payment) and the use of hostages as collateral is avoided (Italy, Bulgaria, Spain, Estonia, France). Three main recurrent methods for settling payments of cocaine have emerged in regard to the majority of OCGs and criminal groups operating at the EU level: **advanced payment, revolving credit and multistep payment arrangements.**

Advanced payment. This scheme involves mainly large-scale cocaine trafficking operations, regarding agreements between producers/importers and wholesalers. Buyers proceed with a payment in advance and receive the load of cocaine later, under a rule which is usually 50% payment (France, Bulgaria, Italy, Estonia).

The sum paid in advance functions as a guarantee of the commitment of buyers and is used to cover costs of transportation and other expenses

⁶³ See also L Korsell, D Vesterhav, and J Skinnari, "Human Trafficking and Drug Distribution in Sweden from a Market Perspective – Similarities and Differences", *Trends in Organized Crime* 14, no. 2-3 (2011): 100-124.

(e.g. bribes to officials). Furthermore, it ensures a kind of loyalty: the customer will more likely return to the same supplier acquiring a new quantity of cocaine. Similarly, in smaller scale trafficking operations, drug couriers or drug mules for example, usually receive part of the payment for their services in advance and then receive the rest after the consignment of the drug (Bulgaria).

Revolving credit. In this arrangement cocaine is paid once part or the whole load is sold by the buyers. When trust is well-established and business relationships well-tested, this settlement of payments is used among criminal entrepreneurs involved in large scale cocaine trafficking operations. In exceptional cases, the drug can be delivered also on full credit, as it occurs with the 'Ndrangheta in virtue of its strong credibility within the international cocaine market (Italy). At the same time, revolving credit represents the most common form of payment at the lower levels of the trafficking chain (Estonia). Indeed, street dealers (either employed in cocaine markets controlled by OCGs or in not controlled areas) receive cocaine on credit, being compelled to repay the sum of money earned in a short time (Estonia, Italy).

Multistep payment arrangements. In general, these arrangements are used by large-scale cocaine traffickers where payments between buyers and suppliers are accomplished in different phases and are carried out via bank or cash transfers (involving also certain money laundering operations) (e.g. in Bulgaria). A typical case is provided in the chapter on cocaine trafficking in Greece in this report, where the payment of between 1.5 and 3.2 tonnes of cocaine amounted to \$4,100,000 and was paid in three stages:

- at the first stage it was paid an amount of \$1,350,000 before the loading of cocaine;
- at the second stage, an amount of \$1,350,000 was paid as for the delivery and transiting of cocaine;
- at the third stage, another \$1,400,000 was paid after the delivery of the loads at the final destination and as a bonus for the success of the trafficking operation.

Payments of cocaine are made mainly in cash. It is the most used method of payment since it is less risky compared to financial transactions that could be intercepted (Italy, Greece, Bulgaria, UK, France, Spain). Indeed, some interviewed experts (Italy, Greece) have argued that traffickers prefer euros to dollars, as the former is available in high denomination notes which is extremely functional to cross border transportations. Cash payments require money couriers who are particularly trustworthy and who are not involved in the cocaine trafficking operations (Italy, Greece). Cash is transported by cars, trucks, airplanes, concealed in bags, false bottoms, and in most cases through means of transportation used for cocaine. It can be delivered directly to either producers/suppliers in South America or to their intermediaries located in other European countries, which in turn are in charge of the final delivery (Italy).

Non-cash settlement of payments – usually used by criminal entrepreneurs in small-scale trafficking operations – rely on money transfers (Western Union, etc.) (Bulgaria, Greece, Italy) or compensation-type money transfers such as the hawala (Spain, Italy). The former allows multiple transactions of money on a daily basis by different individuals, kept below the amount limit imposed by law and guaranteeing the anonymity of senders. The latter is based on a network of intermediaries located in different countries with no tangible traces of money transactions, which are settled and communicated to hawaladars using small papers (Italy, Spain).

Legitimate means are also used for cocaine payments. In this case, transactions occur between legal companies or registered shell companies, and are possible when cocaine is smuggled concealed in container shipments with other commercial products (Spain, Italy, Bulgaria).

Payments are also settled with valuable goods or services both at the high and low levels of the trafficking chains (Greece, Italy, Bulgaria, Estonia). For example, stolen products or gold and diamonds can be offered. At the same time, in kind payment occur as well, with reference to cases where services (e.g. transportation, recruitment) are paid with part of the cocaine smuggled (Estonia, Bulgaria). An example is when suppliers offer a kilo of cocaine and, in turn, receive a number of couriers (Estonia). In general, this practice that can take different forms, seems to allow the sharing of risks linked to the trafficking operation among players; while decreasing the possibility of money to be intercepted by law enforcement (Bulgaria). It is not currently possible to know in what proportions of the illicit trade such barter arrangements exist.

When OCGs operate at the high level of the cocaine market and via trusted relationships with suppliers, retaliation is not the rule since new agreements may take place. Nevertheless, in many cases, especially at lower levels insolvent buyers as well as their family members can face serious consequences (Estonia, UK, Italy). As indicated in the chapter on Estonia, criminal entrepreneurs at first apply various sanctions, especially financial ones, amounting to around 20% of interest rate for the operation.

Costs of doing business

There are variations in the costs sustained by OCGs and criminal groups in organising cocaine trafficking operations that depend on several factors:

- **the price** at which cocaine is purchased in the producing countries underlying the importance of the quantity acquired and the type of relationship with suppliers (i.e. the larger the quantity purchased the lesser the price per unit; well-established relations vs. occasional operations);
- **the place** in which the drug is purchased at the wholesale level (i.e. South America vs. European countries);
- **the scale** of the trafficking operations and the logistic employed/required (i.e. number of actors involved, means of transport);
- **the level** at which criminal entrepreneurs operate within each local market.

The average price per kilo of cocaine at the wholesale level in the producing countries (i.e. cocaine of unknown quality in Peru) in 2010 was estimated by UNODC⁶⁴ at \$947, while coca paste (farm-gate price) at \$784. Prices have started to increase from 2006, while decreasing to lower levels in 2010. These estimations are in line with prices reported by the country studies in the current report, with purchase price of 1 kilo of cocaine in South America ranging between €600 to €3,000 (UK, Italy, Greece), although also higher prices were found (Spain).

If cocaine is acquired at the wholesale level in any EU country, final prices per kilo are particularly higher and increase in respect to the number of passages cocaine has undergone along the trafficking chain (i.e. logistics), the place in which criminal entrepreneurs buy the drug (e.g. in South America or any EU country managing the whole importation process, or in their native country from another criminal group that has imported cocaine), and purity (around 90% at the wholesale level) (Italy, UK, France). For example, a retail dealer in Bulgaria would need €4,000-€9,000 start-up capital to buy 100-200 grams of cocaine.

Countries with the highest wholesale prices of cocaine per kilo in 2010⁶⁵ were the UK (\$76,897), Greece and Finland (\$59,612), Italy (\$53,593), Germany (\$53,496) and Switzerland (\$52,554), followed by Spain (\$45,034) and France (\$39,741). More recent estimates from the country reports underline quite different wholesale prices per kilo of cocaine: €40,000-€53,000 in the United Kingdom; €40,000-€45,000 in Bulgaria; €36,000-€44,000 in Italy; €32,000-€34,000 in Spain; €40,000-€50,000 in Greece and €30,000 in France.

Besides costs sustained by criminal entrepreneurs in purchasing cocaine in South America or in other EU countries, other costs at the importation and wholesale levels involve human and material resources that vary. If the import-export company is owned by traffickers, or cocaine is imported using the “rip-on, rip-off”⁶⁶ method, costs are lower and mainly related to the transportation of cocaine within the EU. If the traffickers need to open a new commercial channel (i.e. cocaine trafficking route) expenses rise since several containers with legal merchandise need to be sent first (Italy, France, UK, Greece).

Although there are cost differences among the studied countries in respect to the structure of each national cocaine market, there are also common features. These reflect the role and importance of individuals within the trafficking chain and consist mainly in fees-for-services (i.e. sum of money or percentages on the value of the load recovered/transported), rather than regular salaries (the only exception to this rule can be found at the retail level, as explained below). Furthermore, in-kind payments do not represent a usual method for members/employees remunerations, except at the high levels and when a cocaine business is

⁶⁴ UNODC, *World Drug Report 2012* (Vienna: UNODC, 2012), 40.

⁶⁵ UNODC, *World Drug Report 2012. Statistical Annex. Prices* (Vienna: UNODC, 2012), 1.

⁶⁶ The method “rip-off, rip-on” consists in sending cocaine in bags introduced in container shipments with the support of accomplices in charge of inserting the drug at departure and extracting it at destination.

at the initial phase. Bribes paid to officials emerge as a common expense needed to ensure the success of the trafficking operations.⁶⁷ Overall, costs can include the following:

- **Transshipment services:** €10,000 to set up an import-export company or \$1,500,000 to create a maritime company (Italy, Greece); payments to complicit legal entrepreneurs owning import-export companies at 30% of the value of the load at the EU price or €50,000 for each supply; transshipment service costing €10,000 per container (Italy).
- **Drug brokers:** earning from 3-4% up to 10% of the value of the load at the EU price (Italy).
- **Drug couriers:** these individuals can be paid per trip with cash or with a percentage on the value of transported loads (at the EU wholesale price). Prices of couriers may range from €600-€1,300 per job (UK) to €4,000-€6,000 per kilo transported within EU (Italy).
- **Drug mules:** swallows are paid per trip with travel and accommodation expenses covered at about €2,000/€3,000 (Bulgaria, Italy), so that an OCG operating with 10-15 drug mules has to secure around €18,000-€22,000.
- **Money counters and collectors:** they may receive €400 to €650 per day or 2-3% of an international transaction (UK).
- **Money couriers:** earning around €1,000 (salary and expenses) per trip (UK).
- **Bribes to officials** are lower in the producing countries and usually between €1,000 and €5,000 per load (Italy, France), and higher in EU destination/transit countries, €10,000 per container (Italy).
- **Fees for protection:** in order to ensure the security of the trafficking operations and the recovering of cocaine in the destination countries, traffickers may need to pay fees to other OCGs, in the form of a share of profits of the deal at around 10% (Estonia).

Once cocaine is imported, OCGs encounter other costs related to the management of the retail level, including fees to individuals in charge of storing the drug or cutting and packaging the doses, paying street dealers or couriers delivering cocaine to the former, while in some cases covering also expenses for gasoline, mobile telephone cards, etc. (Bulgaria, Italy). In cocaine markets which are under the control of OCGs, as in Italy, street dealers receive prepared cocaine doses and they are paid with regular salaries, facing no particular expenses. At the same time, other costs (on a monthly basis) are related to running cocaine markets such as paying chemists for cutting cocaine (€10,000), warehouse keepers (€7,500), armed sentinels (€6,000), money collectors (€10,000-€15,000), street dealers (between €2,000-€6,000 depending on the location).⁶⁸

Profits, profit sharing and investments

Drug trafficking clearly constitutes the largest income for OCGs operating worldwide and cocaine trafficking plays a key role in this. Nowadays,

⁶⁷ See also Korsell, Vesterhav, and Skinnari, "Human Trafficking and Drug Distribution in Sweden from a Market Perspective – Similarities and Differences".

⁶⁸ These estimations are based on a sample of three Italian markets located respectively in Scampia and Afragola – neighbourhoods of the city of Naples and the city of Bari.

the value of the global cocaine market appears to be lower than it was during the 1990s, when prices were much higher and the US market was strong. There is significant dispute over estimates of the size and economic value/profits from drugs markets, especially outside the US. In 1995, the global market was estimated at \$165 billion, a value that was reduced by over a half by 2009. In particular, in the same year, both North America and Western and Central Europe registered 86% of the total amount of the global cocaine market, respectively 47% and 39%. Indeed, whilst the North American market narrowed over the last two decades, the European one has expanded. "Nonetheless, the US market remains the largest globally, but the market of the countries of Western and Central Europe (\$33 billion at retail level in 2009) is – in economic terms – now nearly as large as the US market (\$37 billion in 2009)."⁶⁹ Furthermore, in 2009, out of the \$85 billion in income from global cocaine retail sales, traffickers were estimated to have gained some \$84 billion (99%). In particular, the "largest gross profits were reaped from cocaine sales in North America (around \$34 billion), followed by countries of West and Central Europe (around \$23 billion)."⁷⁰

TABLE 3. ESTIMATES OF GROSS PROFITS MADE BY COCAINE TRAFFICKERS BY REGION, 2009

Region	billion \$	as% of GDP
South America, Central America, Caribbean local market	3	0.1
Export to North America*	6	0.2
Export to Europe**	9	0.3
Subtotal South America, Central America, Caribbean	18	0.6
North America (USA, Mexico, Canada)	34	0.2
West and Central Europe (EU-25 and EFTA)	23	0.1
West and Central Africa (local demand and export to EU)	0.8	0.2
Other	8	0.04
Total trafficking profits	84***	0.1

* Trafficking from producing areas in the Andean region to Mexico.

** All trafficking to transit countries (\$4.9 billion) and from transit countries to Europe (\$6.1 billion) of which 70% (\$4.3 billion) is assumed to be generated by trafficking groups from South America and the Caribbean; gross profits for trafficking to Europe are higher as prices in Spain (the main entry point to Europe) are much higher than prices in Mexico (the main entry point into North America).

*** The difference between the total size of the global cocaine market (\$85 billion) and gross trafficking profits (\$84 billion) is income of farmers; farmers are estimated to earn less than \$1 billion.

Source: Authors' elaboration on UNODC, *World Drug Report 2011*.

The percentages of profits vary and increase throughout the trafficking chain. Farmers in the Andean region take 1% of the proceeds from the cocaine sales in Europe, while OCGs that ship the cocaine from this

⁶⁹ UNODC, *World Drug Report 2011* (Vienna, 2011), 124.

⁷⁰ *Ibid.*, 125.

area to entry points (usually Spain) gain 25% of the final sales value. A further 17% is produced in shipping the cocaine from the entry points to the wholesalers in the final destinations located in Europe. The highest profit is gained in the destination countries. In 2009, “expressed as a proportion of GDP, the cocaine profits were rather small (0.2% of GDP in North America and 0.1% in West and Central Europe). Profits from international trafficking to North America and Europe [amounted] to some \$15 billion, [and] cocaine-related profits generated in South America, Central America and the Caribbean from trafficking cocaine to North America and West and Central Europe amounted to some \$18 billion, equivalent to 0.6% of the total GDP of South America, Central America and Caribbean”.⁷¹

Huge profits are made by OCGs due to significant differences in the costs of purchasing and price of selling of cocaine that exist between South America and EU countries. For instance, when cocaine is imported to the UK – costing around €2,700 per kilo in South America, €10,400 in the Caribbean, €41,000 at the wholesale and €70,000 at the retail levels in the UK – mark-ups are respectively 550%, 280%, 292% and 89%. Nevertheless, profits margins may depend on several factors – availability of cocaine in a given market, the retail prices (which differ among EU markets), quantity acquired, quality of the drug (i.e. level of purity), and risks taken/encountered (seizures and arrests) (UK, France, Italy, Bulgaria).

Mark-ups are fairly consistent at the higher levels of the operations (i.e. importation and wholesale) while decreasing along the trafficking chain (Italy, UK, Estonia, Bulgaria). At the retail level, profit margins are mainly related to cutting cocaine (if acquired at a good level of purity) but still remain low (Italy, UK, Bulgaria). Examples provided by criminal entrepreneurs selling cocaine at this level include €1,300 per month at the peaking of cocaine deals (UK) and higher revenue of €10,000 selling 140 grams per week (Bulgaria).

Profits are not distributed equally to all members but depend on the role and the position within networks and the risk taken within cocaine trafficking operations. Thus, drug brokers or traffickers that invest capital, in charge respectively of contacting suppliers, organising the logistics and transportation on one side and financing the operations on the other, receive high shares (Italy, Greece). Revenues are also divided among OCGs according to their initial investments; while other individuals (mainly employees such as couriers, drivers, drug mules) are paid with lump sums per service provided (UK, Italy).

How profits are invested depends on their scale: criminal entrepreneurs operating at the retail level, gaining lower revenues, use them for personal expenses (e.g. luxury items, lavish life style, gambling) or to acquire further quantities of cocaine, keeping at the same time part of the money aside (Bulgaria, Italy, UK). At higher levels (importation and wholesale), investments are more diversified. In most cases, part of the

⁷¹ Ibid.

profits is used to finance subsequent cocaine trafficking operations as well as other criminal activities, such as tobacco smuggling, trafficking of other drugs (e.g. cannabis, amphetamines), human trafficking, arms trafficking, loan sharking. Part of the revenues is also invested into the legitimate economy through different money laundering techniques (Italy, Bulgaria, Spain).

Investments are made in real estate (e.g. hotels, pubs, restaurants, discos, shopping centres, logistics, etc.) or legitimate companies; some of these are used in cocaine trafficking, as for example import-export companies, shipping companies, etc., and to continue laundering profits (Italy, Greece, Bulgaria). In this regard, **legal entrepreneurs in financial difficulties became particularly vulnerable** to OCGs due to the economic crisis. Indeed, the latter offer loans at high interest rates as to acquire gradually a business with a solid reputation and history, since the legitimate owners, sooner or later, will not be able to repay back the accumulated debts (Italy, Spain). In some cases “a merger is proposed [...] with the aim of isolating and *de facto* excluding from any decisional function the partner in difficulty, at the same time exploiting his good name and honest face”.⁷²

In general, in the acquisition of legal assets a key role is exercised by complicit individuals that may range from straw men, family members to whom the properties are registered to professionals such as bankers and lawyers who facilitate the entering of proceeds into the legal system as well as their further use (Italy, Bulgaria).

Access to capital in critical moments

Critical moments – members or employees arrested, seizures of loads or stealing by competitors – have a lot in common with the initial stages of operation in terms of financing needs (Bulgaria, Italy, Estonia, UK). Criminal entrepreneurs at the high level need to ensure the safety of trafficking (fees to competitive OCGs, bribes to officials), and need to ensure consistent funding to continue the cocaine business. Financial resources are indeed invested in legal businesses/properties that may serve as substitute capital, while cash is also moved into off-shore bank accounts, or bank and/or home-made safe deposit boxes (Italy, Greece, Bulgaria).

In case of arrest of high level OCGs members, detention seems not always to function as a deterrent or incapacitation. Indeed, criminal entrepreneurs may still run the trafficking directly from prison via third persons (e.g. family members, affiliates, trusted accomplices). Furthermore, it is even more likely that new contacts useful for future cocaine trafficking operations would be established. When affiliates or external employees are arrested, the coverage of expenses related to legal assistance as well as family maintenance is guaranteed so as to obtain silence and loyalty (Greece, Italy, UK).

⁷² Europol, *Threat Assessment. Italian Organised Crime*, 16.

Social capital can help people re-enter the cocaine business. Criminal entrepreneurs (usually middle-low segments) can receive the drug on revolving credit or loans from other OCGs to be paid back at some percentage of interest (Italy, Bulgaria, Spain). For example, a UK trafficker was jailed for six years. Once out, he started to buy cocaine on credit from an old associate, although at first at a higher price. But, when trusted relationships are lacking, the possibility to restart cocaine deals is acquired by committing minor crimes (e.g. thefts, robberies), providing services (e.g. transportation) or selling/exchanging personal assets (e.g. cars) (UK, Italy). Overall, despite critical moments, at all levels of the cocaine market criminal entrepreneurs seem to be able to continue with their criminal activity without facing particular problems.

2. ILLICIT TOBACCO TRADE IN THE EU: THE FINANCES OF A FRAGMENTED BUSINESS

The illegal trade in tobacco products is a manifestation of organised crime with a long history that has only relatively recently begun to receive academic and law enforcement attention. The following four schemes characterise the illegal tobacco trade over the last three decades:

- **Bootlegging** – buying an amount of cigarettes and tobacco that exceeds customs regulations. Bootlegging schemes, which abuse cross-border shopping, involve individual entrepreneurs and small groups of entrepreneurs smuggling small quantities of cigarettes and/or tobacco while visiting other countries with relatively cheaper cigarettes.⁷³ According to the European Commission,⁷⁴ approximately one-third of EU citizens who travelled to another EU country in 2008 returned with cigarettes of a lower price, with over 60% of Irish, British and French travellers engaging in the process. There is no indication as to the extent to which these cigarettes were re-sold on the black market (as opposed to being bought for personal consumption), however, the aforementioned figures are indicative of the extent to which the phenomenon of cigarette bootlegging is involved in a process of **decentralisation**.
- **Large-scale smuggling** of untaxed tobacco products diverted from the licit international market. This type of smuggling is dependent upon an interaction with legal businesses who (wittingly or unwittingly) participate. This scheme is, therefore, embedded in legitimate business processes.⁷⁵
- **Counterfeiting** is the manufacturing of fake tobacco products. A significant source country for counterfeit cigarettes destined for the EU market is China. After aggressive and effective crackdowns against cigarette smuggling and domestic distribution channels, the Chinese illegal cigarette industry shifted to exporting large numbers of counterfeit Western brand cigarettes to black markets abroad. This included targeting markets in the EU, most notably the UK. China emerged as a leading supplier of counterfeit cigarettes in the EU and beyond as a result of the contradictions of their economic reform process and of external licit and illicit forces that worked together toward opening up the Chinese tobacco sector to the outside world.⁷⁶ Moreover,

⁷³ See R Hornsby and D Hobbs, "A Zone of Ambiguity. The Political Economy of Cigarette Bootlegging", *British Journal of Criminology*, no. 47 (2007): 551-71.

⁷⁴ European Commission, *Survey on Tobacco. Flash Eurobarometer* (Brussels, 2009).

⁷⁵ K. von Lampe, "The Trafficking of Untaxed Cigarettes in Germany", in *Upperworld and Underworld in Cross-Border Crime2*, ed. P. van Duyne, K. von Lampe, and N. Passas (Nijmegen: WLP, 2002), 141-61.

⁷⁶ A. Shen, G. A. Antonopoulos, and K. von Lampe, "The Dragon Breathes Smoke': Cigarette Counterfeiting in the People's Republic of China", *British Journal of Criminology* 50, no. 2 (2010): 239-58; K. von Lampe et al., "The Changing Role of China in the Global Illegal Cigarette Trade", *International Criminal Justice Review* 22, no. 1 (2012): 43-67.

in recent years there have been reports about counterfeit cigarettes being produced in countries such as Ukraine, Poland, Bulgaria, Spain, and Greece, and closer to destination markets within the EU.

- **Other sources** include legally manufactured cigarettes which are stolen from legal premises (retail markets, supermarkets, kiosks etc.) before they are introduced into the illegal market⁷⁷ and online sales of legally produced tobacco products. Furthermore, a significant phenomenon has emerged relatively recently, which involves legally produced tobacco products manufactured in the free zones of Eastern and South Eastern Europe, UAE, Malaysia and South Africa, that are readily available to illegal marketers (also known as “illicit whites”). The most known case in the European market is that of Jin Ling, a brand legally manufactured in the free zone of Kaliningrad (Russia), yet destined for the EU illegal market. With packaging resembling that of Camel, Jin Ling is one of the most seized brands in the EU.⁷⁸

2.1. ESTIMATES OF THE ILLEGAL TOBACCO TRADE IN EUROPE

A variety of methods have been employed in an attempt to quantify the illegal trade in tobacco products in Europe. They include customs seizure data, smoker surveys, empty pack and cigarette butt collection analyses, household surveys relating to the consumption of tobacco products and governmental and trade monitoring data.⁷⁹ These various data sets highlight a great deal of diversity relating to illegally traded tobacco markets and consumption patterns across different EU countries. For example, in Latvia there is a 28.8% illicit share of the overall tobacco products national market present, whereas in Slovakia only 1.7% of the overall national market is made up of illegal tobacco products. The EU-27 average is 10.5% (Figure 5),⁸⁰ which is slightly lower than the global illicit trade (11.6%).⁸¹

The share of contraband and counterfeit cigarettes in the EU increased by 60.8% between 2006 and 2010.⁸² The most important reasons for this were considered to be the increase in excise rates, alongside VAT and special consumption taxation in several countries which – in light of the reduction in the public’s buying power (particularly after the economic recession in the Eurozone in 2008) – led to a

⁷⁷ G. A. Antonopoulos, “Cigarette Smuggling: A Case Study of a Smuggling Network in Greece”, *European Journal of Crime, Criminal Law and Criminal Justice* 14, no. 3 (2006): 239-55.

⁷⁸ S. Candea et al., “Made to Be Smuggled”, in *Tobacco Underground*, ed. ICJ (Washington D.C.: Centre for Public Integrity, 2009), 13-24.

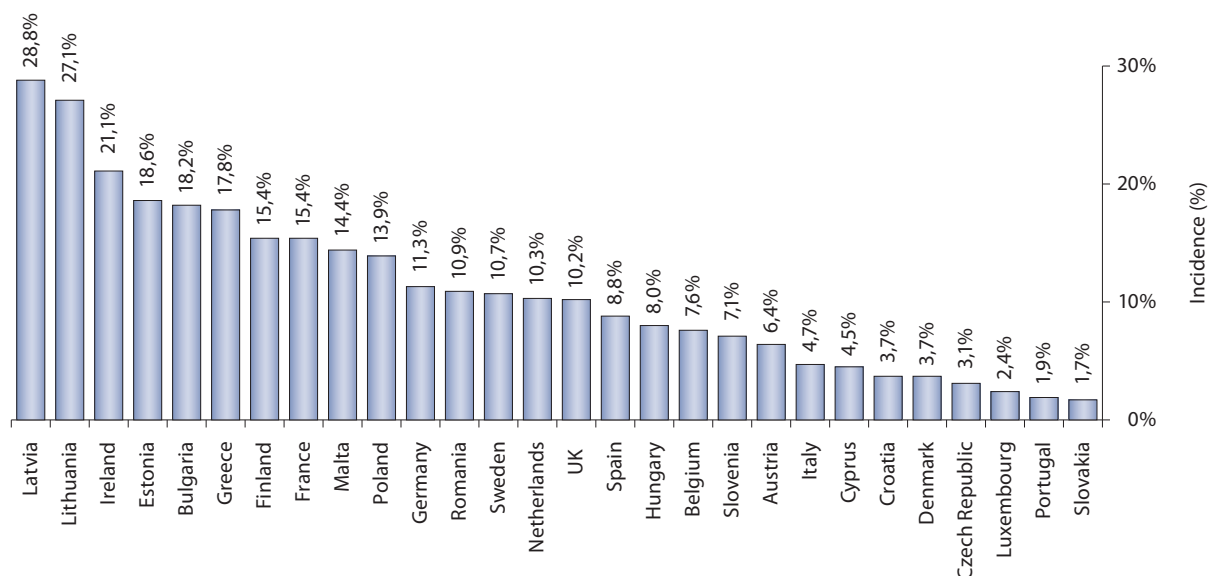
⁷⁹ See F. Calderoni, “A New Method for Estimating the Illicit Cigarette Market at the Subnational Level and Its Application to Italy”, *Global Crime* 15, no. 1/2 (2014): 51-76.

⁸⁰ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

⁸¹ L. Joossens et al., *How Eliminating the Global Illicit Cigarette Trade Would Increase Tax Revenue and Save Lives* (Paris: IUTLD, 2009); see also L. Joossens and M. Raw, “From Cigarette Smuggling to Illicit Tobacco Trade”, *Tobacco Control* 21 (2012): 230-34. For a general review of evidence, see P. Reuter and M. Majmundar (eds.), *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from the International Experience*, (Washington D.C.: National Academies Press, 2015).

⁸² KPMG, *Project Star. 2010 Results*, 2011.

FIGURE 5. SHARE OF ILLEGALLY TRADED TOBACCO PRODUCTS AS PART OF OVERALL CONSUMPTION IN THE EU, 2013



Source: KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results* (London, 2014).

sudden decline in consumer affordability. In addition, according to the available evidence, inflows from non-EU countries accounted for the bulk of illegally traded cigarettes in Mediterranean and Eastern border European Union member states.⁸³ There was also a further small increase (0.6%) from 2010 to 2013.⁸⁴ However, in subsequent years significant and varied changes in the consumption levels of illicit tobacco products (specifically cigarettes) have been noted in different countries, with some countries presenting increases and other decreases in consumption (Table 4).

TABLE 4. CHANGES IN THE CONSUMPTION OF CONTRABAND AND COUNTERFEIT CIGARETTES IN SELECT EU COUNTRIES, 2013 COMPARED TO 2012

Country	Increase%	Country	Decrease%
Greece	+4.4	United Kingdom	-6.2
Hungary	+3.9	Italy	-3.8
Bulgaria	+2.7	Austria	-3.4
Cyprus	+2.4	Latvia	-1.8
Malta	+2.3	Sweden	-1.7

Source: KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

The aforementioned figures need to be treated cautiously. Illegal markets involve economic activities that are intended to go unnoticed and thus unrecorded in the official statistics. Although some data are produced and presented here, a number of factors might have skewed the statistics. For example, the intensity and success/failure of law enforcement operations or the weakness of the methods adopted to collect data impact on the figures. Therefore, measu-

⁸³ Ibid.

⁸⁴ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

ring the actual extent of the illicit market in tobacco in the EU (and elsewhere) is extremely difficult.⁸⁵

2.2. STRUCTURES AND KEY ACTORS INVOLVED

Tobacco-related criminal conduct is often presented by media, law enforcement and industry accounts in the rhetoric of “transnational organised crime”, a phrase with much mystique and threatening imagery.⁸⁶ However, the available evidence from a variety of European contexts shows that a substantial part of the distribution market, with the exception of big importers in some countries (e.g. Bulgaria), is covered by somewhat older, lower middle-class, individuals who are not hardened career criminals and are not involved in a diverse set of criminal activities.⁸⁷ Instead, most are action-oriented individuals, who in most instances act for their own personal interests in this market alone. The closer one gets to a cigarette smuggler, the more the stereotypical image of an “organised criminal” dissolves. Illegal cigarette entrepreneurs are often “unusual suspects” who do not fit the profile of an archetypal smuggler.⁸⁸ The composition of a typical group of transporters – the groups most involved with the authorities – is better understood in the context of varied and networked relationships of individuals keen on securing a share of the market. Generally, these individuals do not form structured organisations characterised by a sophisticated division of labour. At the core of collaboration between and among these entrepreneurs often lie family or kinship relationships, as well as relationships forged within legal businesses (e.g. employer-employee, business partners, etc.).⁸⁹ Violence and threats of violence are rare as they attract unnecessary attention and are deemed bad for business. However, although entrepreneurs involved in the trade do not use violence as an integral part of their illicit tobacco trade schemes, there are instances in countries such as the UK, Greece and Germany, where they have become the victims of extortionists who impose informal taxes on their profits. In addition, there are cases in which legal retailers are forced by illegal suppliers to sell contraband tobacco products in their legal businesses (Sweden) and extremely rare cases in which threat of violence is sometimes used to ensure share of profit by investors (Austria).

⁸⁵ See P. Reuter and M. Majmundar (eds.), *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from the International Experience*, (Washington D.C.: National Academies Press, 2015).

⁸⁶ See National Audit Office (UK), *Progress in Tackling Tobacco Smuggling* (London, 2013).

⁸⁷ See P. C. van Duyne and G. A. Antonopoulos, *The Criminal Smoke of Tobacco Policy Making: Cigarette Smuggling in Europe* (Nijmegen: Wolf Legal Publishers, 2009).

⁸⁸ G. A. Antonopoulos, “Cigarette Smugglers: A Note on Four ‘Unusual Suspects,’” *Global Crime* 8, no. 4 (2007): 393-98.

⁸⁹ K. von Lampe and P.O. Johansen, “Criminal Networks and Trust: On the Importance of Expectations of Loyal Behaviour in Criminal Relations”, in *Organised Crime, Trafficking, Drugs*, ed. S. Nevala and K. Aromaa (Helsinki: HEUNI, 2004), 102-13.

Overall (excluding actors such as corrupt public officials,⁹⁰ political elites or extortionists that are not involved in the business *per se*), the major players in the illegal tobacco business can be distinguished according to the following categories:

- **Manufacturers.** For the majority of EU countries manufacturers are based outside the country. However, there are a small number of countries where merchandise is legally produced in the country before being fictitiously exported and re-introduced into the country of origin and its illegal market. These manufacturers can operate a legal or illegal business in a similar vein to the cases of Chinese counterfeiters mentioned above. Some illegal manufacturers own mobile production facilities, which are installed for brief periods of time in various countries (primarily in Eastern and South-eastern Europe) (Bulgaria, Poland).
- **Importers and wholesalers.**⁹¹ Similar to other illegal trades, importers and wholesalers are the entrepreneurs who have the capital to invest in the illegal cigarette market. Importers and wholesalers tend to absorb most costs relating to the business and the risks associated with it (for example, seizure or loss of the merchandise, transportation between/among countries, and bribes to officials). Although the available evidence largely suggests that there is very little “commodity hopping”, it is not unusual for this type of entrepreneur, at this level, to be involved in cigarette smuggling alongside the smuggling of other commodities such as fuel, medicines or alcohol fraud.
- **Retailers.** This category includes individuals who regularly travel (tourists, students, etc.) driven by the price disparities between/among countries. These individual smugglers could be labelled as **occasional smugglers**, presented with a one-off smuggling opportunity during a trip abroad, or **regular smugglers** who see a business opportunity and become more frequently involved in tobacco smuggling whilst travelling abroad. This category also includes small (legal) shop-owners and street-sellers. For some retailers, such as those who own a legal business selling cigarettes or other commodities, the illicit trade in tobacco products is a means of increasing income or covering losses encountered in their legal business (Greece, Spain). For some other retailers, and specifically those involved in street-selling (very often migrants struggling to find legitimate work) socio-economic marginalisation is the common characteristic and the illicit tobacco trade is one of the very few employment options available.

⁹⁰ Although, it should be mentioned that in some cases these corrupt officials have been active participants in the illicit tobacco business. The intensive involvement of State Security officers in the Bulgarian tobacco business in the 1980s, for example, is considered a decisive factor for the evolution of the tobacco smuggling networks in the 1990s.

⁹¹ In some pieces of work (e.g. Antonopoulos, “Cigarette Smuggling: A Case Study of a Smuggling Network in Greece.”) the term “pusher” is used to connote a mid-level wholesaler being linked to street-sellers or other retailers.

2.3. FINANCING AND FINANCIAL MANAGEMENT

Sources of capital

Start-up capital is perhaps the most critical issue in the financing of the illegal tobacco trade. This is because once a smuggling operation is up and running it can generate sufficient profit to allow further investment in schemes in a number of self-financing cycles (Belgium, Bulgaria, Greece, Netherlands, UK). Start-up capital is required to enter the illicit trade in tobacco and the amount can depend on the quantity or quality of the merchandise a criminal entrepreneur desires to trade or can trade in. There are a wide range of financial sources used to initiate tobacco smuggling operations. The first concerns small scale smuggling/bootlegging, which usually involves **funds from legitimate work and savings** (Italy, Greece, UK). These are the types of funds that are the least remarkable because virtually anyone with a small amount of capital can become involved in the business via this source of finance, from holidaymakers and immigrants, to students and those whose legitimate work includes international travel (e.g. transportation, import-export industry). Usually in these instances, small amounts of money are invested in the illegal tobacco trade because small-scale entrepreneurs cover a minor market share in their specific locality. Moreover, in some cases these small-scale criminal investors/entrepreneurs invest less than they could as an intentional detection avoidance tactic, in order to circumvent both the attention of the police and local extortionists (see UK).

The second source identified in this study relates to **funds from legal businesses** that belong to, or are managed by, illicit tobacco entrepreneurs. Industries such as transportation, the construction and food industries and establishments catering to the night-time economy (pubs, bars, clubs) are prominent as a financing source in large-scale smuggling. It is interesting to note that grey profits from legal businesses (e.g. defrauding customers, black labour or tax evasion) have also been noted as means of investment in the illicit tobacco business (Sweden, UK).

In a large number of cases legitimate businessmen invest funds in “**financing consortia**” or “**conglomerates**.” By grouping together their investments and spreading the risk, larger quantities of tobacco can be imported with a reduced financial risk per individual investor if the merchandise is seized by the authorities or lost (Bulgaria, Germany, France, Hungary, Sweden, UK). In Bulgaria, oligarchic groups involved in large-scale schemes use political and judicial influence to protect their investment. Some investors stick with such a conglomerate for a prolonged period of time, some drop out after a few importations, and some are involved in a single importation. Usually there is a core set of investors who know each other through their involvement in various other legal (and occasionally illegal) projects who are better positioned in the scheme because they know brokers and other strategic individuals involved in the whole process (Bulgaria, Greece, Sweden, UK). Other

similar conglomerates are facilitated by ethnicity (Czech Republic, UK). Thus, in essence, social capital is as important as financial capital, especially in large-scale smuggling networks.

Another source of funds for the illicit tobacco business is other **illegal activities and businesses**, although this is a rather uncommon source. This study came across individuals heavily involved in drug dealing, fuel smuggling, theft, extortion schemes, the illicit pharmaceutical trade, and counterfeiting (Greece, Italy, Romania, Sweden, UK). Once they have a profit from cigarettes they invest in cycles (Belgium, Sweden). There are also illegitimate financing consortia in which 2-3 criminal entrepreneurs similar to the legal businessmen mentioned above invest a sum towards importing a load of cigarettes and then share the profit on the basis of the investment. In some countries, the type of illegal activities and businesses as sources of capital in the illicit tobacco business is often dependent on the level of smuggling. For example, in France wholesale smuggling is funded by gambling and extortion, and small-scale smuggling by frauds, small-scale drug dealing and thefts and receiving. Loans from criminals and/or loan sharks are extremely rare in the illegal tobacco business (Sweden, UK). Finally, some entrepreneurs have multiple funding sources, which amalgamate some of the sources that are mentioned above or include some ingenious ways of making money such as setting up a raffle.⁹²

With reference to the background of investors involved in the illegal tobacco trade, it is difficult to provide a typical profile due to the openness and low entry threshold of this particular market as well as local and national peculiarities. In some cases the supply chain is so fragmented and diverse across countries, that it makes it extremely difficult for the authorities to obtain information on the background of financiers (Spain). However, when it comes to large-scale smuggling, entrepreneurs are usually legal businessmen with links to legal manufacturers and others in industries that are functional for tobacco importation, i.e. transportation, import-export company owners (Bulgaria, Belgium, Germany, Greece, Netherlands, UK). However, legal business people whose legal portfolios are irrelevant to the tobacco industry are also present (e.g. Vietnamese textile trades in the Czech Republic; also Greece, Hungary, Ireland, Italy, UK). Criminals involved in a variety of illegal activities also invest in the tobacco trade, although by no means are they typical tobacco entrepreneurs (Bulgaria, France, Italy, Romania, Sweden, UK). In Bulgaria, the Czech Republic, and France the links among investors are facilitated by ethnic links, business links (Bulgaria, Czech Republic, Germany, Greece, France, Ireland, Netherlands, UK), familial and neighbourhood links (UK), and links established in prison (Greece, UK).

Settlement of payments

Usually small-scale smugglers/bootleggers of illicit tobacco tend to use a variety of suppliers including duty-free shops or legal retailers in foreign countries with lower prices for cigarettes and tobacco. In this

⁹² See the UK chapter in this report.

case, there are no special arrangements with regards to payment. The merchandise is purchased legitimately via credit card or cash up-front. In large-scale schemes, cash is the typical method used for payment of a large quantity of illicit tobacco and in most of the cases there is exchange of merchandise with money (Germany, Greece, Romania, UK). In some cases, there is pre-payment for a load (Bulgaria, Germany, Lithuania), and in extreme cases, guarantees are offered in the form of other assets (e.g. a boat, UK) and commodities such as drugs (Bulgaria, UK). In one case in Bulgaria, cocaine and heroin were provided for a load of cigarettes. Credit is rather rare in the tobacco business at the European level, although it is present in some contexts. The provision of credit is facilitated by trust among actors involved and, specifically, the broker who may be able to vouch for the trustworthiness of the entrepreneur receiving the merchandise. Credit is more prevalent at the importation/wholesale level and after years of frictionless collaboration between and among entrepreneurs in both legal and illegal schemes. The nature of the business relation (consolidated vs. non-consolidated) is integral in the cases in which credit exists, most frequently with cash in advance, particularly if the business relationship is new.

In order to settle payments a number of actors facilitate the process. This includes brokers (Ireland, UK, Greece, Germany, Hungary) who can be members of a close-knit ethnic group, which was reported in both the Czech Republic and France. Brokers get paid towards the upper level (wholesale/importation level) of the business and their fee may be standard (e.g. a couple of thousands of pounds/euros per importation), or in the case of large deals, they can be paid 1% of the profit made by an importer (UK). Other important actors involve commercial money transfer services (Austria), and cash couriers/money collectors (Belgium, Bulgaria, Czech Republic, Germany, Latvia, UK). Money couriers sometimes work for a number of unconnected schemes, and they are hired because of the trustworthy reputation they have built over time (Germany). When money couriers/collectors are involved they charge a fee, which varies depending on the scale of the project as well as the context in which the transactions take place (Austria, Belgium, Czech Republic, Germany, Ireland, UK). For example, in Belgium the fee is 10% of the collected amount, in the UK it is 0.5%, in the Czech Republic it is 1-2% of the total amount and in Germany 3-5%. There was a case in Hungary in which money couriers/collectors were paid with merchandise instead of a fee. These data are based on a limited range of known examples, and what accounts for this market variation in fee levels is not well understood: all that is clear is that this is not an area where the Single European Market regulations apply.

At the EU level bank transfers are rarely used to settle payments and are a rather atypical feature of the illicit tobacco trade (Greece, Spain). In Bulgaria, however, at the level of importation of illicit whites and raw tobacco by legal tobacco manufacturers producing cigarettes for the illegal market, a great deal of the payments are carried out through the legitimate financial system – either through money order services or bank transactions. It is after the tobacco is imported in the country that business transactions are settled in cash.

Towards the lower echelons of the business in Sweden, legal retailers can be intimidated into selling contraband cigarettes by suppliers. These retailers simply sell the cigarettes and hand over the money to the supplier. In these cases, settlement of payment resembles extortion rather than normal business strategy.

Costs of doing business

The costs of doing criminal business depend on a variety of factors: the scale of the scheme and its logistical complexities, the country of supply and the distance from the consumption/destination country, the legality and number of different suppliers per scheme, the number of actors involved, the assumption of the risks involved, and a number of *ad hoc* unforeseen expenses.

Buying and producing the merchandise. Usually small-scale smugglers/bootleggers buy and sell relatively small quantities of cigarettes and tobacco obtained primarily from legal retailers. However, occasionally, as is the case with slightly bigger schemes, they will be obtained through illegal suppliers (UK). For small-scale schemes, buying the merchandise depends on the legal prices of tobacco products in the particular country in which the merchandise is purchased. For large-scale schemes (importation/wholesale) costs depend on the legality of the merchandise imported. For instance, a container of legally produced cigarettes is more expensive than a container of counterfeit cigarettes, which in turn is more expensive than a container of illicit whites.

In order to cut down the costs associated with importing cigarettes and tobacco from China, Eastern Europe and other producing countries, illegal factories have begun to be identified in a number of EU countries.⁹³ These factories are not present in every EU country and the costs associated with production vary considerably. Costs can depend on the scale of the scheme and the differential sophistication and resulting costs involved in, for example, renting a warehouse with a long-term or short-term horizon (Belgium vs the UK). Costs also depend on the amount required to purchase and install the essential tobacco manufacturing machinery required to begin production, which varies significantly depending on its source. For example, manufacturing machinery that was seized by the German authorities cost €500,000, machinery found in Latvia cost €150,000-200,000, in Belgium €220,000, and in a case in the UK as little as £7,000. Finally, the costs associated with the production of tobacco products depends on whether cigarettes (legal, counterfeit or illicit whites) or hand-rolling tobacco is being produced (Bulgaria, UK). Less start-up capital is required in order to establish illicit tobacco factories that simply pack tobacco. Furthermore, costs can include repayment of loans, as was the case with one legal tobacco manufacturer in Bulgaria.

⁹³ Equipment for these illegal factories is widely available from closed factories in Eastern Europe. Part of the problem is that in many countries (especially in Eastern Europe) when illegal factories are shut by the authorities, the confiscated equipment is not destroyed but sold on public auctions in order for revenues to be secured (see further the chapter on Bulgaria in this report).

Transporting the merchandise. Transportation fees naturally vary on the basis of the distance covered and the risk of seizures or arrests associated with specific entry points. However, it is not impossible for the transportation fee to be significantly different for an identical distance covered and possible risk. For example, some entrepreneurs invest in their own vans and lorries (Belgium, Netherlands, Sweden, UK). Furthermore, when the illegal tobacco trader is the owner of a legal transportation company, the illegal business is facilitated logistically by his existing legal business, resulting in less transportation expenses. This also allows additional control over the operation. In this case, drivers might not even be aware that they transport contraband merchandise. Costs are also affected by the presence of a cover load (Greece, UK).

Storing the merchandise. In many cases tobacco products are simply kept in the trader's house or the houses of relatives and friends. In wholesale cases, smaller industrial spaces or warehouses are rented to store and/or repackage the merchandise. On average, renting a 1500m² warehouse costs approximately €2,000 per month (Greece, Sweden), although on numerous occasions entrepreneurs rent significantly cheaper and smaller premises costing as little as £25 per week (UK).

Payment to actors in the tobacco business including "runners"⁹⁴ (in cases of small-scale smuggling) (UK), brokers (Hungary, Italy, UK), couriers (individuals who are trusted with transporting merchandise and/or money), minders who accompany money couriers, and retail/street sellers. Payments to actors involved in tobacco smuggling can differ enormously depending on their role and the size and scope of the operation.

Other costs in the illegal tobacco trade involve:

- bribes and other corruption costs (Bulgaria, Germany, Greece, Italy, UK);
- political protection costs (Bulgaria);
- security costs;
- insurance, which is sometimes bought to protect entrepreneurs if their merchandise is seized or lost (Sweden, UK);
- cash management costs;
- informal taxation/extortion by criminals;
- decoy expenses (expenses towards diverting the attention of the authorities and/or misleading legal suppliers of tobacco products (UK);
- criminal justice system-related costs (Bulgaria);
- supporting the family members of imprisoned partners (Germany, Italy);
- bonuses for informants, sometimes in the form of merchandise (Germany);
- counterintelligence (Sweden);
- "unforeseen circumstances" most often as a direct consequence of the unpredictable nature of the business and individuals involved (see UK).

⁹⁴ In some contexts these are also referred to as "ant smugglers" – see further the introduction to the section on the illegal tobacco trade below.

Profits, profit sharing and investments

In most EU contexts, information about quantities of illegal tobacco products sold and the value of the overall illegal market is either unavailable or insufficient. Therefore, with some exceptions, it is not possible to accurately establish the quantities and prices of illicit cigarettes that are exchanged at each level of the supply chain, or to estimate the cash flow and profits at each level of the process from importation/wholesale to middle-level to retail. There are a variety of reasons for this:

- The huge **variations in taxation and prices in the legal market** in each jurisdiction. This has a direct impact on prices in the illegal markets of said jurisdictions, consequently affecting demand, supply and the “maturity cycles” of the specific market;
- The diversity of smuggling schemes, **decentralisation of the business** and associated low risk and low entry threshold;
- The diversity in local transportation and storage costs for each type of smuggling scheme or context in which the scheme operates. For example, in two separate investigations in the UK, one driver/transporter received £1,000 per successful channel crossing and the other £10,000.⁹⁵

Profit margins from the illegal tobacco trade also depend on a number of additional variables. Firstly, they depend on the type of merchandise sold (i.e. non-tax paid merchandise vs illicit whites vs counterfeit products). Generally, **counterfeit products tend to outweigh profit in all other types of smuggling**, as they are very cheap to buy and have a very high mark-up. Legal tobacco products bought abroad from legal retailers appear to have the smallest profit margin.

Secondly, profits depend on the position of the illegal entrepreneurs in the supply chain (with profits reducing as the merchandise moves down the supply chain). A criminal entrepreneur involved in the retail market will make an average of 50 cent profit per pack of cigarettes in the UK. Generally, **profits are bigger at the production, importation level and wholesale level**, and these profits correspond to the amount invested (Belgium, Finland, Ireland, Romania, Sweden, UK). This was exemplified by one UK law enforcement agent: “if you put 20% to importation, you expect to get 20% of the merchandise that will reach the UK. Simple as that.” It is interesting to note that not all investors in the illegal tobacco market are actively involved in the trade. For those cases in which the financiers/investors are not directly active in the business, a 70:30 model is applied (Czech Republic), in which the investors obtain 70% of the profits even though they provide 100% of the start-up capital.

Other important actors in the illegal tobacco business – such as intermediaries involved in large scale schemes (Netherlands, Romania, UK) – profit individually from payments, salaries or fees, sometimes of a significant amount depending on the size of the scheme they are involved in. Smaller profits in the form of payments/fees are also

⁹⁵ FATF, *Illicit Tobacco Trade* (Paris: FATF/OECD, 2012).

obtained by transporters, loaders, vehicle/vessel and warehouse owners, and corrupt officials (Italy, Lithuania, Romania, UK, Greece). Occasionally, some actors are paid via a mixture of cash and cigarettes, enabling them to make an additional profit themselves. This opportunity is dependent on ties of trust which are established via long term involvement in a smuggling scheme.

Profits can vary depending on the context of the sale, the amount of tobacco products sold, the current market conditions, and a number of additional peculiarities existing in different locales. For instance, at the retail level, the price of a pack of 20 cigarettes in Milan is higher than in Naples. At the retail level, variations in profit can relate to the low cost associated with marketing via word of mouth (Germany, UK), better prices and discounts to existing customers or those who buy large quantities (Bulgaria, UK), and the lower price of merchandise of deteriorating quality (Bulgaria, Greece). Finally, profits can depend on the size of an illegal entrepreneur's customer base. Contraband products sold via legal businesses seem to facilitate transactions with more customers and lead to higher profits (Czech Republic, Ireland, UK). Local pubs in small localities are also used in the distribution of merchandise and this is often viewed as a guarantee of the quality (Ireland, UK). Finally, the internet has been found to be an up-and-coming and available platform for the marketing and illegal distribution of tobacco products in some countries, which can cut costs and increase profits for operations in a number of ways (Estonia).

Largely, although this is an illegal market in which safeguards do not exist, there is no need for financiers/investors to ensure their share of profits since the illicit trade in tobacco products is a rather pacified market (Greece). Instead, trusted relationships established and consolidated in legal businesses and lengthy legal projects are paramount. On rare occasions financiers/investors ensure their share of profit through the threat of violence and use of violence (Austria), and through agreements with collateral including real estate, stocks, vehicles, and ownership share of a legitimate company (Czech Republic, Estonia). In the case of collateral, contacts formed via family or ethnic group are integral in facilitating the agreement.

Spending and investing profits from the illegal tobacco trade. Much of the profit made is simply spent on hedonistic pursuits and conspicuous consumption: nights out, gambling, buying luxury cars and bikes, boats, buying luxury clothes and jewellery, travelling to foreign countries, and so on. Profits are also invested in property or other assets, foreign currency and precious metals. Importantly, profits from the illegal tobacco trade are invested in legal businesses including bars, clubs, restaurants and pubs, hotels, transportation companies and, in the case of Greece, football and basketball clubs. In some cases, ethnic minority or immigrant entrepreneurs invest in legal businesses or property in their country of origin. For example, Vietnamese tobacco entrepreneurs based in the Czech Republic invest in Vietnam, and British-Kurdish entrepreneurs invest in Iraqi Kurdistan. Providing for or lending money to family members and friends for a variety of reasons including making

investments is not uncommon (UK, Sweden, Czech Republic, Greece). In the UK, there have also been illegal tobacco entrepreneurs investing in the enhancement of their existing legal businesses or in establishing or extending their legal business portfolios. There are very few examples of entrepreneurs who deposit money in accounts abroad (Sweden). Examples of investment in offshore bank accounts are rather atypical cases although they are present. In addition, money has been laundered in a variety of ways such as legitimate companies that are involved in the Stock Exchange and gambling (e.g. buying lottery tickets from people who have already won) (Greece).

Investment in criminal activities. Profits from cigarette smuggling are also re-invested in cycles in the illegal tobacco trade, often in order to upgrade and grow the particular business. Generally, there is very little commodity hopping among illegal tobacco traders. However, there are entrepreneurs who also invest in separate criminal businesses: counterfeit luxury clothes (Czech Republic), counterfeit medical products (Austria), alcohol smuggling (Sweden), cannabis, cocaine and crack cocaine businesses (Belgium, Spain, Greece, Ireland, Lithuania, Sweden, UK), stolen goods (Sweden), VAT fraud (Czech Republic, Spain), establishing illegal gambling dens (Sweden), and human trafficking (Lithuania).

Access to capital in critical moments

There are a number of critical moments in the illegal trade in tobacco which include:

- the merchandise and transportation means being confiscated by the authorities;
- the illegal entrepreneurs being arrested and/or fined by the authorities;
- the merchandise being lost, destroyed/damaged or stolen by competitors or others;
- times of sharp increases of the excise tax or times of political instability which require additional investment by criminal entrepreneurs (see the chapter on Bulgaria);
- the criminal entrepreneur wishing to retire while insuring himself against prosecution or media inquiries.

These critical moments require access to capital not only in order for entrepreneurs to re-enter the business and perhaps expand it, but also in order for some to discreetly and uneventfully retire from the business and/or cover legal expenses.

Excluding the common “rainy day” funds, which involve criminal entrepreneurs putting money aside in bank accounts or in safety deposit boxes for their retirement from the business, contingency funds as such are generally not present in the illegal tobacco market. However, the study highlighted two specific references to such a fund. The first refers to a UK case in the 1960s and 1970s, when bootlegging groups during the first few months of an operation diverted *all* proceeds into a fund that would cover future legal expenses (UK). The second concerns a contemporary Bulgarian practice, in which a number of master cases

from each shipment are set aside, and revenue from them is placed in a reserve fund, as an insurance against unexpected losses; such as those caused by inexperienced new entrants in the business and additional expenses at turning points of an operation.

If cigarettes and other tobacco products in small-scale schemes are confiscated at country entry points, entrepreneurs are able to re-enter the trade by re-investing money from their legal work and/or savings (UK, Sweden, France). Due to the **low risk and high profit associated with the illegal trade in tobacco products**, seized shipments are seen as more of an inconvenience because the money invested is relatively small. Therefore, entrepreneurs are able to re-enter the business with ease.

In relation to large-scale schemes, money from previous successful importations is re-invested. In some countries (e.g. UK) entrepreneurs take part in “bulk container rolls”, i.e. simultaneous importations of 5-6 containers on the same day at different entry points throughout a country. The profit margins are so big that if only one container importation is successful there is still a considerable profit to be made. The high profitability of the illegal tobacco trade allows the entrepreneurs involved in importation/wholesale of tobacco products to enjoy relative security from the financially critical moments of the trade (Belgium, Greece, Sweden, UK). However, in critical moments, entrepreneurs have also been known to invest money from other illegal activities and personal savings, receive loans from official and unofficial credit institutions (Czech Republic), or – using their social capital – receive loans from acquaintances.

In Greece – although this is a rare occurrence and concerns the most successful and centralised structures – individuals involved in a large-scale tobacco smuggling scheme that are arrested have been known to get financial support from a business partner during their time dealing with the criminal justice system (e.g. hiring lawyers, offering money for the period of incarceration, and taking care of their family financially). They may also offer him/her a “welcome back gift” upon their release from prison. Loan sharks are generally not an integral part of the financing in the illicit tobacco business. There were very few cases in which retailers lack access to legal financing and resort to local loan sharks to receive money on credit to invest in tobacco products (UK and Sweden).

3. ORGANISED VAT FRAUD IN THE EU: MIXING THE MONEY FLOWS

The value added tax (VAT) mechanism is central to the functioning of the European single market (i.e. the free movement of goods, capital and people). However, the administration of VAT taxation across different tax jurisdictions in intra-community trade proves vulnerable to fraudulent transactions due to a variety of factors. These include the current transnational tax arrangements in the EU regarding supply and acquisition of goods and services (the “destination principle”), the lack of a unitary legal framework within the EU, the fundamental principle laid down in the Lisbon treaty for the free movement of goods in the EU that in practice neutralises the border control regime on the flow of goods, and the ineffective cooperation between tax and law-enforcement institutions at national and EU levels.⁹⁶

Under the destination principle of taxation, VAT is paid in the country where the goods and services are consumed.⁹⁷ So when a VAT registered trader is purchasing goods and services from another member state, he would not pay value added tax on import and would only charge and account for VAT when he sells the same goods on the domestic market. Conversely, exporters apply zero VAT rate on exported goods and services and have the right to reclaim the VAT credit for their inputs.

Since 2006, the EU has worked towards a common VAT anti-fraud strategy and recently strengthened anti-fraud measures.⁹⁸ In July 2013, two new directives were adopted by the Council: one on introducing a Quick Reaction Mechanism allowing member states an immediate reaction to a sudden and massive VAT fraud; and on the application of the Reverse Charge Mechanism in relation to supplies of certain goods and services susceptible to fraud (carbon emissions, mobile phones).⁹⁹ Under this directive, member states have the option to apply this mechanism on a temporary basis and for a pre-agreed list of sectors/goods. The reverse charge mechanism entails that the liability for the payment of VAT is shifted from the supplier (as normally required by EU rules) to the customer. However, some member states are concerned that the application of a generalised reversed charge mechanism would result in

⁹⁶ K. Pashev, *Fighting VAT Fraud: The Bulgarian Experience* (Sofia: Center for the Study of Democracy, 2006). K. Pashev, “Countering Cross-Border VAT Fraud: The Bulgarian Experience”, *Journal of Financial Crime* 14, no. 4 (2007): 490-501.

⁹⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. M. Keen and S. Smith, “VAT Fraud and Evasion: What Do We Know and What Can Be Done?”, *National Tax Journal* LIX, no. 4 (2006): 861-87.

⁹⁸ European Commission, *Combating tax fraud and evasion. Commission contribution to the European Council of 22 May 2013*. (Brussels: European Commission, 2013).

⁹⁹ Council of the European Union, Council approves measures to tackle VAT fraud schemes. Press release 12627/13, Brussels, 22 July 2013.

the fraud shifting to the last stage of the distribution link, instead of the first (as is the case with the missing trader).¹⁰⁰

A range of goods and services are affected by organised VAT fraud schemes. Mobile phones, computer and electronic components have been used particularly often, because their small size and high price makes them very convenient for simulating high value export transactions.¹⁰¹ Other types of goods commonly involved in VAT fraud include railway vehicle components, scrap metal, precious metals, metal allocations, new and used cars, footwear, and mobile phone credits, among others.¹⁰² In recent years, VAT fraudsters have been targeting energy markets and the trade in carbon credits. Europol reports that fraudulent companies have managed to capture some 90% of all carbon credit transactions and defraud large amounts of VAT.¹⁰³ Along with carbon emissions markets, other preferred targets for VAT fraud are cloud computing and VoIP due to the immateriality and the high-speed transfer of goods.¹⁰⁴ Fraud involving intangible goods is making use of large financial institutions who knowingly or not provide financial liquidity.¹⁰⁵

3.1. BASIC TYPOLOGY OF VAT FRAUD

VAT fraud can be interpreted in two broad categories, depending on whether the undue payoff consists of reduced tax liability (tax evasion) or embezzlement of VAT (failing to remit the VAT due and/or false claims of tax credit), or both.¹⁰⁶ Another classification is based on the complexity of the scheme: whether the fraud involves only a domestic or an international (intra-community) component, a single operation or a carousel chain of transactions.¹⁰⁷

Evasion and saving of VAT can take many forms, such as undervaluation of input and overvaluation of output to reduce tax liability, false classification of goods to take advantage of lower rates, declaring false quantities, false or no invoices, smuggling or economic actors operating entirely in the shadow economy.

Tax credit abuse, on the other hand entails pocketing large sums of undue VAT refund claims by fraudulent networks through a chain

¹⁰⁰ Ernst & Young, *Assessment of the Application and Impact of the Optional "Reverse Charge Mechanism" within the EU VAT System* (Brussels: European Commission, 2014). International VAT Association, *Combating VAT Fraud in the EU. The Way Forward* (Brussels: IVA, 2007).

¹⁰¹ FATF, *Laundering the Proceeds of VAT Carousel Fraud* (Paris: Financial Action Task Force, 2007).

¹⁰² Europol, *EU Organised Crime Threat Assessment* (The Hague: Europol, 2011).

¹⁰³ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

¹⁰⁴ M. C. Frunza, "Aftermath of the VAT Fraud on Carbon Emissions Markets", *Journal of Financial Crime* 20, no. 2 (2013): 222-36.

¹⁰⁵ Europol, *EU Organised Crime Threat Assessment*.

¹⁰⁶ S. Fedeli and F. Forte, "EU VAT Frauds", *European Journal of Law and Economics* 31, no. 2 (2011): 143-66.

¹⁰⁷ *Ibid.*

of fictitious and real transactions and traders. It is recognised as an organised crime activity involving theft on a massive scale and a systematic criminal attack on the VAT system in EU member states.¹⁰⁸ The most common type of organised criminal VAT fraud is known as the missing trader intra-community (MTIC) fraud. It is recognised as one of the major organised crime threats in the EU affecting all member states.¹⁰⁹

Within the classic missing trader fraud schemes a taxable person (“missing trader”) purchases goods from another country at zero VAT rate and subsequently re-sells the goods at VAT-inclusive price on the domestic market, without remitting the due VAT tax to the national tax administration. The scheme could be applied in a number of ways, but the most common forms are:

Acquisition fraud – the missing trader supplies the imported goods at the final consumption market and then disappears, embezzling all the due VAT debited. The missing trader usually sells the goods below their market value. This is the simplest form of the missing trader fraud as it involves a single operation.

Carousel fraud – the goods imported by the missing trader are sold through a chain of domestic companies (“buffers”) and finally re-exported to another country applying zero VAT rate. Although the missing trader fails to remit the due VAT, the enterprise in the end of the chain (“exporter”) claims tax refund for input VAT paid. The scheme relies on multiple domestic and cross-border transactions, which makes tracing and counteraction more difficult, while at the same time allows for additional inflation of prices and therefore the tax credit claimed by the exporter. The situation is additionally aggravated when lack of border control between member states is taken into account, as this allows for entirely fictitious transactions with fictitious goods.¹¹⁰ According to FATF the amounts of money involved and the complexity of the schemes means that it is restricted to organised criminal groups with high level of sophistication. Fedeli and Forte¹¹¹ stress that the carousel may be launched due to expected profits from the initial stage (the supply side) or by expected gains at the final stages of the chain (demand side). A more complex scheme may consist of different elements, including a chain of undue VAT refund claims and missing traders followed by a regular sale at the end, a completely black chain where tax is directly evaded, a chain of undue rebate claims entirely on fictitious sales, as well as in combination with savings on direct taxes.¹¹²

¹⁰⁸ D. Ruffles et al., “VAT Missing Trader Intra-Community Fraud: The Effect on Balance of Payments Statistics and UK National Accounts”, *Economic Trends* 597 (2003): 58-70. FATF, *Laundering the Proceeds of VAT Carousel Fraud*.

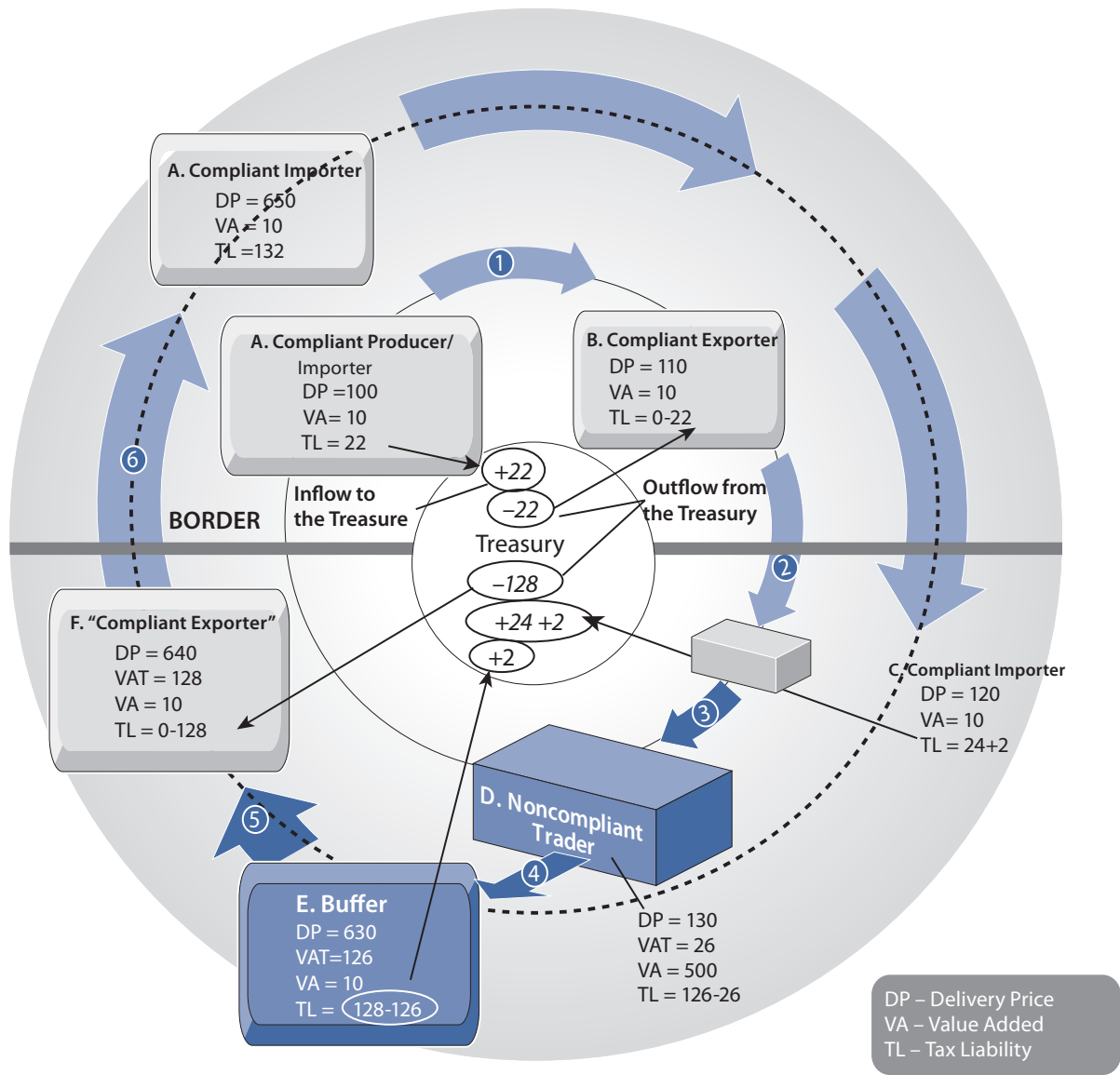
¹⁰⁹ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

¹¹⁰ F. Borselli, *Organised VAT Fraud: Features, Magnitude, Policy Perspectives* (Rome: Banca d'Italia, 2011).

¹¹¹ Fedeli and Forte, “EU VAT Frauds”.

¹¹² *Ibid.*

FIGURE 6. INTERNATIONAL VAT CAROUSEL FRAUD SCHEME



Source: K. Pashev, *Corruption and Tax Compliance. Challenges to Tax Policy and Tax Administration* (Sofia: Center for the Study of Democracy, 2005).

Other common scheme is **fictitious export**. Under this scheme a trader performs an export transaction on paper, levying zero VAT tax and claiming VAT refund to the tax authorities, while at the same time selling the goods on the domestic market without sales invoices.¹¹³ The scheme usually involves corrupt customs officers who process the paperwork for the export transaction and assure the criminal entrepreneurs that the transaction shall evade administrative controls. A more modest version of

¹¹³ Pashev, *Fighting VAT Fraud: The Bulgarian Experience*.

this scheme relies on overstating quantities, where these could be easily manipulated (e.g. sugar, grain, fuels).

Various other fraudulent schemes were also reported such as “invoice mills”,¹¹⁴ “crossed invoicing”, abuse of customs procedure for transit of goods, fraud with the margins of the sale of second hand assets. Among those, **the invoice mill** is one worth mentioning, although it is a less sophisticated form of organised VAT fraud. These mills are in practice providers of fictitious invoices to legitimate companies willing to diminish their VAT tax liabilities. The mills could be structured around legitimate accounting service providers or be run by entirely criminal networks and usually operate on a fee-for-service basis.

3.2. ESTIMATES OF VAT NON-COMPLIANCE AND FRAUD IN EUROPE

The estimation of the scale of organised VAT fraud presents a common challenge to all member states. The VAT gap is estimated as the difference between the tax that is actually paid and the tax that should be collected. It is used as a measure for tax non-compliance and revenue loss. However, the components of the tax gap might include not only organised crime tax fraud, but also conventional tax avoidance, bankruptcies, insolvencies, legal avoidance practices, errors, misreporting and miscalculations.¹¹⁵ Therefore, it is an indicator for the effectiveness of VAT enforcement and compliance measures, but it cannot be directly interpreted as an estimate of the organised VAT fraud.

VAT gap estimates are generally calculated based on two approaches: top-down and bottom-up. Top-down approaches are most commonly used, although it is the bottom-up approach that allows a more precise diagnosis of the size of different types of fraud and evasion. As Reckon stresses, bottom-up estimates start with identifying the types of fraud and then the proceeds for each of the components, which means such an approach relies on operational data held by national tax authorities.¹¹⁶ The top-down approach, on the other hand, relies on macro-economic data on consumer spending to estimate the theoretical VAT liability and compare it to actual revenue.

The tax gap might be indicative, but it reflects more than the actual levels of VAT fraud. However, estimates of the volumes of MTIC fraud in EU have been made in some countries. HMRC in UK assessed that between 2006 and 2011, MTIC fraud accounted for 5.4% – 19.6% of the overall VAT gap, which equals £0.5-2.5 billion.¹¹⁷ The National Revenue

¹¹⁴ Keen and Smith, “VAT Fraud and Evasion: What Do We Know and What Can Be Done?”

¹¹⁵ CASE, *2012 Update Report to the Study to Quantify and Analyse the VAT Gap in the EU-27 Member States*.

¹¹⁶ Reckon LLP, *Study to Quantify and Analyse the VAT Gap in the EU-25 Member States* (London, 2009).

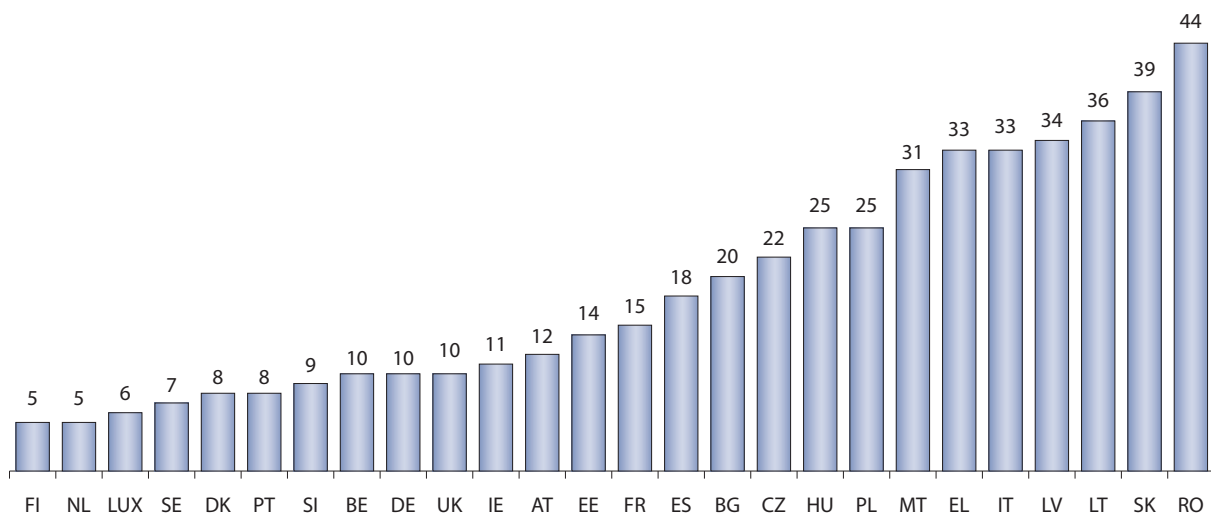
¹¹⁷ HMRC, *Measuring Tax Gaps 2012. Tax Gap Estimates for 2010-11* (London, 2012).

Agency in Bulgaria estimated the volume of organised VAT fraud for 2011 at €350 million.¹¹⁸ Borselli estimates the volume of VAT fraud in Italy at €5-9 billion. According to Europol,¹¹⁹ EU countries are losing €100 billion annually due to MTIC fraud.¹²⁰ This is a significant proportion of the estimated costs of organised crime within the European Union.¹²¹

The most recent EU-wide estimates of the VAT gap are available from an EU-commissioned study, covering the period 2000 – 2011 and 2011 – 2012.¹²² The average data for 2000 – 2011 shows that the largest economies of Germany, France, Italy and the UK were the biggest contributors to the overall gap. Taken as% of the GDP, however, the countries with the largest VAT gap were Romania, Latvia, Greece and Lithuania.

In 2012, the overall VAT gap for the EU-26 was estimated at €177.2 billion, or 16% of the overall tax liability. In 2012, the countries with the largest gap were Romania (44% of theoretical liability), followed by Slovakia (39%) and Lithuania (36%). In Finland, the Netherlands and Luxembourg the gap is in the range of 5-6% of the VAT due. Thus, the data uncovers an interesting division between Western European countries and East and South East European countries, where the latter

FIGURE 7. VAT GAP IN EU-26 AS% OF TOTAL TAX LIABILITY (2012)



Source: CASE, 2012 Update Report to the Study to Quantify and Analyse the VAT Gap in the EU-27 Member States (The Hague: CPB Netherlands Bureau for Economic Policy Analysis, 2014).

¹¹⁸ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

¹¹⁹ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

¹²⁰ Borselli, *Organised VAT Fraud: Features, Magnitude, Policy Perspectives*.

¹²¹ M. Levi, M. Innes, P. Reuter and R. Gundur, *The Economic, Financial & Social Impacts of Organised Crime in the EU*, Report to European Parliament, (Brussels, 2013).

¹²² CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report* (The Hague: CPB Netherlands Bureau for Economic Policy Analysis, 2013); CASE, *2012 Update Report to the Study to Quantify and Analyse the VAT Gap in the EU-27 Member States*.

appear far more vulnerable and affected by this phenomenon. Looking at changes from the previous year, out of 11 countries that reduced their VAT gap in 2012, the most notable decrease was in Greece and Bulgaria, while the most notable increases took place in Poland, the Czech Republic and Slovakia.

3.3. KEY ACTORS INVOLVED

Usually VAT fraudulent chains are depicted and analysed as a circuit of legal entities performing fictitious and real transactions between each other. However, behind any fraudulent chain of legal entities operates a group of individuals. While there are some analyses and estimations about the scale of the problem on the macro level (national and European), far less research focuses on the micro level – the individual perpetrators, the nature and size of their organisation, the division of profits between different actors, etc. To a large extent this could be explained by the many variations of the fraud schemes, the differences in scale from case to case, number and role of actors involved. Alternatively it could also reflect the lack of interest and/or difficult access in the academic community and the case-oriented nature of law enforcement efforts.

The most common type of VAT fraud – **the missing trader chains** – usually involves three main types of legal entities in terms of their function and role as actors in the scheme: the missing trader, the buffer enterprises and the broker. The missing trader is the key node in the chain and usually is a shell or short-lived company, which is formally controlled by “dummy managers” or “front men.” The buffer companies could be either bogus companies or compliant traders carrying out regular business. They take part in the scheme in order to inflate prices, make transactions harder to trace and obscure the link between the missing trader and the broker. The broker is a formally compliant and legitimate company, which stands in the end of the fraudulent chain and is the one that claims the VAT refund from the tax authorities. Apart from the listed more complex fraudulent chains may also involve transportation companies (to simulate movement of goods), companies operating VAT warehouses, providers of law and accounting services. Where the schemes involve export to non-EU countries, corrupt customs officers are also important key actors, who provide the necessary papers for the fictitious movement of the goods.¹²³

Analysing the fraudulent networks on the basis of the individuals involved, three levels of participation in VAT fraud schemes can be identified.¹²⁴ The first level is **the core of the fraud scheme** – the inner circle players, who are the actual organisers responsible for the design and the organisation of the fraud. Although they would usually get the lion’s share of the profits (or

¹²³ Borselli, *Organised VAT Fraud: Features, Magnitude, Policy Perspectives*; Pashev, *Fighting VAT Fraud: The Bulgarian Experience*.

¹²⁴ A. Aronowitz, D. Laagland, and G. Paulides, *Value Added Tax Fraud in the European Union* (Amsterdam: Kugler Publications, 1996).

so is expected), in most cases their names do not appear on any document or in the companies involved. The second level is **the outer circle**, where are involved actors with various roles – “straw men” who are only owners/managers on paper and “front men” – people like accountants, lawyers, different professionals and ad-hoc players. For example a range of services provided by a lawyer to a crime group involved in VAT fraud might include creation and dissolution of corporate vehicles (i.e. front companies and shell companies), financial and tax advice, creating of false legal documentation, assuring credibility.¹²⁵ The actors at this level are generally aware of the fraudulent nature of their activities. The third level of actors in a VAT fraud scheme consists of **the facilitators**, who in many cases might not be aware of the fraudulent scheme. The facilitators are legitimate businesses trading in real goods and services, which would purchase VAT free goods or services (buffer companies) or would accept false invoices in their bookkeeping.¹²⁶ The third level participants would benefit from fees for processed invoices or from purchasing goods below the market price. Of course, proving awareness and intent in court is different from suspecting knowledge (or turning a blind eye) in the real world.

An analysis of large scale tax fraud cases in Sweden, including VAT fraud, conducted by the Swedish National Council for Crime Prevention (Brå) found that with the principal actors or organisers have known each other and worked together for a long time; hence there is a certain level of stability of the cores of criminal networks.¹²⁷ However, for the most risky parts of the schemes, the organisers use accomplices – or “fire-walls” – to protect the scheme and key individuals.

3.4. FINANCING AND FINANCIAL MANAGEMENT

Designing, starting and running a VAT-fraud scheme requires certain initial investments in order to cover costs such as setting up fictitious companies, purchasing goods, paying to VAT warehouse operators and shipping companies to simulate movement of goods across borders, corrupting tax and customs officials, paying for specialised services to accountants or lawyers. Whereas VAT carousel frauds on EU level may involve complex schemes operating with millions of euro, fraud schemes on national level such as the invoice mills could be set up with a minimal investment of a few thousand euros. Regardless of the scale and type of the VAT fraud, the fraudulent schemes require certain capital, raising questions about its sources and volume. Other financial aspects, which are key to understanding of the financing of VAT frauds, are the settlement of payments, structure and size of costs, profits and profit sharing.

¹²⁵ D. Middleton and M. Levi, “The Role of Solicitors in Facilitating ‘Organized Crime’: Situational Crime Opportunities and Their Regulation”, *Crime, Law and Social Change* 42 (2004): 123-61.
D. Middleton and M. Levi “Let Sleeping Lawyers Lie: Organised Crime, Lawyers and the Regulation of Legal Services”, *British Journal of Criminology* (2015), doi: 10.1093/bjc/azv001.

¹²⁶ Aronowitz, Laagland, and Paulides, *Value Added Tax Fraud in the European Union*.

¹²⁷ J. Skinnari, “Policing Large-Scale Tax Crime”, in *Researching the Police in the Nordic Countries*, ed. V. Houtari (Tampere, 2013), 67-74.

Sources of capital

The organisers of VAT frauds use a variety of sources to acquire capital for setting up and running their operations. The start-up capital may come from both legitimate and illegal sources.¹²⁸ The outcomes of the survey that informed the development of this report suggest that investments in VAT fraud schemes originate mostly from reinvestments of the fraud ring leaders that stem from criminal or legitimate proceeds, whereas external sources of financing are viable but less common option.

The ring leader as a financier (self-financing). The profile of the VAT fraud organisers proves to be diverse. Both legitimate businessmen and professional crooks specialised in swindles, tax frauds, excise and customs duty frauds were identified as ring leaders. Among legitimate businessmen two profiles emerged as typical. The first profile is of businessmen whose companies are having financial difficulties, and they are looking for high payoff investments even at the edge of the law. The other profile is that of high-risk entrepreneurs readily investing in high-profit “projects.” In Eastern Europe, the so called “oligarchs” were often mentioned as key players (Bulgaria, the Czech Republic). Most of them belong or have close ties to the old communist *nomenklatura* or secret services and have acquired their capitals through corrupt and shady practices in the beginning of the transition period in the nineties. Currently well-established businessmen with close ties to the political elite, they still tend to keep part of their business in the licit sector, while the other part is in the shadow economy.

The most common source of capital for initiating new VAT fraud schemes is through **re-investing proceeds** from previous fraudulent schemes. Following the initial investment, successful VAT fraud generates enough profits to sustain itself, if the players want to stay in criminal business. Proceeds from other criminal activities are also among the possible, although not so commonly invested in VAT frauds.

However, the research indicated that it is also not uncommon for legitimate businessman to invest part of their **legitimate revenues** or even **personal savings** to initiate a VAT fraud scheme. Apparently, **grey revenues** derived from conventional tax evasion also constitute an important source of capital for initiating VAT fraud. Grey economy practices such as use of undeclared labour, overstating inputs or undervaluing outputs, overstating loss due to normal spoilage or false declaration of loss due to decay/depreciation, appear to be an easy way to generate additional revenues through the legitimate business that could subsequently be invested in VAT fraud. This pattern of intermixing legitimate, grey and entirely criminal finances to initiate and perpetuate the criminal operations of the VAT fraud rings seems to be very typical for the oligarchs from Eastern Europe.

Furthermore, criminal entrepreneurs invest **proceeds from other criminal activities**. Various cases were reported in the countries studied, which

¹²⁸ FATF, *Laundering the Proceeds of VAT Carousel Fraud*.

included use of money stemming from activities such as property crime (car thefts), extortion racketeering, drug trafficking, smuggling of goods, illicit tobacco trade, and loansharking. However, criminal investors coming from typical organised crime markets such as drug trafficking, human trafficking, extortion racketeering seem to be rather an exception in the VAT fraud field.

External sources of financing. In some of the cases reported, the VAT fraud networks do not have the financial capacity to initiate and sustain the fraudulent operations from their own resources and rely on external sources of financing. These could also be both legitimate and criminal sources of financing. Apparently, well-established entrepreneurs with legitimate businesses may acquire financing through licit channels such as **obtaining a bank loan**. Such a case took place in Bulgaria, where a ring leader of a big VAT fraud ring received €23 million in the form of bank guarantees and loans from a Bulgarian bank through two companies under his control. Other licit sources of financing could be **subsidies from local or national government**. There was a case in Spain in which a fraudulent scheme was initiated with EU funds provided for fishing companies. **Trade credits from manufacturers or big wholesalers**, as well as **advanced payments from the final consumers** of the goods or services are another possibility to secure financing for a given project. Although most EU countries have introduced provisions sanctioning such practices, apparently proving intention and direct involvement of such actors remains a big challenge for authorities.

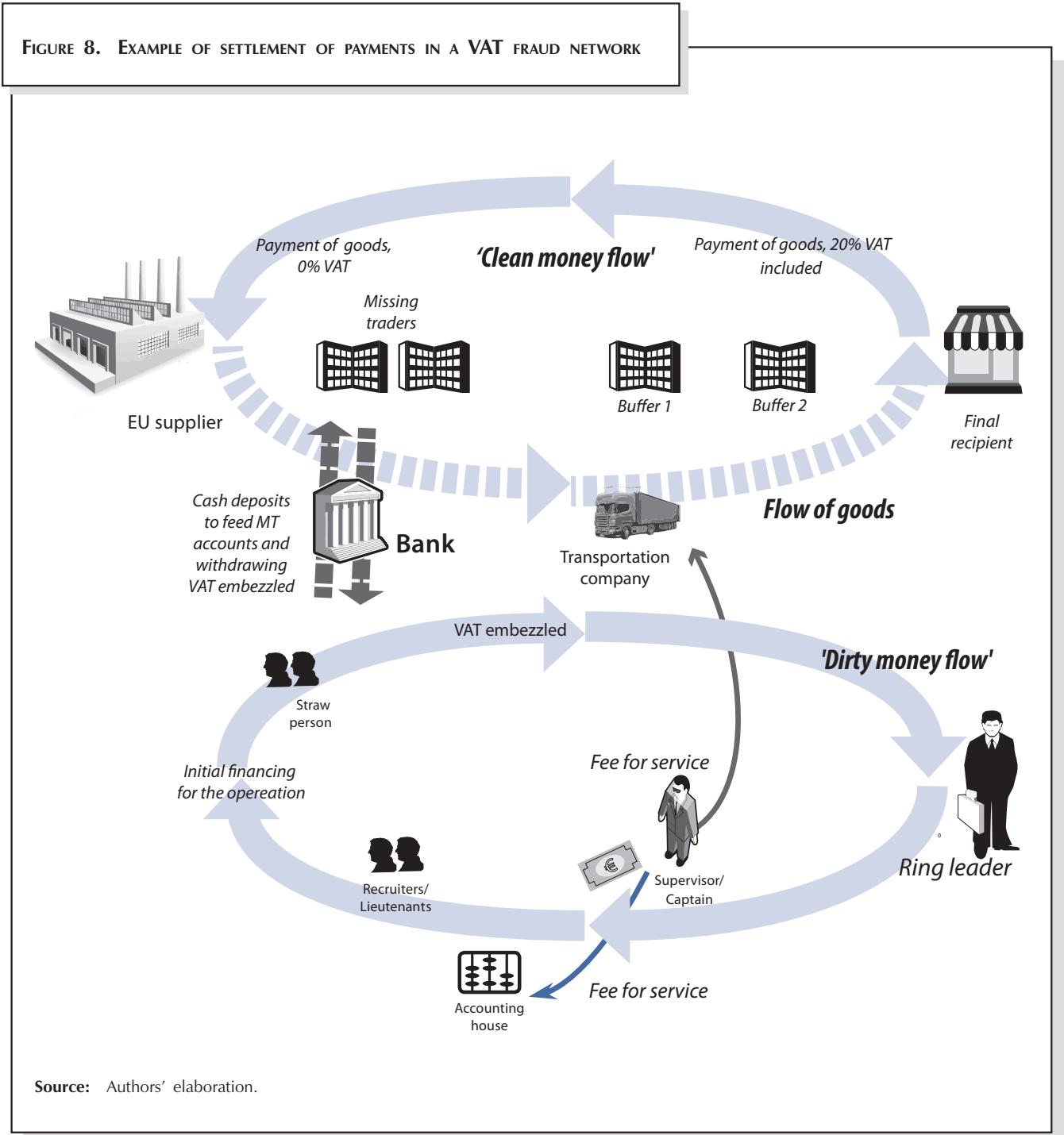
The normal business practices for acquiring external financing such as the described so far are generally accessible mainly to established legitimate entrepreneurs, whose companies have some proven track record. However, they are not accessible to new entrants in the VAT fraud business, as well as to criminal entrepreneurs. Thereby such actors may turn only to **illegal (or “black”) financiers or investors**. For example, FATF reports that participants in the fraud schemes cooperate with each other, so it is not uncommon for third level actors to borrow initial capital as a “business loan” from other people already established in the field to start their own scheme.¹²⁹ Similar cases were reported in some of the countries analysed in this report (Belgium, Bulgaria, Spain). The profile of the black financiers identified was diverse – from people involved in VAT fraud to criminal entrepreneurs involved in drug trafficking, illicit tobacco trade, loansharking and entirely legitimate businessmen looking for high-profit investments. Access to external financing through such means is a matter of **social capital** and **reputation**. Therefore, mainly actors who have already been part of VAT fraud networks and have gained a certain credibility manage to secure capital in this way.

Settlement of payments

When analysing the settlement of payments in the VAT fraud networks, two distinct flows of money need to be considered. The first flow of money comprises the payments between the corporate entities involved

¹²⁹ Ibid.

in the fraudulent chain that are disguised to mimic legitimate transactions. These payments are typically settled through legitimate bank transactions and declared to tax authorities. This is why this flow of money can be labelled as the “**clean money flow**”. Conversely, the “**dirty money flow**” comprises the payments between the individuals behind the fraudulent chain – organisers, supervisors, proxy persons, buffers, straw persons, facilitators. According to the country case study reports, the payments between these actors seem to be settled usually in cash, although there could be certain exceptions to this rule (Belgium, Bulgaria, the Czech Republic).



The point of intersection of these money flows appears to be the account of the missing trader or – in some fraudulent scenarios – the account of one of the buffer companies. This is the in-and-out point where the criminal money feed the clean money flow at the kick-start of the fraudulent cycle. Conversely, the legitimate money feed the dirty money flow with the embezzled VAT that is cashed out at the end of the cycle (Bulgaria). Being the weakest node of the fraudulent chain, the missing trader's account is a common target for law enforcement authorities. Therefore, leaders of VAT fraud rings employ a variety of risk mitigation strategies to conceal the origin of funds and nature of transactions and thus hinder detection and possible freezing or seizing.

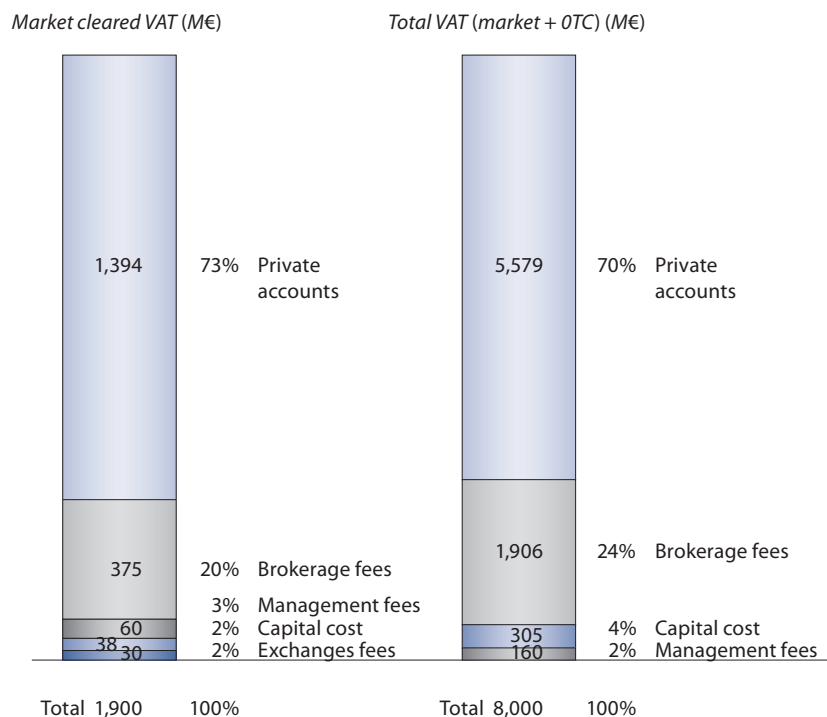
The most common strategy involves declaring of false premises for the bank transfers to or from the missing traders bank account such as intercompany loans, consultancy fees, etc. Another common strategy is to create the bank accounts of the missing trader and the other actors in offshore or virtual payment platforms, which seems to be more common in Western European countries (Belgium, Spain). Usually all actors of a given fraudulent chain keep their accounts in the same bank in order to speed up the transactions (Bulgaria, Spain) and all payments between the corporate entities within the chain are ordered in a single day or in a matter of a few days (Bulgaria). Corruption of bank officials is also practised, as an additional safeguard when domestic bank institutions are involved (Bulgaria). Use of proxy persons to order bank transfers or withdraw cash is also reported (Bulgaria).

Costs of doing business

Costs for initiating and perpetuating organised VAT fraud are merely indicative for the initial capital needed to enter this criminal business. Two categories of costs have been discussed in relation to the setting up and conducting of VAT frauds. Most often, operational costs were discussed, whereas costs for purchasing the merchandise or services have in many cases not been taken into account. Operational costs are usually composed of expenses such as the incorporation of fictitious companies, payments to straw men, proxy men, accountants, supervisors and facilitators, corruption fees. Since these costs are relatively low, many law enforcement experts asserted that a VAT fraud project does not require substantial initial investments. However, others argue that this seems to be true only in part. Some fraud schemes such as the invoice mills and fictitious export do not involve acquisition of goods or involve acquisition of goods with minimal value, so the ring leader does not need to put forward large initial investment and several thousand euros would be sufficient (Bulgaria, the Czech Republic).

This is not the case with missing trader schemes for acquisition or delivery of real goods or services from or to other EU member states, where the ring leader needs to secure credit or funds to purchase them and also cover the logistical and transportation costs. The costs of the goods and the accompanying logistical and transportation costs are typically several times bigger than the operational costs (Bulgaria, the Czech Republic). The scale of the merchandise costs depends on the

FIGURE 9. EXAMPLE OF THE DISTRIBUTION OF PROFITS AND COSTS FROM VAT CARBON EMISSIONS CAROUSEL FRAUD CONDUCTED VIA AN EXCHANGE MARKET AND OVER THE COUNTER



Source: Frunza, "Aftermath of the VAT Fraud on Carbon Emissions Markets", 226.

type of goods, as well as on the final recipients of the goods. If the goods are destined for the black market, then the ring leader may start with smaller quantities. Since in carousel fraud the goods are traded in a closed circuit over and over again, the fraud could also be started with smaller volumes. In such scenarios ten to fifty thousand euros would be enough (Germany). However, when the final recipient of the goods is some big retailer or big exporter, then the fraudulent network should be capable of delivering larger quantities of goods. This is why such MTIC fraud schemes require initial investment starting from a million to a few million euros, and could be carried out only by VAT fraud networks with substantial financial capacity (Bulgaria, the Czech Republic).

The case with MTIC frauds exploiting emission allowances is similar (Belgium). Previous studies of carbon emissions fraud provide a detailed breakdown of different costs associated with running the schemes as well as the final profit. An analysis of VAT fraud that took place between 2008 and 2009 via a French-based trading platform found that an initial investment of €100 million is multiplied through VAT carousels to €600 million, after 10 rounds.¹³⁰ Out of the entire VAT pocketed, 20% was paid for brokerage fees, while around 7% of the profit went for management fees, exchange and capital cost. In the case of over the counter trade, the brokerage fees were higher at 24%. The remaining profit of 70% – 73% of the VAT cleared (market cleared and over the counter) went to private and offshore accounts.

Profits, profit sharing and investments

The profitability of organised VAT fraud depends on a number of factors such as the rate of VAT tax, the type of goods (in some countries the rate of the VAT is different for different goods), the type of the fraudulent scheme and the scale of the fraud scheme and the number of actors involved. The gross profit is usually equal to the amount of the VAT tax embezzled. The net profit is lower, as part of the proceeds is used to cover the business costs. Furthermore, most missing trader schemes

¹³⁰ Frunza, "Aftermath of the VAT Fraud on Carbon Emissions Markets".

involve selling goods below market value; hence part of the profit is used to cover for the discount offered to the final recipients of the goods or services (Belgium, Bulgaria). The average net profit reported by experts from several countries that participated in the electronic survey is around 5-7% of the fraudulent turnover (Belgium, Bulgaria, Germany, Latvia). In fee-for-service based schemes like invoice mills, the profit equals the agreed fee for the fraud ring, which according to the reports amounts to 10-15% of the VAT cleared (Bulgaria).

Profit sharing schemes among the actors involved are subject to preliminary agreements between them. Various profit sharing schemes were reported, including actors such as ring leaders, supervisors, financiers, buffers and brokers. Rank-and-file participants of the VAT fraud rings, as well as facilitators usually receive a pre-agreed fee. The enforcement of these arrangements often involves intimidation and use of violence (Belgium).

The most common **investment strategy** regarding profits is re-investment in a new tax fraud project. Other investment strategies reported included both legal and illegal investments. Illegal investments were reported less often and were related mostly to swindles and other frauds. Legal investments included real estate, gold, and luxury goods. Investments in legitimate businesses were also reported – either businesses that could be used to facilitate future VAT fraud operations such as logistical and transportation companies (Belgium) or cash-intensive businesses that could be used for money laundering – hotels, night clubs, restaurants (the Czech Republic, Greece). Depositing money in offshore accounts as a contingency fund is also widely practiced (Belgium, Bulgaria).

The FATF in 2007 reported on schemes with more complex financial links between other criminal activities (e.g. drugs) and VAT carousel fraud that go in both directions with profitable results, for example, in Spain and Sweden.¹³¹ Evidence from the UK also suggested that the proceeds from VAT carousel fraud have led to further criminal activity.¹³²

Access to capital in critical moments

Just like any other criminal business, organised VAT fraud often exposes the actors to the risks of being prosecuted and having their assets and money seized and confiscated. This also brings about various incidental costs such as covering for the loss of money and litigation expenses. Therefore they might need to secure capital in order to recommence business. Apparently, most fraudsters in such occasions rely on their own “rainy day” savings from previous criminal projects (Belgium, Bulgaria). In some cases they have to rely on their social capital and reputation to secure start-up financing, so advanced payments from customers or trade credit from their contractors abroad were reported as possible alternatives (Bulgaria). As with other elements of this study, however, the dark figure of unrecorded fraud and of unsuccessful investigations

¹³¹ FATF, *Laundering the Proceeds of VAT Carousel Fraud*, 11.

¹³² *Ibid.*

means that the actual proportion of these techniques remains uncertain, and there may be other financing mechanisms of which researchers are currently unaware.

However, despite these inevitable caveats about a very under-researched component of criminal activity, the authors believe that this report provides sufficient information and analysis to stimulate more academic and practitioner research on these important topics.

4. NATIONAL CRIMINAL MARKETS AND FINANCES: COCAINE TRAFFICKING

This section contains the results of the studies of cocaine trafficking in seven European countries. Based on original research involving law enforcement officials and criminal entrepreneurs, as well as existing literature, the studies analyse the financing of this kind of “business” against the background of its changing organisational patterns. Since cocaine constitutes only a small part of the drug market in Estonia and Bulgaria, the studies in these two countries have a bigger scope and focus on the drugs market in general. The chapter on France focuses on the cocaine and cannabis markets.

“Drug trafficking is a global illicit trade involving the cultivation, manufacture, distribution and sale of substances which are subject to drug prohibition laws.”¹³³ Its evolution from disciplined, hierarchical structures into looser networks of collaborating criminal entrepreneurs provides both opportunities and challenges to researchers and law enforcement. The findings of the studies described in the following chapters indicate the implications of the business model for the management of the financial flows. The enterprise may be illegal but it requires good customer relationship management, adequate incentives and disincentives, analysis of investment opportunities, accurate logistics, etc. Understanding the corresponding management of the financial affairs of this enterprise would contribute substantially to designing effective enforcement policies.

The texts in this section reference a number of sources as they draw on numerous in-depth interviews with government officials, independent experts and criminal entrepreneurs. The sources have been coded in order to preserve their anonymity. The first two letters of the code indicate the country (e.g. GR – Greece), “E” indicates an expert, while “C” means criminal entrepreneur. The description of the background of the individual sources referenced can be found in the “List of interviewees in the section on cocaine trafficking” in the Annex.

¹³³ UNODC, <http://www.unodc.org/unodc/en/drug-trafficking/index.html>

4.1. ITALY: AN INCREASINGLY COMPETITIVE MARKET

Introduction

Nowadays, cocaine trafficking is one of the most profitable criminal activities of Italian OCGs.¹³⁴ After the 1970s and 1980s, in which heroin trafficking represented the main criminal business, during which time there were high numbers of heroin addicts while cocaine consumption was regarded as an elite phenomenon, the acknowledged health damages together with HIV emergency, caused a heavy drop of heroin consumption, thus opening renewed marketing opportunities for cocaine. Furthermore, the saturation of the cocaine market in the United States and the incoming return of heroin, created the need for Colombian cartels to expand cocaine distribution to new territories: "At the beginning of the last decade, there was the need to cross the Atlantic [and reach Europe] with tonnes of cocaine while inventing new strategies. The organisational and logistic system of cocaine needed new perspectives, rules and expertise."¹³⁵

In this mutating scenario, a key role was played by the 'Ndrangheta, which at the beginning of the 1990s started to exploit previous contacts and routes developed during the heroin business together with Cosa Nostra, while reinforcing connections with Colombians in South America.¹³⁶ Thus, Italy has gradually become the destination of huge quantities of cocaine, at relatively low prices in comparison to the 1980s so as to pervade the local drug market. Indeed, at present cocaine is widespread among different social classes; an elite drug turned also into a popular drug.¹³⁷

"Cocaine is used by the person sitting next to you on the train, taken to wake up in the morning, or the bus driver bringing you home because in need to make some overtime. Cocaine is consumed by people very close to you, if not your father, your mother or sister, probably your son. If not your son, your boss at work, or his secretary to enjoy herself on Saturdays. If not your boss, it is his wife to relax herself, and if it is none of these persons, it would be the lorry driver which delivers coffee to your bar and consumes cocaine not to feel tired after many hours driving [...], the park-car attendant to have energy in his feet, or the architect that has fixed your vacation villa."¹³⁸

Despite the existence of different influences on the Italian cocaine market, in terms of market extension (i.e. levels of demand and supply),

¹³⁴ V.R. Spagnolo, *Cocaina S.p.A.* (Cosenza: Pellegrini Editore, 2010); F. Sallusti, *Estimating Cocaine Market in Italy. New Methodological Tools for Policy and Program Evaluation*, 2013, <http://www.drugpolicyevaluation.eu/web/workstream/6>; L. Giommoni, "The Retail Value of the Illicit Drug Market in Italy", *Global Crime* 15 (2014): 27-50.

¹³⁵ Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco]*.

¹³⁶ S. Becucci, "Old and New Actors in the Italian Drug Trade: Ethnic Succession of Functional Specialization?", *European Journal on Criminal Policy and Research* 10 (2004): 257-83; S. Bizzarri et al., *Narconomics*, ed. Tacconi M. (Rome: Lantana Editore, 2010).

¹³⁷ R. Saviano, *Zero, Zero, Zero* (Milano: Giangiacomo Feltrinelli Editore, 2013); Spagnolo, *Cocaina S.p.A.*

¹³⁸ Saviano, *Zero, Zero, Zero*, 1.

routes and places of importation, as well as actors involved,¹³⁹ the financial aspects of cocaine trafficking activities in Italy have not yet been investigated.

Market overview

According to EMCDDA,¹⁴⁰ Italy has high rates of cocaine use (i.e. lifetime prevalence, population aged 15-64 years old), placing it after the United Kingdom, Spain, the Netherlands, and Denmark.¹⁴¹ In particular, at national level (among the same population) cocaine represents the second illicit drug used after cannabis, as reported by the General Population Survey (GPS-DAP) carried out by the Department of Anti-Drug Policies.¹⁴² Prevalence of cocaine use is estimated at 0.60% in 2012 and 0.89% in 2010 (last 12 months prior to the survey). The slight decline in prevalence registered within the general population (-0.29), is not confirmed when considering users among the juvenile population (15-19 year olds; student population survey). Cocaine remains the second used drug after cannabis, but with a percentage in prevalence of 1.86% in 2012 and 2.05% in 2013 (+0.19%). At the same time, wastewater analysis conducted in the EU in 2011,¹⁴³ was consistent with prevalence data at European level¹⁴⁴ revealing higher rates of cocaine use in Italy, Belgium, Sweden, France and the Netherlands (Table 5).

At national level, and in regard to the general population, 12 tonnes of pure cocaine used per year are estimated (vs. 130 tonnes at EU level), a value that increases to 25-50 tonnes of cut cocaine (retail level).¹⁴⁵ Differences among patterns of use throughout the national territory (17 Italian cities analysed) emerge as well, with highest levels (doses/day per 1,000 people) in the cities of Rome, Naples, Turin, Perugia.¹⁴⁶ Despite

¹³⁹ Reitox National Focal Point-Italy, *2012 National Report (2011 Data) to the EMCDDA: Italy*, 2012; EMCDDA, *European Drug Report 2014. Trends and Developments*, 2014; EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis* (Luxembourg, 2013); DCSA, *Relazione Annuale 2013 [Annual Report 2013]*; Becucci, "Old and New Actors in the Italian Drug Trade: Ethnic Succession of Functional Specialization?"; Spagnolo, *Cocaina S.p.A.*; G. Barbacetto and D. Milosa, *Le mani sulla città. I boss dell'Ndrangheta vivono tra noi e controllano Milano, [Hands on the City. Bosses of the 'Ndrangheta Lives Among Us and Control the City of Milan]* (Milano: Chiarelettere Editore, 2011); F. Forgione, *Mafia export. Come 'Ndrangheta, Cosa Nostra and Camorra hanno colonizzato il mondo [Mafia Export. How 'Ndrangheta, Cosa Nostra and Camorra Have Colonised the World]* (Milano: Baldini Castoldi Dalai Editore, 2009); V. Tenti and C. Morselli, "Group Co-Offending Networks in Italy's Illegal Drug Trade", *Crime, Law and Social Change* 62 (2014): 21-44.

¹⁴⁰ EMCDDA, *European Drug Report 2014. Trends and Developments*.

¹⁴¹ As underlined in the EMCDDA, *European Drug Report 2014*, data have to be interpreted with caution, and thus are indicative, due to methodological differences among countries within surveys.

¹⁴² Reitox National Focal Point-Italy, *2012 National Report (2011 Data) to the EMCDDA: Italy*.

¹⁴³ Wastewater analysis is a method "involving sampling a source of wastewater, such as a sewage influent to a wastewater treatment plant. This allows to [...] estimate the quantity of drugs consumed in a community by measuring the levels of illicit drugs and their metabolites excreted in urine" (EMCDDA, *Wastewater Analysis and Drugs: A European Multi-City Study*, 2014, 1.). Data were collected every day for a week period in the month of March 2011. For further details on data collection and methodology see E. Zuccato and S. Castiglioni, "Consumi di sostanze stupefacenti nelle città Europee [Psychotropic Substances Use in European Cities]", *Ricerca & Pratica* 28 (2012): 252-60.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ The Italian cities included in the sample are Palermo, Milan, Bari, Naples, Merano, Pescara, Potenza, Verona, Cagliari, Bologna, Gorizia, Turin, Terni, Florence, Nuoro, Rome, Perugia. Data were collected every day for a week period in the month of October 2011.

TABLE 5. COMPARISONS OF COCAINE USE, ESTIMATED BY WASTEWATER ANALYSIS AND NATIONAL PREVALENCE

Wastewater analysis		Epidemiological data	
Level of use (mg/day/1000 inhabitants)		Prevalence in use of young adults% (aged between 15-34)	
High level of use (1,000 – 2,000 mg)	<ul style="list-style-type: none"> – Antwerp (Belgium) – Amsterdam, Eindhoven, Utrecht (The Netherlands) – Valencia, Barcelona, Castellon (Spain) – London (UK) 	High level of prevalence use (4-5%)	<ul style="list-style-type: none"> – UK – Spain
Medium level of use (500 – 1,000 mg)	<ul style="list-style-type: none"> – Paris (France) – Milan (Italy) – Brussels (Belgium) – Santiago de C. (Spain) 	Medium level of prevalence use (1-3%)	<ul style="list-style-type: none"> – Italy – Belgium – Sweden – France – The Netherlands
Low level of use (>200 mg)	<ul style="list-style-type: none"> – Helsinki, Turku (Finland) – Stockholm, Umea (Sweden) – Budweis (Czech Republic) – Oslo (Norway) 	Low level of prevalence use (>1%)	<ul style="list-style-type: none"> – Finland – Norway – Czech Republic

Source: Authors' elaboration on E. Zuccato and S. Castiglioni, "Consumi Di Sostanze Stupefacenti Nelle Città Europee [Psychotropic Substances Use in European Cities]".

the limitations of the aforementioned estimations,¹⁴⁷ reported prevalence and trends are somehow in line with the opinions of some experts (IT-E4, IT-E19, IT-E16), underlying a widespread use of cocaine within the national territory, especially in larger urban cities, with an increasing involvement of both youths at lower ages, and various social classes. At present, elite and popular markets of cocaine – of different qualities in terms of purity and prices – coexist (IT-E19). Nevertheless, as noted by one expert (IT-E15), the boundaries between the two are becoming blurred, since the need for cocaine pushes elite consumers to frequent more popular retail places.

Cocaine is imported to Italy through two main routes: a) directly from South America, mainly Colombia, via Ecuador, Panama, Venezuela, Brazil, Chile, and Dominican Republic) or via the countries of Western Africa such as Guinea, Guinea Bissau, Gambia, Senegal, Ghana, Togo, Benin, Nigeria; b) European countries – the Netherlands, Spain and the Balkan countries (Serbia, Montenegro, Albania). "The investigation evidence suggests Spain is the main transit country for cocaine to be further imported to Italy, both for large and small amounts" (IT-E23). Cocaine was the most seized drug in 2013, with a slow decline compared to 2012

¹⁴⁷ See EMCDDA, *European Drug Report 2014. Trends and Developments*; Giommoni, "The Retail Value of the Illicit Drug Market in Italy".

TABLE 6. DRUG SEIZURES IN ITALY IN 2013 AND VARIATION IN% COMPARED TO 2012

Drug	Kg seized in 2013	Variation%
Cocaine	4,971.75	-6.28
Heroin	881.85	-6.21
Hashish	36,347.15	65.84
Marijuana	28,821.21	33.89
Cannabis plants (n.)	894,874	-78.29
Synthetic drugs	97.20	42.26
Other drugs	951.20	122.03

Source: Authors' elaboration on DCSA, *Relazione Annuale 2013 [Annual Report 2013]*, 2013.

TABLE 7. ITALIAN REGIONS WITH HIGHEST LEVELS OF COCAINE SEIZURES

Region	Kg
Calabria	1,663.85
Lombardy	626.63
Trentino Alto-Adige	613.37
Liguria	554.11
Lazio	534.82
Campania	270.34
Sardinia	245.22

Source: Authors' elaboration on DCSA, *Relazione Annuale 2013, [Annual Report 2013]*.

(Table 9), followed by hashish and cannabis.¹⁴⁸ Despite this, some experts have indeed suggested that at present the cocaine market has reached a level of saturation, indicating a stable trend during recent years (IT-E17).

As indicated by DCSA¹⁴⁹ and experts as well, higher levels of police seizures in the areas shown in Table 10, are related to the following factors: a) presence of international transshipment ports, which is the case of the region of Calabria, and minor ports such as Genoa, Vado Ligure in the region of Liguria, and Naples and Salerno in the region of Campania; b) presence of urban cities and thus large cocaine markets (the city of Milan in the region of Lombardy and the city of Rome in the region of Latium); c) role as transit points (again, the cities of Milan and Rome, since cocaine flows from the North to the South and vice versa mainly involve these two places); d) proximity to borders (regions of Liguria and Trentino Alto-Adige); e) key positions as for example the case of Sardinia, with ports and many coastline locations where cocaine can be concealed, as explained by a

recent journalistic inquiry,¹⁵⁰ and underlined by one expert: "Sardinia is underestimated. Cocaine arrives not only at ports, but also via cargo ships anchored in the sea with fishing boats recovering the drug and transporting it to different locations along the coast. And the proximity to Spain, as well" (IT-E19); f) presence of OCGs that function as drivers in determining entry, transit and destination points of cocaine trafficking. Nevertheless, data on cocaine use and police seizures seem to represent the tip of the iceberg of the national cocaine market. As stated by some experts when one load of cocaine is seized others have entered the national territory (IT-E18, IT-E13).

¹⁴⁸ DCSA, *Relazione Annuale 2013 [Annual Report 2013]*.

¹⁴⁹ Ibid.

¹⁵⁰ N. Francalacci, "I pastori sardi come i trafficanti colombiani? [Sardinian Shepherds Like Colombian Traffickers?]", *Panorama*, July 2012.

Market structure and actors

Cocaine use in Italy is widespread, and the market is dynamic and fragmented due to the interplay of different actors that range from big OCGs, minor criminal groups, to groups of individuals either with a criminal background or not belonging to the criminal milieu. As stated by one expert (IT-E15), “contacts and capital are enough to enter any cocaine business”.

In particular, Italian OCGs are active along the three stages of cocaine trafficking (importation, wholesale and retail), although at different levels of operation. Due to the immigration flows of the 1990s, there are also foreign OCGs and criminal groups in this market which, except for a few cases, are mainly involved at the retail level. The latter have had to confront with the monopoly of Italian OCGs, while struggling to reach medium or high level positions.¹⁵¹

Consistently, at the importation level actors can be identified in regard to three levels of the market: a) **High segment** – OCGs involved in large scale trafficking operations, which import cocaine directly from South America and act as wholesalers; b) **Middle segment** – traffickers importing lesser quantities of cocaine, usually from other European countries (Spain, the Netherlands, Belgium), and in some cases offering logistical support to large scale importers; c) **Low segment** – criminal groups, or families, involved in small scale cocaine trafficking operations and active locally.

As reported by experts, especially at the importation and wholesale levels, actors are structured into fluid, horizontal and loose networks made of independent nodes and connected by key actors, displaying specific roles and duties. Networks are based on contacts, intermediaries, brokers and include persons in charge of contacting suppliers, financiers, import-export companies, or responsible for arranging locations for storing cocaine, or acting as guarantors for the cocaine businesses; each belong to separate levels of cocaine trafficking operations and are not aware of each other (IT-E4, IT-E13). Connections among actors are created in virtue of joint ventures, where alliances and collaborations may vary depending on circumstances: “it can be one OCG or more OCGs joined together. For example, a group in the Netherlands mediating an importation from South America for an Italian group with the latter being unaware of suppliers, and the former supplying different groups at the same time” (IT-E8).

Within these networks, trust is fundamental and is usually guaranteed either by family, ethnic, kinship ties, or friendship/acquaintanceship bonds (IT-E9, IT-E1). “It is more likely that, high level traffickers managing large scale importations of cocaine, have limited contacts based for example on ethnicity or clan membership. If the trafficker is Turkish, he will probably have a Turkish supplier or broker, and similarly for the Colombian or the Italian trafficker. Albanians, for example, trust each other in virtue of familial ties as well as clan membership. The latter, implying strict codes of conduct, reinforces fair conduct in the business” (IT-E1).

¹⁵¹ See also Tenti and Morselli, “Group Co-Offending Networks in Italy’s Illegal Drug Trade”.

Acquaintances and friendships may form in different contexts, as reported by some experts (IT-E1; IT-E11), with prison being the favoured environment used to establish contacts for further joint ventures (IT-E24). Referring to Italian OCGs, a prosecutor at the DDA of the city of Naples¹⁵² has indeed addressed how the lack of rooms for prisoners serving sentences under art. 41bis (close confinement prison regime), has resulted in facilitating contacts among bosses that, in this way, get to know each other and have the opportunity to decide future joint ventures and alliances.

Importation and wholesale levels

High segment – large scale cocaine trafficking operations

At this level, a large part of the national cocaine market is managed by criminal entrepreneurs belonging to Italian OCGs, in particular the 'Ndrangheta, Camorra, and Cosa Nostra, although the latter act more as a partner of joint ventures exploiting routes and contacts of the former and providing in some cases logistical support.¹⁵³ As for foreign OCGs, Serbian-Montenegrin traffickers, were able to settle in the national cocaine market despite the rooted presence and control of Italian OCGs, representing nowadays competitive actors as well. All these groups import significant quantities (several kilos to tonnes) of cocaine to Italy, in virtue of direct contacts with suppliers in South America, while at the same time exporting cocaine from Italy to other European countries to supply members or contacts (IT-E24).

In particular, the majority of interviewed experts pointed out the strong and key role of the 'Ndrangheta (defined as a quasi-monopolistic position), at national and international level, addressing the following factors:

- Its horizontal structure (IT-E14) – the presence of affiliates almost worldwide¹⁵⁴ – activated when needed and displaying different roles: “During an eight month period of surveillance, a pizza chef in Miami conducted a normal life (pizzeria-home-family-pizzeria), until he received a telephone call from Calabria (Costa Ionica). This is how he was informed that the family was recruiting him, and from a pizza chef he turned into a cocaine trafficker” (IT-E18).

¹⁵² G. Tizian, “Mafie, la grande alleanza [Mafia, the Big Alliance]”, *L'Espresso*, July 30, 2013.

¹⁵³ In the opinion of some experts (IT-E18, IT-E13, IT-E15), Cosa Nostra represents at the moment a “second level player” within the national cocaine market, as a result of the massive government counteraction started in the 1990s in response to the violent strategy adopted by this OCG. “After this time, Cosa Nostra was not able to further replace its previous contacts due to heroin trafficking, and nowadays seems dependent on the 'Ndrangheta and Camorra for cocaine importation” (IT-E13); see also Spagnolo, *Cocaina S.p.A.*; Becucci, “Old and New Actors in the Italian Drug Trade: Ethnic Succession of Functional Specialization?”.

¹⁵⁴ In particular, it is documented that affiliates of the 'Ndrangheta are located in many European countries such as Spain, the Netherlands, France, Belgium, Germany, Hungary, Poland, Romania, as well as in other non-European ones as for example Canada, United States, Venezuela, Colombia, Australia and countries in Africa (Forgione, *Mafia export. Come 'Ndrangheta, Cosa Nostra e Camorra hanno colonizzato il mondo [Mafia Export. How 'Ndrangheta, Cosa Nostra and Camorra Have Colonised the World]*; R. Sciarrone and L. Storti, “The Territorial Expansion of Mafia-Type Organized Crime. The Case of the Italian Mafia in Germany”, *Crime, Law and Social Change* 61 (2014): 37-70.

- Tried and trusted relationships with suppliers in the producing countries, also via trusted drug brokers.
- Huge availability of capital and strategic assets to carry out cocaine trafficking operations.
- The control, through own structures, of key points of cocaine transit and importation to Italy. It is the case, for example, of the port of Gioia Tauro (region of Calabria), and the “Ortomercato” (the central vegetable market) in the city of Milan. In line with collected data, it has indeed been documented the role of ‘Ndrangheta families (‘ndrine) in first controlling and then also acquiring, transshipment services or import-export companies operating in these places.¹⁵⁵

Consistently, a similar strong and competitive position has been underlined by some experts (IT-E8, IT-E21, IT-E24) in regard to Serbian-Montenegrin OCGs, due to their paramilitary structure, the high availability of financial capital and the longstanding experience acquired with tobacco and arms smuggling during the post-Yugoslavia conflicts. At present, investigative evidence (IT-E21) suggests that these groups are increasingly becoming suppliers of Italian OCGs, since dealing with huge quantities of high purity cocaine, assuming on their side risks related to transoceanic transportation and storage, and further delivered at competitive prices on the Italian market.

Except for Camorra clans, which are also involved at the retail level, Italian and Serbian-Montenegrin OCGs act mainly as wholesalers. All these groups may import cocaine by sea directly from South America, or by road when importation is managed by intermediaries located in other European countries. This is the case of Serbian-Montenegrin groups that exploit the Balkan route, and further deliver cocaine through the border between Italy and Croatia or directly to the ports along the Adriatic coast; or of Camorra clans that import cocaine mainly via Spain, where stable affiliates reside providing logistics support, to the port of the cities of Caserta or Naples in the South of Italy (region of Campania), (IT-E8, IT-E25, IT-E12).

Import-export companies and transshipment services represent the main means used in large-scale cocaine trafficking operations. The companies may be either owned by OCGs or created *ad hoc* for few importations and registered to straw men. At the same time, the presence of complicit import-export companies offering services on a fee basis supporting the transportation of cocaine hidden with other legitimate products was reported by a number of experts (IT-E4, IT-E19, IT-E23, IT-E11, IT-E27). Furthermore, OCGs can rely on accomplices (e.g. customs agents, shippers) at the ports of departure and destination (and when needed of transit as well), facilitating both the shipping and subsequent recovery of containers, preventing controls and facilitating the overall trafficking operations. In particular, accomplices are necessary when cocaine operations are organised through the “rip-on/rip-off method”, i.e. these individuals are in charge of inserting and subsequently removing bags with cocaine loaded in containers (IT-E19, IT-E11).

¹⁵⁵ See also Barbacetto and Milosa, *Le mani sulla città. I boss dell'Ndrangheta vivono tra noi e controllano Milano*, [Hands on the City. Bosses of the 'Ndrangheta Lives Among Us and Control the City of Milan].

Once cocaine reaches Italy, OCGs use storage places for second extraction, repackaging and further distribution. While Serbian-Montenegrin OCGs mainly supply buyers situated in the northern areas, especially in the region of Lombardy (IT-E21), Italian OCGs have wider contacts being able to supply different buyers throughout the country (IT-E10).

“We have investigated a small group of traffickers working for a family of ‘Ndrangheta organising several cocaine trafficking operations from South America to the ports of the region of Liguria. During the last importation, the drug was collected at the port and then transported to a storage place situated in another nearby region. There, we found 5 modified vehicles, previously sent to a garage in Spain to be equipped with false bottoms and returned back to Italy with an articulated lorry. A very professional work, false bottoms activated by remote control and impossible to discover through routine police control” (IT-E11).

Middle segment – medium scale trafficking operations

At this level of the national cocaine market both Italian and foreign OCGs are involved, organising smaller scale cocaine trafficking operations. In this case, importation occurs mainly in virtue of intermediaries (i.e. members or contacts) located in other European countries such as the Netherlands, Belgium, Spain, Albania, which, in turn, have links with suppliers in South America. These criminal entrepreneurs, who contribute to a significant part of the cocaine market, may either import via their own suppliers, or collaborate with Italian OCGs (e.g. the ‘Ndrangheta, Camorra, Cosa Nostra, Sacra Corona Unita) both as suppliers (offering logistical support) or customers, depending on the nature of joint ventures (IT-E21, IT-E10, IT-E16). Although some experts reported examples of Italian OCGs¹⁵⁶ operating at this level (IT-E18, IT-E10), in general it was pointed out that the middle segment concerns mainly foreign groups, such as Albanians, Tunisians, Roma, especially in the central regions of Italy (e.g. Tuscany, Marche, Umbria, Abruzzo), and Nigerians (IT-E8, IT-E4, IT-E14, IT-E13, IT-E15).

“The Italian cocaine market has its regional peculiarities. In the South, there is an inevitable mixture of major Italian OCGs and foreign groups, where the former have almost complete control. In the north, as for example in the region of Lombardy (the city of Milan), in the region of Liguria (the city of Genoa), in other medium and large cities where Italian OCGs are rooted and have their interests, a link, a point of contact has to be present. Other regions, cities and towns, especially in the centre, where Italian OCGs have no interest to expand their criminal activities, foreign OCGs can manage the cocaine business with almost no opposition. And, although the latter have in

¹⁵⁶ One example regard the Fasciani clan (IT-E18, IT-E22), operating in Ostia (administrative division of the city of Rome) as wholesalers and retailers, relying on own routes and contacts for cocaine importation. “Indeed, in this place they have a monopoly role based on direct contacts (native individuals of Ostia) residing in Argentina and other places worldwide. From Colombia and Spain, they import hundreds of kilos of cocaine, which is also distributed to different areas within the city of Rome” (L. Abbate, “Così funziona la mafia di ostia [This Is How the Mafia in Ostia Operates]”, *L'Espresso*, June 11, 2014).

most cases their own supplying contacts and routes, they do not have yet the necessary know-how to compete at the same level" (IT-E13).

Among foreign groups, Albanians are considered second lead actors (IT-E13) since they are able to manage supply, transportation and distribution with high levels of organisation, similarly to Italian OCGs. "Laboratory analysis of cocaine seized to Albanian traffickers revealed refinement techniques which are different from the ones used by South Americans as to assume that at present the Balkan area functions as destination and storage but also of cocaine refinement" (IT-E21). This group, active at wholesale and retail levels¹⁵⁷ rely on a wide network of affiliates (members of clans) residing both in different northern and central areas of Italy, and other European countries, such as the Netherlands, Spain (more recently) and Albania (where bosses usually reside). Cocaine is then imported via road or sea routes through different means: recruited drivers of lorries, false bottom cars, taxi, rented cars; skippers of sailing boats, yachts; complicit seamen or executive officers, or passenger ships with cocaine hidden in bags or cars (IT-E8, IT-E3, IT-E4, IT-E11, IT-E15).

"In one investigation we detected a German courier in need of money since addicted to gambling who lived on the border between Germany and the Netherlands. Approached by two Albanian traffickers he was recruited to transport cocaine from the Netherlands to Italy, using his sister's car. It was a medium size family group, a brother residing in the Netherlands organising purchase and transportation of the drug and the boss (his brother) located in Tuscany, importing and selling cocaine at wholesale level" (IT-E2).

Nigerians import cocaine employing several drug mules (swallowers) transporting around a kilo of cocaine on each trip. For example, drug mules may leave from Nigeria, transit through the airports of Madrid, Amsterdam, London, Berlin, Frankfurt to reach major and minor Italian airports. Indeed, this group, considered to be highly competitive is particularly widespread due to: a) the existence of a transnational network of affiliates (family members formed in cells) being able to import cocaine from various locations almost worldwide; b) the presence of organised retail distribution spots in many cities and towns of Italy, from the North to the South. In the South, especially in places such as Naples, Caserta, Castel Volturno, where parts of the territory is controlled by Camorra clans, Nigerians are allowed to sell cocaine at street level for a fee for each kilo delivered (IT-E22, IT-E24).

Low segment – small scale cocaine trafficking operations

At this level of operation, different actors are involved belonging either to the criminal milieu or legitimate contexts, which in some cases may

¹⁵⁷ It has been underlined for example, that Albanians are the main wholesalers to Roma families, due to a well-established business relationship, with the latter supplying other families of the same ethnicity in the region of Abruzzo. At the same time, Roma criminal entrepreneurs may turn to other suppliers: direct contacts located in Spain and the Netherlands, or Calabrian or Neapolitan higher level wholesalers in regions such as Lombardy, Campania, Latium and Calabria (IT-E17).

also join together to carry out small cocaine businesses depending on contacts and opportunities. The involvement of Dominican, Brazilian, and Colombians criminal groups (usually family-based) was underlined, importing cocaine from South America and Santo Domingo by way of drug mules travelling by plain, with a distribution model limited to their ethnic communities (IT-E5, IT-E11, IT-E13, IT-E12). At the same time, different cases were reported among the following:

- A domestic group of criminal entrepreneurs operating in the centre of Italy importing some kilos of cocaine per week thanks to contacts with intermediaries of an Italian OCGs (Sacra Corona Unita) and supplying around 400 customers in their town and surrounding areas (IT-E1).
- An Italian entrepreneur in the north whose woodwork business went bankrupt, collecting money from acquaintances and friends (other legal entrepreneurs) and importing cocaine directly from South America (Colombia) and the Netherlands through a small network of suppliers (in the first place) and intermediaries (in the second place). “Fortuitous occasions may facilitate involvement in small cocaine trafficking operation. In this case, an Italian man had a Spanish friend who in turn had another Spanish friend living in Amsterdam, the latter in contact with Dutch traffickers” (IT-E11).
- A group of acquaintances in the city of Milan consisting of a professional, two ladies and other three or four individuals, all Italians, met while on vacation were importing cocaine from Santo Domingo (10 kilos 2-3 times a year) with the oldest lady travelling with children and expenses paid by the group (IT-E15).

Retail level

“Besides wholesale distribution, each street dealer may be a consumer as well, thus in our country there is an endless number of retail channels guaranteeing a widespread distribution of cocaine” (IT-E17). At this level both Italian and foreign individuals are active, separated from the higher levels of the trafficking chain (IT-E8, IT-E5). “Nigerians, Moroccans, Tunisians, Albanians, Serbians, Croats and Bulgarians. In the Italian criminal underworld, the melting pot so attended by European governors within the legitimate economy has been actually realised.”¹⁵⁸ Indeed, the need during the 1990s of Italian OCGs to distribute huge quantities of cocaine turned into the creation of organised “drug supermarkets” (IT-E12), opened almost 24-hours a day, subsequently exported to a number of Italian cities: Milan, Turin, Genoa, Verona, Rome (IT-E23).

Nowadays, in regard to the different regions of the Italian territory and in line with the collected data, it can be argued the existence of three main types of open air cocaine markets located in central and suburban areas of cities and towns:

- **Controlled markets** managed by Italian OCGs (the ‘Ndrangheta, Camorra, Cosa Nostra, Sacra Corona Unita) where Italian and foreign

¹⁵⁸ Spagnolo, *Cocaina S.p.A.*, 176.

individuals are employed and paid regular salaries;

- **Tolerated markets** where criminal entrepreneurs (mainly foreigners) operate under indirect control of Italian OCGs that require the payment of a fee for street dealing distribution;
- **Free markets** – areas without the control of Italian OCGs, in which mainly foreign dealers are active and that acquire cocaine from suppliers located in different Italian cities. Depending on the areas, ethnicities are Serbian, Roma, Albanian, Maghrebian, Moroccan, Tunisian, Nigerian, Ghanaian, Senegalese (IT-E2, IT-E4, IT-E12).¹⁵⁹ At the same time, clubs, pubs, discos of the night-time economy in larger cities or towns represent places of distribution as well, together with more covert locations such as private apartments or houses (IT-E8).

Financing and financial management

Although the national cocaine market appears dynamic and fragmented, recurrent financing patterns can be found: the need to have start-up capital for entering the market; the coexistence of illegal and legal capital as sources of financing; the key role of social capital as start-up capital, the presence of individuals (i.e. facilitators) collecting and delivering money to suppliers.

Sources of capital for criminal operations. Profile of financiers in criminal operations

Social capital more than financial capital

Contacts and trust (i.e. social capital) and reputation represent, in most cases, important elements that allow criminal entrepreneurs to enter the cocaine market even without financial start-up capital. Indeed, it has been underlined by experts, especially at the high and medium levels of operation, the key role of trusted individuals functioning as guarantors of cocaine transactions on the side of buyers and suppliers. Thus, after having gained access, increased credibility and reliability are at the basis for continuing to operate in the cocaine market without the need of advanced payments. Similarly, at the lower level, cocaine is given on credit as start-up capital in virtue of acquaintances or friendships, also developed during periods of detention. Dealers can also benefit from ethnic or kinship links to receive drugs on credit or to be recruited within a structured cocaine market (e.g. controlled markets) where no initial capital is required.

The most cited example by experts, at the high level segment, is that of the 'Ndragheta, which when entering cocaine business around the 1990s, was able to efficiently exploit previous contacts established through heroin trafficking (during the 1980s) managed together with Cosa Nostra (IT-E1). At present, the strength of this OCG relies in its undoubted reputation as credible traffickers, both at international and national

¹⁵⁹ See also Becucci, "Old and New Actors in the Italian Drug Trade: Ethnic Succession of Functional Specialization?"

level, and the availability of direct contacts in South America via trusted affiliates or drug brokers, that in turn, enable this group to organise large scale cocaine trafficking operations without anticipating any financial capital (IT-E18, IT-E13).

“Roberto Pannunzi,¹⁶⁰ who is well-known and esteemed in Colombia, is the one that contacts suppliers, negotiates the price of cocaine, establishes the quantities of cocaine to be distributed on the basis of the capital invested, decides the means of transport. With Barba, one of the main ‘commercial agents’ of Colombian narcos, he does not need either to sign agreements nor to pay a sum in advance. His word and a handshake are enough. In Bogotá they know he works for families of ‘Ndrangheta.’”¹⁶¹

Recognised expertise, reputation and contacts have allowed some foreign OCGs to ascend from bottom to medium/high levels of the cocaine national market, as is the case, for example, of Albanian and Serbian-Montenegrin groups (IT-E5; IT-E24, IT-E14). The former were able to use their credibility to become in a short time assistants of brokers, and trusted criminal entrepreneurs as to form joint ventures with national OCGs, employing for the retail level other ethnic groups (e.g. Tunisians and Maghrebians). The latter have gradually become reliable suppliers in the city of Milan for ‘Ndrangheta families. “An efficient cocaine agency” capable of importing cocaine and covering costs of importation and transportation, thus avoiding the need to wait for the proceeds of sales to customers.¹⁶²

Illegal sources of financing and criminal careers

The availability of financial start-up capital appears to be of equal significance to social capital especially in the high and middle segments. When organising large/medium scale trafficking operations, some costs cannot be postponed as for example transport (i.e. couriers, drug mules, drivers) or corruption of officials, if needed. That is, OCGs operating at these levels usually already have financial capital to start and then sustain the cocaine business.

¹⁶⁰ Roberto Pannunzi and Pasquale Locatelli are considered the most important and influent Italian pioneering drug brokers, that at the beginning of their criminal careers were able to redraw the international schemes of cocaine importation, mainly from South America to Italy. Indeed their fundamental and innovative role consisted in paving the way to cocaine joint ventures in the form of associations among families of different Italian OCGs (e.g. the ‘Ndrangheta, Camorra, Cosa Nostra) managing the different orders (in huge quantities), the payments to suppliers and the further distribution, in virtue of their trusted contacts (both with Italian and South American OCGs) and credibility as businessmen (see also Saviano, *Zero, Zero, Zero*; Forgione, *Mafia export. Come ‘Ndrangheta, Cosa Nostra e Camorra hanno colonizzato il mondo [Mafia Export. How ‘Ndrangheta, Cosa Nostra and Camorra Have Colonised the World]*; Spagnolo, *Cocaina S.p.A.*; M. Mologni, “Processo in vista per Pasquale Locatelli. Saviano lo definì il broker della cocaina” [Upcoming Trial for Pasquale Locatelli. As Defined by Saviano, the Broker of Cocaine]”, *La Repubblica*, November 13, 2013).

¹⁶¹ Forgione, *Mafia export. Come ‘Ndrangheta, Cosa Nostra e Camorra hanno colonizzato il mondo [Mafia Export. How ‘Ndrangheta, Cosa Nostra and Camorra Have Colonised the World]*, 58.

¹⁶² G. Anastasio, “Droga, il tramonto dell’Ndrangheta: A comandare ora è la mafia serba [Drug, the Decline of the ‘Ndrangheta: Now the Serbian Mafia Is in Command]”, *Il Giorno*, January 25, 2014; Becucci, “Old and New Actors in the Italian Drug Trade: Ethnic Succession of Functional Specialization?”; Bizzarri et al., *Narconomics*.

In particular, in the case of Italian OCGs which can be considered as high level criminal entrepreneurs, entering into the national cocaine market occurred in virtue of their long-standing criminal career, which in turn allowed for accumulating financial sources via other criminal activities. As noted by one expert (IT-E1): “cocaine trafficking offered the opportunity to invest money coming from loansharking, extortion racket, kidnapping, gambling and prostitution since at that time (during the 1980s) no laundering system was yet available.” At present, extortion racket and loansharking are considered by the majority of experts the main financial sources for cocaine trafficking, with the latter having become a source of financing as well. At the same time, capital coming from OCGs’ criminal activities is reinvested into the legal economy (e.g. acquisition of properties and goods), producing revenues and legitimate methods of payments that are used for cocaine trafficking operations (IT-E18, IT-E14).¹⁶³

“For example, with reference to ‘Ndrangheta families, sources of financing appear blurred. The evidence is the huge availability of cash that allows them to buy tonnes of cocaine. Money comes either from legal properties or illegal activities. In the city of Bologna we have seized a supermarket, a hotel, cars, two garages, for a total value of around €4-6 million. The hotel was registered in a straw man’s name, a person with a clean record but close to an ‘Ndrangheta family. Each client of the hotel, unintentionally financed their criminal activities. Here, there are many businesses run by Calabrian affiliates, restaurants, pubs, bars, all representing a source of finance for cocaine trafficking” (IT-E15).

Besides, high level criminal entrepreneurs, the collected data suggest that different criminal activities are the source of capitals to be invested into cocaine trafficking, and this is valid for both individuals belonging to the middle/low segments. After having entered the cocaine market, the revenues acquired are the main sources used to sustain further trafficking operations. Sexual exploitation and prostitution, for example, has been the criminal activity for Albanians OCGs to gain capital at first: “A prostitute earns around €600-€700 a day, which multiplied for the working days in a month, is a significant amount of money for purchasing cocaine” (IT-E16).

Other illegal sources of financing are used more or less by different criminal groups, or even individuals to finance small scale cocaine trafficking operations, such as the ones perpetrating armed robberies or burglaries allowing an immediate availability of cash to be invested into cocaine operations (IT-E13). “In one case, we prevented a person from committing a robbery. The intention was to have money to finance a cocaine deal, earning around €400,000-€500,000 and raise his living standard” (IT-E6).

At the retail level, criminal entrepreneurs need smaller amounts of money, but if operating outside a network of contacts need cocaine

¹⁶³ See also Barbacetto and Milosa, *Le mani sulla città. I boss dell’Ndrangheta vivono tra noi e controllano Milano*, [Hands on the City. Bosses of the ‘Ndrangheta Lives Among Us and Control the City of Milan].

on credit that functions as start-up capital. After this initial phase, profit margins are reinvested to buy other quantities of cocaine, thus gradually expanding the business. “Tunisians can obtain 50 grams of cocaine on credit from middle suppliers, and after selling with good profit margins (i.e. cutting or selling 0.80 at a dose), start having a small capital to reinvest. After a short period (around two months) they are able to buy half a kilo” (IT-E5).

Legal sources of financing

Besides cases in which sources of financing for cocaine trafficking derive from legitimate business activities run by OCGs, legal capitals loaned by external financiers have been mentioned in two instances. The first concerns legal entrepreneurs (which in the opinion of the expert are numerous) owning small companies or commercial premises in the city of Milan that decide to make use of their contacts and invest dirty money into several cocaine deals, seen as the easiest and most profitable investment. They can make from €50,000 up to €200,000, and risks (e.g. load seizures) are covered by the right to collect profits on subsequent cocaine trafficking operations. “Some investors had to wait 2 years to have their money back, others only 3 months. There is no guarantee, since it depends on several factors: the quality of contacts, the capacity of traffickers, the routes of importation” (IT-E4). The second, regarding legal financiers who are running regular businesses and lending money to dealers at the initial stage. “Different street dealers referred that to start the cocaine business, were at first introduced to these people borrowing capital to be returned within a month” (IT-E5). At the same time, legal capital is also used to finance small cocaine trafficking operations when legitimate entrepreneurs are willing to increase their overall profits. In these circumstances, money is collected among a restricted group of individuals who – having the right contacts – are able to import and sell cocaine usually to acquaintances or friends (IT-E11, IT-E15).

Financial joint ventures

Raising capital is usually done among more OCGs, so as to share costs and risks. As contended by one expert (IT-E4), cocaine trafficking operations are first financial joint ventures, i.e. accepting to divide profits in virtue of fewer risks for each actor involved. In several cases, for example, ‘Ndrangheta families join together with Camorra clans to finance a single cocaine deal, dividing the loads in respect to the initial investment (IT-E7). In this regard, a common *modus operandi* has been underlined at all levels of operation: the presence of individuals in charge of testing the interest of different buyers, collecting quotes offered by each participant, forwarding the order to suppliers via skype, email, telephone coded messages and, in most cases, also arranging importation (IT-E3, IT-E9).¹⁶⁴ Italian OCGs, for example, rely on trusted drug brokers, individuals external to the organisation that arrange cocaine trafficking

¹⁶⁴ See also P. Campana, “Eavesdropping on the Mob: The Functional Diversification of Mafia Activities Across Territories”, *European Journal of Criminology* 8 (2011): 213-28.

operations and work for different families or clans. Indeed, as explained in Rastello (2009), families of the 'Ndrangheta or Camorra clans finance cocaine trafficking operations, open markets and control the retail level, but are not involved in logistics. Technical aspects are managed by professionals, reliable individuals capable of solving problems.

"A real narcos does not need any intermediaries. He manages relationships with Colombian, Bolivian, Mexican cartels to import huge quantities of cocaine [...]. When the load is ready, from Toronto he starts to arrange meetings and negotiations to define the quotes of participation. It is at this point that he contacts the bosses of 'Ndrangheta families in Calabria, or their representatives in Canada. His job is not easy, it requires credibility and reciprocal trust among all the participants. These are affairs of millions of dollars that no notary can ratify. The 'word of honour' and 'respect' represent the only contractual bonds as a guarantee of one's own undertaken engagements."¹⁶⁵

Access to capital in critical moments

Critical moments (e.g. arrest, seizures of loads, theft by competitors, etc.) have different impacts depending on the level of operation. OCGs, in virtue of large scale cocaine trafficking operations are able to make savings that allow them to continue the cocaine business. Financial resources are preserved using different means: reinvested in legal properties or deposited in bank accounts/safe deposit boxes registered to straw men, or even kept in cash and concealed in various places (e.g. warehouses, apartments, etc.). Furthermore, in case of arrest, individuals keep being connected to other members that not only provide legal and familial assistance, but also continue to run cocaine trafficking. One expert (IT-E26) related how some bosses of OCGs are capable to continue running the criminal activity although imprisoned, due to communications via third persons attending weekly meetings. Although OCGs have been heavily dismantled, in most cases trusted relationships with drug brokers or suppliers in South America represent the basis from which to restart after a period of detention and source support if capital is needed. Credibility and trust are the re-entry tickets to the business and for receiving cocaine on credit (IT-E21, IT-E3). At lower levels, contacts and trust appear even more important for starting the cocaine business again, under the condition to have been silent during detention. Street dealers can be reintegrated within the group where cocaine is provided at first on credit; in cases in which contacts are not available, minor crimes (robberies, thefts) function as sources of initial capital.

Overall, at all levels of the cocaine market criminal entrepreneurs are likely to continue with their criminal activity without facing particular difficulties (IT-E9, IT-E2).

¹⁶⁵ Forgione, *Mafia Export. Come 'Ndrangheta, Cosa Nostra e Camorra hanno colonizzato il mondo [Mafia Export. How 'Ndrangheta, Cosa Nostra and Camorra Have Colonised the World]*, 193.

Settlement of payments

According to experts, trust is fundamental when settling payments among buyers and suppliers. In particular, the possibility to have less or no start-up capital is correlated to the arrangements players make within cocaine trafficking operations. The 'Ndrangheta, for example, has well-established credibility within the national and international cocaine market that can arrange trafficking operations and receive the drugs without any advanced payment. As reported by one expert (IT-E18) "suppliers are aware that these traffickers are solvent". Indeed, when trust is lacking or buyers and suppliers are at their first deal, the most common forms of guarantee are cash upfront or alternatively the use of individuals as collateral: "persons whose life is important enough to buyers as to compel to payment" (IT-E11).

Besides the role of trusted relationships, another significant variable discriminating among different schemes of payment is the level at which criminal entrepreneurs operate: more often up-front arrangements are made at the lower levels (between medium wholesalers and dealers, or the latter and users), (IT-E2). Nevertheless, although other modes of payment exist – such as partial payment and revolving credit arrangements, especially applicable at the higher/medium levels (importation and wholesale) – it has been underlined by some experts that in more recent times the trend at all levels is the request of advanced cash payments. In this regard, one main reason has been identified: the presence of various insolvent buyers. At the retail level, on the one hand, dealers may build customers loyalty by giving cocaine on credit; on the other, the latter may face economic difficulties being not able to repay quickly. As a result, the entire cycle of payment may be compromised (IT-E14), resulting in certain cases in violence (IT-E2, IT-E18). Similarly, at higher levels, it has been argued that the reduced availability of cash – due mainly to the policy of some criminal entrepreneurs to move their capital as little as possible – results in cocaine deals remaining unpaid:

"In recent times there is less cash, and this way buyers lose loads of cocaine. Usually the deal is to repay back at first a quantity of cocaine corresponding to 30% of the value (at European price) once it has been sold. The remaining part is liquidated through a second tranche. Thus, many suppliers run the risk either to remain unpaid, or to wait long periods before receiving the money back, until facilitators (e.g. custom officers, entrepreneurs) get paid" (IT-E3).

Despite this, when operating at higher levels and between trusted OCGs, retaliations are not the rule; instead, new arrangements are set up in order to continue to run the cocaine business smoothly. The most common option is to benefit from another consignment by suppliers to fix previous unsolved payments (IT-E18).

Instalments and revolving credit arrangements

Instalments and revolving credit arrangements are, in the opinion of experts, the most used in cocaine trafficking. The first, regarding high

and medium levels of operation, requires an advance by the buyers of around a 10% to 20% of the value of the agreed overall price per kilo in the producing countries (IT-E3). This advanced sum is aimed at: a) ensuring the commitment of buyers; b) covering costs of transportation and other expenses (e.g. corruption), usually charged to customers; c) covering risks (e.g. seizures by police; stealing by competitors).¹⁶⁶ The remaining part is then paid either when cocaine is delivered or sold. Again, the degree of trust is crucial: if the business relationship is at the beginning, or is guaranteed by intermediaries, the advanced amount is higher; on the contrary, if deals are well-established the amount required is less (IT-E10).

Nevertheless, this mode of payment is not fixed since, besides trust, may depend on other contingent factors such as for example the availability of drug on the side of suppliers. Indeed, a variation of this main settlement of payment scheme has been explained as follows:

“The buyers pay an anticipated sum, let’s say, for a load of 100 kilos of cocaine which is actually the quantity that is able to sell on the Italian market. The supplier, at the same time, supply 200 more kilos, requiring this part to be sold at the European price. This way, if the buyer is a capable seller, that is selling at a major price, repay the supplier while having profit margins as well. More likely, this happens, since in South America, the quantity of cocaine available is huge” (IT-E4).

The second, i.e. revolving credit arrangements, are more related to medium or low levels of operation, with trust as a form of guarantee more than in the aforementioned cases. The drug is then given to customers on credit, and it is repaid on an agreed timetable. “Street dealers, for example Albanians, receive small quantities of cocaine on credit, especially when entering the business” (IT-E5). At the same time, this kind of arrangement is employed by medium wholesalers to keep dealers (IT-E20). Similarly, in the cocaine markets controlled by Italian OCGs, dealers recruited as employees receive the drug on a free basis, being repaid back with regular salaries (IT-E24).

Payment methods

The collected data has underlined three main methods for cocaine payments used by criminal entrepreneurs, which are employed depending on the level of operation (high, medium, low), (IT-E20): cash which is physically transported; transactions via bank accounts; money transfer services and hawala (also applied for laundering profits of cocaine trafficking).

Cash payments

In the opinion of the majority of experts cash still represents the most method used, due to the low risks of detection that money couriers are

¹⁶⁶ See also Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco]*.

likely to face, and as stated in Rastello (2009) interviewing an Italian drug broker, financial transactions are at major risks of being intercepted. One expert (IT-E4) pointed out the current debate at the EU level centred on two opposite views: the first intended to prohibit €500 banknotes, the second willing to introduce €1,000 banknotes. The circulation of high denomination notes allows the transportation of huge sums of money requiring limited room.

“Payments of loads are made in cash. At present, there is the €500 banknote, a real blessing for us. It is then useful to have an accomplice in a bank – not the director, a controlled cashier is enough – willing to exchange huge sums of money into large denomination notes of €500. Money can be concealed into the drums of washing machines, refrigerators, transported in containers.”¹⁶⁷

Money collectors, persons in charge of gathering capital to finance cocaine trafficking operations, may be money couriers as well, while in other cases drug brokers or other individuals recruited for this purpose may be involved. They should not be related to the criminal entrepreneurs organising the trafficking. More often, buyers are in charge of delivering money; nevertheless, suppliers also have their own money collectors and couriers in charge of recovering payments (IT-E18). When Italian OCGs are involved, one expert (IT-E24) pointed out the key role of affiliates, among which the most trusted and closed to the bosses are in charge of transporting the money. “Camorra clans are at first families, brothers, nephews, etc., and significant amounts of money are entrusted to them, or affiliates that are like family members. And besides, individuals with different roles and duties are recruited.”

Cash is transported by cars, trucks, airplanes, concealed in bags, false bottoms, and in most cases through the means of transport used for cocaine (IT-E9). It can be delivered directly to suppliers located in South America or via intermediaries residing in transit countries such as Spain or the Netherlands.

Non-cash payments

Legitimate transaction channels are used by criminal entrepreneurs, especially when dealing with large scale cocaine trafficking operations (IT-E8, IT-E18). In these cases, cocaine is more often concealed in containers transporting legitimate commercial products, and this way the drug can be paid through the issue of regular invoices between import-export companies. The latter are likely to be owned by OCGs and registered to other family members or straw men. Besides regular shipping of commercial products, the use of bank accounts, finance and shell companies has been reported, again registered to the same individuals, and located also in offshore zones (IT-E15, IT-E10). In the first case, as indicated by one expert (IT-E15), criminal entrepreneurs may rely on complicit bank officers, or even directors, who facilitate the entering of the money into the banking system, especially in countries where anti-

¹⁶⁷ Ibid., 145.

money laundering legislation (i.e. reporting of suspicious transactions) is in force. When these means are involved, schemes of payment are more complex and sophisticated, as explained by the following example:

“In one investigation we detected numerous money transactions carried out using several bank accounts located in different countries registered to members, straw men and shell companies. Cash was transported by couriers at first to Switzerland and deposited into bank accounts registered to different individuals; transactions were then made via bank accounts in the Netherlands to Virgin Islands, United States and Brazil. This way, they have been able to send several thousands of euros” (IT-E10).

In smaller scale cocaine trafficking operations, two different means of payment – mainly used by foreign OCGs – were underlined by experts: the mainstream money transfer services (Western Union, MoneyGram, Ria) and the hawala. The first allows multiple transactions by different individuals (straw men or recruited persons using personal ID documents) circumventing the imposed limit for each transaction (i.e. €999 per day/entire week), and guaranteeing the anonymity of the actual sender. In some cases, owners of money transfers are accomplices in providing ID documents and in omitting to signal suspect transactions. The second, that could be defined as a “human bank system”, is based on the connections among at least three individuals (hawaladars) residing in different countries and transferring money through the use of small paper documents. This way, criminal entrepreneurs themselves, or via trusted individuals, pay suppliers without moving capital. Indeed, the network of hawaladars is usually at OCGs disposal, also assisting in money laundering operations, thus having huge financial resources to be used in these circumstances (IT-E15, IT-E3).¹⁶⁸

“The hawala functions as follows: person A has to pay person B, for example in Dubai. The former receives from the hawaladar in Milan a receipt in front of a cash payment and travels to Dubai. There he consigns the receipt to a second hawaladar and receives the sum of money previously consigned and then pays suppliers of cocaine. After a month the cocaine arrives to Italy. The hawaladar charges from 6% up to 8% for his service” (IT-E3).

In one case another form of payment was mentioned – a trade based system – involving a group of Roma criminal entrepreneurs operating as medium level wholesalers (IT-E17) and paying for cocaine through fictitious transfers of cars ownership. This method was preferred since it allowed them to avoid the risk of money being intercepted, while at the same time suppliers could sell cars in order to receive capital to reinvest in the cocaine business.

¹⁶⁸ See also M. Naím, *Illecito. Come trafficanti, falsari e mafie internazionali stanno prendendo il controllo dell'economia globale, [Illicit. How Traffickers, Forgers and International Mafias Are Taking Control of Global Economy]*, (Milano: Arnoldo Mondadori Editore, 2006).

Costs of doing business

Costs of business include both expenses criminal entrepreneurs face in organising cocaine trafficking operations as well as possible extra costs (e.g. corruption, seizures of cocaine, theft by competitors, payments of legal expenses as well as support to families of imprisoned members). As pointed out by the majority of experts, it is possible to have estimations of approximate costs due to the interplay of different variables especially when importing at large scale levels:

- the place in which cocaine is purchased – producing countries or another European country;
- the quantity of cocaine acquired (usually the larger the quantity, the cheaper per unit of weight);
- the type of relationship between buyers and suppliers – new or longstanding business relation;
- the level of operation (importation, wholesale, retail);
- the type of logistics used also has a major impact on costs (IT-E4, IT-E19, IT-E13, IT-E15).

As a consequence, the reported estimations refer more to the costs of different aspects of cocaine trafficking (e.g. price of cocaine per kilo, transportation, facilitators) than to the cost of each single trafficking operation. At the same time, although extra costs were identified, quantifications were possible only for corruption. Police seizures, for example, are, in the opinion of experts, already considered as risks and are thus being computed in the prices of cocaine and transportation (IT-E4, IT-E15, IT-E11). Nevertheless, at the high level of trafficking, shipments seized by police seem to have no significant impact on the overall costs (IT-E8). Support is provided to imprisoned members and their families, or to external individuals who are particularly important, or to guarantee their silence (IT-E17).

Importation and wholesale

The price of cocaine in the producing countries (South America) ranges from €1,000 to €3,000 per kilo (IT-E4, IT-E14, IT-E11) depending on the quality of contacts, while at the wholesale level in Italy varies from a minimum price around €36,000 to a maximum price around €44,000 per kilo.¹⁶⁹ If cocaine is imported from another European country, Spain and the Netherlands, for example, the price per kilo is respectively between €27,000-€29,000 (IT-E4) and €27,000-€30,000 (IT-E2). As stated in Rastello (2009), prices of cocaine per kilo are fixed in major European markets, that is the Netherlands in the past years and more recently Spain due to the presence of big importers (such as the 'Ndrangheta) preferring cocaine to be discharged in this place as a first EU destination area.

¹⁶⁹ Data on prices were provided by DCSA during the interview with the appointed expert and refer to the second semester of 2013, calculated on the basis of the mean prices registered in the cities of Palermo, Reggio Calabria, Naples, Bologna, Venice, Florence, Trieste, Turin, Rome, Genoa, Milan, Verona. Variations between the minimum and the maximum prices are related to the purity of cocaine. These values are in line with the prices reported by experts interviewed in the different locations throughout the Italian territory.

In the opinion of experts, variations in prices in Italy depend mainly on: a) the level of purity of cocaine, which at the importation and wholesale levels is between 80% – 98%; b) the balance between demand and supply of cocaine – if the latter declines, prices tend to increase; c) the number of stages within the trafficking chain – if criminal entrepreneurs are able to import from South America to Italy, or if 1-2 transit countries are involved; d) whether the transportation and related risks are charged to buyers or suppliers; in the second case the price at which cocaine is purchased is higher (IT-E8, IT-E3, IT-E4, IT-E17).











“If importers buy the cocaine from South America or Spain and then arrange transportation on their own, prices are around respectively €1,500-€2,000 and €27,000-€29,000 per kilo. If they receive the drugs in Italy, without arranging transportation, the cost goes up to €35,000 per kilo. Similarly, if they arrange a delivery in the city where they are located then the price further increases to around €37,000-€38,000” (IT-E4).

“In general, OCGs try to join trafficking operations with as few transits as possible. For example, if they buy and import cocaine from South America the price is €1,000-€1,500 per kilo and they sell it at a price around €27,000-€33,000 per kilo in the EU. If there is a transit country in between, with the need to pay facilitators or transporters, they can negotiate the price, but actually it increases significantly. When cocaine is sold at €45,000-€46,000 per kilo, it means that at least three passages have occurred” (IT-E3).

At importation and wholesale levels costs are higher compared to the retail level, and in many cases prices of cocaine already include risks and transportation costs if they are born by suppliers (IT-E10). When criminal entrepreneurs organise trafficking operations themselves from producing to destination countries, the main costs are related to transportation, individuals dealing with logistics and corruption. Once again, costs of transport vary depending on the method employed. Indeed, cocaine can be imported in containers of unaware owners of import-export companies, thus implying costs related solely to facilitators recovering the drug (e.g. custom officers). Similarly, when cocaine is well concealed, cost for facilitators at customs are not required (IT-E14). Despite this, and taking into account all the resources (both material and human) needed to organise large or medium scale cocaine trafficking operations, experts have reported the following costs (Figure 10).

In-kind payments with cocaine have been reported in regard to intermediaries (drug brokers), with the latter usually requesting this type of remuneration. It may be, for example, 1 kilo out of 10 delivered, where the payment consists in profit margins obtained with drug selling (IT-E8, IT-E19). An interviewed Italian trafficker provides similar information: “at the beginning of the business relationship the agreement may consist in a remuneration of 20 kilos out of 100 kilos of delivered cocaine with transportation costs covered on the side of

FIGURE 10. COSTS OF LARGE/MEDIUM SCALE COCAINE TRAFFICKING OPERATIONS IN ITALY

	Opening an <i>ad hoc</i> import-export company*	€10,000
	Compliant entrepreneurs owing import-export company receiving cocaine	<ul style="list-style-type: none"> - 30% of the value of the load at EU price - €50,000 for each supplying
	Transhipment service	€10,000 (per container)
	Customs expenses	22% of the value of the load
	Intermediaries (drug brokers)	From 3% – 4% up to 10% of the value of the load at EU price
	Couriers	<ul style="list-style-type: none"> - €4,000/5,000/6,000 per kilo transported within EU - 5% up to 10% of the value of the load within the national territory
	Drug mules (swallowers)	From €2,000 up to €3,000 depending on the capacity (i.e. quantity transported) + travel expenses
	Individuals recovering cocaine nearby ships	€1,000 each kilo recovered
	Individuals recovering cocaine at ports of destination (method “rip-on, rip-off”)	25% – 30% of the quantity recovered at EU price
	Facilitators (customs officers, etc.)	<ul style="list-style-type: none"> - 10% to 30% of the value of the load at EU price - €10,000 per container in EU - €1,000 in South America/Africa for the entire load

* In these cases, some experts (IT-E4, IT-E7) pointed to the need to open a commercial trade channel. With reference to an investigative operation, costs included several trial trips with commercial goods at €20,000 each.

Source: Authors’ elaboration on collected data.

buyers; when the relationship is well-established the trafficker may keep 50 kilos out of 100 kilos.”¹⁷⁰

Retail

At the retail level prices of cocaine depend on the quantity purchased, level of purity and the relationship among wholesalers and dealers. Prices also vary in regard to the different areas within the Italian territory,

¹⁷⁰ Quoted in Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco]*, 115.

where the most expensive are registered in the northern/central parts of the country.

The costs to purchase cocaine for dealers range from €30 to €40/45 per gram, sold at the street level at around €60 to €90 per gram. In particular, costs at this level were reported for organised and controlled markets, where OCGs (for example Camorra clans or groups) pay salaries to the different employees based on their role and duties, dealers included. In this case, the latter do not have to buy the drug or cut it since they are supplied with single doses ready to be sold. At the same time, they have to guarantee certain amounts of quantity delivered. Figure 11 illustrates prices for each individual employed in three sample of drug markets, respectively Scampia and Afragola (neighbourhoods in the city of Naples) and the city of Bari (IT-E24, IT-E26). Besides salaries, some dealers which are more crucial to OCGs receive benefits as well, such as coverage of legal expenses and other forms of aid.¹⁷¹

FIGURE 11. COSTS OF RUNNING CONTROLLED COCAINE MARKETS IN ITALY (MONTHLY PAYMENTS)

Chemist for cocaine cutting	Warehouse keeper	Armed sentinels	Money collector ("capobastone")	Dealers (city of Naples)	Dealers (city of Bari)
					
€10,000	€7,500	€6,000	€10,000 – €15,000	€2,000 – €3,000	€4,500 – €6,000

Source: Authors' elaboration on collected data; P. Samarelli, "La Nuova Gomorra, [The New Gomorrah]", *L'Espresso*, April 29, 2014.

Profits and profits sharing

Profits of OCGs in the cocaine market depend mainly on the level of operation and the position within the trafficking chain where stages of distribution may vary. Thus, cocaine can be imported from South America to Italy and then sold at the national wholesale level, but before reaching the retail level another middle wholesale level may intervene. Similarly retail level can be divided into different stages where 1 kilo of cocaine can be sold to different street dealers (1,000 grams each). As stated by some experts (IT-E16, IT-E17), the highest profits are gained operating at the wholesale level, where mark-ups consist mainly in the difference between the purchasing price (per kilo) in the producing countries and

¹⁷¹ IT-E26 and Samarelli, "La Nuova Gomorra, [The New Gomorrah]".

TABLE 8. MARK-UPS AT THE DIFFERENT STAGES OF A COCAINE TRAFFICKING OPERATION PER KILO IN ITALY (EXAMPLE 1)

Stage of cocaine trafficking	Mean prices (€/kilo)	Mark-ups
Importation (South America)	2,250	
Spain	33,000	93.18%
Italy (wholesale)	40,000	17.5%
Italy (retail)	70,000	75%

* Mean prices are calculated considering the minimum and maximum values reported by experts and DCSA.

Source: Authors' elaboration on collected data.

TABLE 9. MARK-UPS AT THE DIFFERENT STAGES OF THE DISTRIBUTION OF COCAINE IN ITALY (EXAMPLE 2)

Stage of cocaine trafficking (national)	Prices (€/kilo)*	Mark-ups
Wholesale (stage 1)	30,000	
Middle wholesale (stage 2)	90,000 (cut 1 to 3 kilos)	200%
Retail	210,000 (70,000 x 3 kilos)	133%

* Prices are based on a case reported by IT-E2.

Source: Authors' elaborations on research data.

the selling price in the national territory (Table 8). At this stage, cocaine is sold maintaining the initial level of purity, which decreases at each further step of the national distribution chain (Table 9), (IT-E8, IT-E26, IT-E2).









“Cocaine throughout the transportation from producing countries can be adulterated several times, depending on routes, and especially intermediaries active within the trafficking chain. For example, kilos of pure cocaine are imported from Colombia to reach Spain where it can be cut at 20% to further reach Italy where wholesalers cut a 15% – 20% more. Another adulteration process, the more consistent, is carried out by street dealers before selling to final consumers; at the end it is at 20% level of purity. As a result, each kilo of pure cocaine (at a price of around €1,000), produces 4 or 5 kilos to be sold at the retail level at €70/80 per gram. Investigations reveal the following prices in transit places such as Spain (€35,000-€40,000 per kilo) and Italy (€55,000-€60,000 per kilo)” (IT-E26).

Furthermore, at the retail level street dealers, except for controlled cocaine markets, can further adulterate cocaine, or sold a dose with less quantity (e.g. 0.80) or increase prices, depending on circumstances, type of relation with supplier and consumers as well as margins left for cutting the acquired cocaine. Usually from 1 gram it is possible to obtain 4/5 doses with around 20% purity (IT-E24). Nevertheless, overall profit margins at this level remain low, allowing in most cases to sustain basic living standards (IT-E2). Conversely, profits are particularly high for drug brokers who, besides mediating between buyers and suppliers, also arrange logistics¹⁷² in regard to the importation of 1,250 kilos of cocaine from South America to Italy (Figure 12).

¹⁷² Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco].*

In particular, profits are related to the risk taken within cocaine trafficking operations, and this explains the high margins for criminal entrepreneurs that invest capital, as well as for individuals in charge of logistics and organisation. Profits are also divided on the basis of the initial investment, so if one clan or family has invested 20% of financial resources, the same percentage is expected in return (IT-E23). At the same time, all the other actors in the trafficking chain, who are usually external individuals, are paid regular daily wages (e.g. street dealers) or lump sums in respect to the service provided (e.g. drivers, drug mules, curriers) (IT-E26). Nevertheless, as noted by one expert (IT-E14), profits do not end up with cocaine trafficking operations, instead they further increase due to reinvestments in different legal activities, that in turn produce revenues as well.

**FIGURE 12. INDICATIVE PROFIT MARGINS OF A DRUG BROKER
IN AN INTERNATIONAL COCAINE TRAFFICKING OPERATION**

	<ul style="list-style-type: none"> - Material (marble blocks) - Processing of marble for concealment - Transportation (+ tips for drivers) 	\$120,000
	<ul style="list-style-type: none"> - 30 containers - Transporters (+ tips for carriers) 	\$50,000
	Fee to custom officer at port of destination (20% on the value of regular invoices \$45,000)	\$8,000
	Transportation to final destination (city of Milan)	\$1,000
	Other costs	\$21,000
	Overall costs	\$200,000
	Profits (€3,000 paid for 1 kilo imported)	\$3,750,000
	Net profits	\$3,550,000

Source: Authors' elaboration on L. Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco]p* (Milano: Chiarelettere Editore, 2009).

Investment schemes

Investment schemes depend mainly on the level of operation. At lower levels, most of the profit is used for personal expenses and to raise living

standards. Especially in regard to foreign criminal entrepreneurs, such as for example Colombians, it has been pointed out that they invest in a lavish lifestyle buying luxury or fashion items (IT-E5). Similarly, OCGs spend part of their revenues on personal expenses, due to the illicit nature of money (IT-E4).

At the same time, profits are used to finance cocaine trafficking and other criminal activities, in particular at higher levels, such as loansharking, illicit tobacco trade, arms trafficking, human trafficking. Reinvestments in the legitimate economy are more recurrent at importation and wholesale levels, where the amounts of profits are significant. As stated by the majority of experts, Italian OCGs invest revenues in very different sectors, mainly in the northern and central areas of Italy and in other EU and non-EU countries. In particular, real estate, land, night time economy establishments (e.g. pubs, restaurants, discos) commercial properties (e.g. hotels, real estate agencies, trade centres, shops, car dealerships, supermarkets, etc.), public contracts sector, businesses enterprises (e.g. real estate companies, import-export companies) (IT-E13, IT-E14, IT-E6, IT-E23, IT-E19, IT-E15). With reference to the latter, some experts pointed out the role of the economic crisis in facilitating the gradual acquisition by OCGs of legitimate businesses, at first through loansharking (IT-E23, IT-E3, IT-E16).

“Unsuspecting professionals approach entrepreneurs having economic difficulties offering to lend them money. Then a gradual process of acquisition starts. At first, some straw men are entered in the board of directors of the company as to control the business. Subsequently, complete ownership is acquired and, in the case for example of import-export companies, cocaine trafficking activities are covered by legitimate appearance. In this way, they are used to launder money as well” (IT-E8).

Foreign criminal entrepreneurs operating at lower levels invest profits mainly in their country of origins. Usually revenues are used to support family members (especially North Africans), or to buy real estate, land or commercial properties: “In one case, a Tunisian dealer was able to send €120,000 to Tunisia, then he went back home. There he bought a pub, he built his house with a swimming pool and at present he runs his pub” (IT-E5). Cash is sent using money transfer services and hawala which is also a means to launder profits (IT-E2, IT-E5, IT-E23, IT-E9).

In general, Italian OCGs invest in profitable legal activities. One expert (IT-E18) reported the acquisition of the most historical bar of the “dolce vita romana” (e.g. Café de Paris) in the centre of Rome by a family of the ‘Ndrangheta. The owner was about to reach a selling agreement with Lebanese buyers when he was compelled to turn to a different purchaser. The Café de Paris was, this way, acquired and registered to a straw man, actually a hairdresser from Sinopoli (Calabria). Straw men, complicit bankers, accountants, notaries, lawyers, financial brokers are crucial when reinvesting profits and laundering money, and in most cases families of OCGs also send their sons to the best universities worldwide in order to create a network of insider professionals (IT-E10, IT-E24,

IT-E7, IT-E8, IT-E3). In one case, for example, an Italian drug broker in charge of laundering money for an 'Ndrangheta family could benefit from a complicit bank director in San Marino, facilitating the depositing of cash in coded bank accounts (IT-E15).¹⁷³ In other cases, besides the use of offshore bank accounts, OCGs may directly create banks: "in one investigation regarding the 'Ndrangheta, banks were found in Spain, France, and the Maldives, not big buildings, but basic counters where to transfer €5 million and have it back laundered" (IT-E23).

"Of course not all bankers are accomplices, but some may offer support to a person willing to buy real estate. In this case, the scheme is the following: a banker grants a loan to be repaid in instalments of €1,000 per month, raising a mortgage on the house. The loan can be paid in cash coming from cocaine trafficking since on the other hand a complicit entrepreneur produces a fictitious but regular contract of €3,000 per month that justify payments of €1,000 each month into the bank account" (IT-E3).

Similarly, regular transactions of money can be performed via holding companies owned by OCGs or and registered to straw men or family members, or compliant individuals for buying properties or to transfer cash among different companies as to hide the origin of the money (IT-E8).

Nevertheless, the level of sophistication of laundering techniques depends on the amount of profits. Methods range from the use of gambling (e.g. casinos where betting 2 fiches out of 100 bought and then collecting for 98); legitimate businesses (e.g. restaurants) that can produce overbillings; shell companies to perform inexistent transactions; fictitious transfers of real estate or lands; investments in block of shares (IT-E9; IT-E4, IT-E27).¹⁷⁴

"Two brokers (working for a family of Cosa Nostra) took over, through straw men, two mineral companies about to go broke, at the same time advertising the opposite: claiming the presence of other mineral resources and raising the capital in the balances of the companies through dollars of cocaine trafficking. This way, the value of stocks in the Bremen Exchange increased."¹⁷⁵

¹⁷³ See also A. Nerazzini, *I professionisti, [The Professionals]* (RAI Report, 2012), http://www.rai.it/dl/docs/1337159451387professionisti_pdf; La Repubblica, "San Marino connection. Gli affari dei clan nelle banche sanmarinesi. Così si ripuliscono i soldi della 'coca' [San Marino Connection. Clans Affairs in the Banks of San Marino. This Is How Cocaine Money Is Laundered]", May 25, 2012.

¹⁷⁴ See also Rastello, *Io sono il mercato. Teoria, metodi, e stile di vita del perfetto narcotrafficante, [I Am the Market. Theory, Methods, and Life Style of the Perfect Narco]*; Barbacetto and Milosa, *Le mani sulla città. I boss dell'Ndrangheta vivono tra noi e controllano Milano, [Hands on the City. Bosses of the 'Ndrangheta Lives Among Us and Control the City of Milan]*.

¹⁷⁵ Spagnolo, *Cocaina S.p.A.*, 373.

4.2. UNITED KINGDOM: THE SHIFTING STRUCTURES OF A MARKET WITH HIGH DEMAND

Introduction

In the 1990s, a number of household surveys found that all four countries in the United Kingdom (UK) had levels of illicit drug use that were several times the size of any other European country.¹⁷⁶ Increasing in popularity and decreasing in price in the late 1990s and early 2000s, cocaine became a sought after and more readily available drug among this drug-experienced population. By 2011, there were over 4 million users of cocaine in Western and Central Europe, within which the UK – closely followed by Spain – had the highest prevalence rates.¹⁷⁷ The most recent estimate in real terms indicates that there are over 1 million users in the UK.¹⁷⁸

The most recent statistics from 2003 – 2004 value the UK's illicit drugs market at between £4 billion and £6.6 billion. Powder cocaine¹⁷⁹ accounts for an 18% share of expenditure in the market, whereas crack cocaine has a 28% share.¹⁸⁰ Both powder and crack cocaine are classified as Class A drugs in the UK. Under the Misuse of Drugs Act – which determines sentences by the class and weight of the drug – maximum sentencing for supply is life imprisonment.¹⁸¹ Yet despite the risks involved, the strong demand results in large amounts of cocaine entering Britain, with various networks, means of distribution and sources of financial investment all playing a part in the process.

However, little research has been conducted on financial investment in the British cocaine market. Exceptions include two broader studies funded by the Home Office, one exploring middle market drug distribution and the other the illicit drug trade more generally,¹⁸² which offer some information on the financial aspects of the cocaine market. This chapter provides detailed preliminary data and analysis that focuses specifically on the structures and financing of the UK cocaine market. Although it is estimated that the crack cocaine market in Britain accounts for a much larger proportion of expenditures on

¹⁷⁶ H. Parker, "Unbelievable? The UK's Drugs Present", in *UK Drugs Unlimited: New Research and Policy Lessons on Illicit Drug Use*, ed. H. Parker, J. Aldridge, and R. Eggington (London: Palgrave Macmillan, 2001), 2.

¹⁷⁷ EMCDDA, *European Drug Report 2013: Trends and Developments* (Lisbon, 2013); UNODC, *World Drug Report 2013* (Vienna, 2013).

¹⁷⁸ J. Doyle, "UK Cocaine Market Is the Largest in Europe", *The Independent*, June 24, 2009; B. Kilmer and R. L. Pacula, *Estimating the Size of the Global Drug Market: A Demand-Side Approach* (Cambridge, UK: RAND Europe, 2009).

¹⁷⁹ Cocaine hydrochloride.

¹⁸⁰ Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom* (Home Office Online Report, London, 2007); T. McSweeney, P. J. Turbull, and M. Hough, *Tackling Drug Markets and Distribution Networks in the UK: A Review of the Recent Literature* (London: UKDPC, 2008); EMCDDA, *United Kingdom Drug Situation: UK Focal Point on Drugs* (Lisbon, 2012).

¹⁸¹ For a discussion of the penalties for importing cocaine into the UK see J. Fleetwood, "Five Kilos: Penalties and Practice in the International Cocaine Trade", *British Journal of Criminology* 51, no. 2 (2011): 375-93.

¹⁸² G. Pearson and D. Hobbs, *Middle Market Drug Distribution*, Home Office (London: Home Office, 2001); Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*.

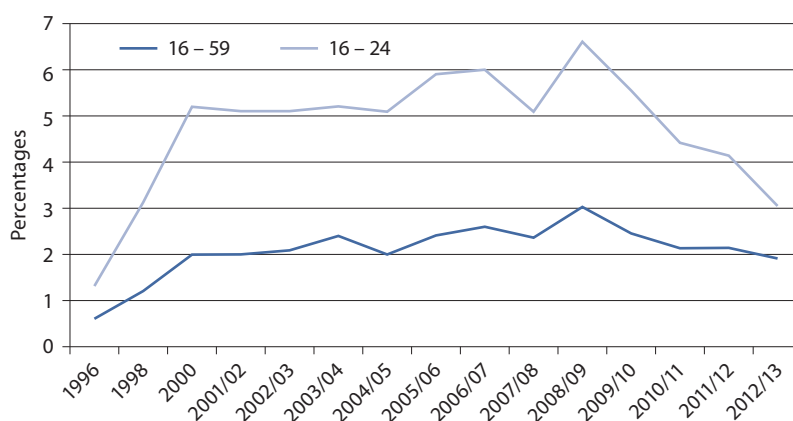
cocaine¹⁸³ and up to “80% of all primary crack episodes in Europe”,¹⁸⁴ the main focus of this chapter is the powder cocaine market. Research of this market benefited from in-depth interviews with four criminal entrepreneurs involved in powder cocaine supply in the UK active at the time of interview. Furthermore – along with a review of relevant literature and questionnaires completed by UK law enforcement during the first phase of data collection – in-depth interviews were undertaken with five experts with knowledge of the UK cocaine market.

Market overview

Over the past fifteen years powder cocaine has emerged as a drug of choice among a significant percentage of the British drug-using population. Use peaked in 2008 – 2009 at around 3% among adults and over 6 per cent among young adults.¹⁸⁵ In 2011, the percentage of young adults using cocaine in the UK had dropped to 4.2%¹⁸⁶ and it became commonplace to talk of an overall decline in the market.

However, the 2012 – 2013 crime survey for England and Wales found that powder cocaine remains the second most commonly used drug among adults (aged 16-59) after cannabis. Although a fall in overall drug use is noted, cocaine use remains relatively steady over the last year in England and Wales: 1.9 per cent in 2012 – 2013 in comparison to 2.2% in 2011/12.¹⁸⁷ This is a decline since its peak in 2008 – 2009, but still much higher than the 1990s. Overall, powder cocaine use has continued at between 2 and 3 per cent since 2000 (Figure 13).

FIGURE 13. PREVIOUS YEAR POWDER COCAINE USE AMONG ADULTS AND YOUNG ADULTS IN ENGLAND AND WALES, 1996 TO 2012 – 2013



Source: CSEW, *Drug Misuse: Findings from the 2012 to 2013 Crime Survey for England and Wales*.

Evidence suggests that powder cocaine users in the UK tend to come from a number of demographic groups.¹⁸⁸ On the one hand, cocaine is

¹⁸³ S. Pudney, “Estimating the Size of the UK Illicit Drug Market”, in *Measuring Different Aspects of Problem Drug Use: Methodological Developments*, ed. N. Singleton et al. (London: Home Office Online Report 16/06, 2006).

¹⁸⁴ Kilmer and Pacula, *Estimating the Size of the Global Drug Market: A Demand-Side Approach*, 30.

¹⁸⁵ EMCDDA, *European Drug Report 2013: Trends and Developments*.

¹⁸⁶ Ibid.

¹⁸⁷ CSEW, *Drug Misuse: Findings from the 2012 to 2013 Crime Survey for England and Wales*, 2013, <https://www.gov.uk/government/publications/drug-misuse-findings-from-the-2012-to-2013-csew/drug-misuse-findings-from-the-2012-to-2013-crime-survey-for-england-and-wales>

¹⁸⁸ D. Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)* (London: Springer, 2002); F. Measham and K. Moore, “Repertoires of Distinction: Exploring Patterns of Weekend Polydrug Use within Local Leisure Scenes across the English Night Time Economy”, *Criminology and Criminal Justice* 9, no. 4 (2009): 437-64; T. C. Ayres and J. Treadwell, “Bars, Drugs and Football Thugs: Cocaine Use amongst English Football Firms”, *Criminology and Criminal Justice* 12, no. 1 (2012): 83-100.

popular among chronic polydrug users and, on the other, it is a popular recreational drug normalised in the context of Britain's ever-expanding night-time leisure spaces. Thus, it is not always a "problem" drug used by "problematic" people. A controlled and largely concealed demand can be found among sections of Britain's professional class,¹⁸⁹ and it is particularly popular among young people and those who regularly inhabit the alcohol-focused venues of Britain's night-time economy (NTE).¹⁹⁰ The demand for crack, however, has in large part remained limited to economically deprived areas of the UK's big cities, specifically London.¹⁹¹

Previous research positions powder cocaine demand in Britain in the context of the NTE¹⁹² and particularly its dance and rave scenes.¹⁹³ It has been noted that along with increased weekend binge drinking, and after a decline in ecstasy use in recent years, cocaine use is prevalent; proof of the excesses and hedonism of late-modern cultural consumption patterns¹⁹⁴ and the criminogenic nature of commodified night-time leisure spaces.¹⁹⁵ A large scale study,¹⁹⁶ using self-report surveys undertaken in clubs and bars in a large English city, investigated the link between illicit drugs and 'alcohol focused leisure activities' in Britain's NTE. Its findings offer the following insights into cocaine use in the UK:

- Night-time leisure pursuits are important as contexts for the consumption of cocaine.
- The prevalence of cocaine use across age groups and night-time scenes, thus the drug is widespread in clubs, bars and after parties along with cannabis and ecstasy pills.
- From a sample of 323 people attending club events 83.3% reported having taken cocaine in their lifetime, along with 36.3% of a sample of 350 bar attendees.
- One in 20 bar customers consume cocaine or ecstasy on a night out.
- The notion of a decline in recreational drug use is problematic.

¹⁸⁹ Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*, 79.

¹⁹⁰ A. R. Winstock, P. Griffiths, and D. Stewart, "Drugs and the Dance Music Scene: A Survey of Current Drug Use Patterns among a Sample of Dance Music Enthusiasts in the UK", *Drug and Alcohol Dependence* 64, no. 1 (2001): 9-17; Measham and Moore, "Repertoires of Distinction: Exploring Patterns of Weekend Polydrug Use within Local Leisure Scenes across the English Night Time Economy".

¹⁹¹ Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*; C. Allen, "The Links between Heroin, Crack Cocaine and Crime: Where Does Street Crime Fit In?", *British Journal of Criminology* 45, no. 3 (2005): 355-72; EMCDDA, *European Drug Report 2013: Trends and Developments*.

¹⁹² Measham and Moore, "Repertoires of Distinction: Exploring Patterns of Weekend Polydrug Use within Local Leisure Scenes across the English Night Time Economy"; Ayres and Treadwell, "Bars, Drugs and Football Thugs: Cocaine Use amongst English Football Firms."

¹⁹³ F. Schifano and J. Corkery, "Cocaine/crack Cocaine Consumption, Treatment Demand, Seizures, Related Offences, Prices, Average Purity Levels and Deaths in the UK (1990 – 2004)", *Journal of Psychopharmacology* 22, no. 1 (2008): 71-79.

¹⁹⁴ Ayres and Treadwell, "Bars, Drugs and Football Thugs: Cocaine Use amongst English Football Firms".

¹⁹⁵ O. Smith, "Easy Money: Cultural Narcissism and the Criminogenic Markets of the Night-Time Leisure Economy", in *New Directions in Crime and Deviancy*, ed. S. Winlow and R. Atkinson, Routledge (London, 2012).

¹⁹⁶ Measham and Moore, "Repertoires of Distinction: Exploring Patterns of Weekend Polydrug Use within Local Leisure Scenes across the English Night Time Economy".

- The British Crime Survey's statistics on drug use are unreliable and underestimated, particularly among young people who have left school.

While recent prevalence figures show a slight decline in use among the population, a number of obstacles stand in the way of estimating the real extent of the demand for cocaine in the UK. Primarily, the accuracy of official statistics is limited due to a large amount of underreporting. Basing their analysis on a number of surveys, Kilmer and Pacula propose that around 15.3% of underreporting takes place in the context of cocaine use.¹⁹⁷ This point is also made by Zaitch who contends that "non-deviant" users "remain a rather unknown quantity" in European prevalence figures.¹⁹⁸ Moreover, continuously mutating practices of consumption are apparent. For example, the 2014 Global Drugs Survey revealed a growing number of people buying their illicit drugs online; the UK has the highest percentage of people doing so in the world.¹⁹⁹ Young people are also diversifying their stimulant drug use and a number of new psychoactive substances with variations in availability and popularity run alongside the cocaine market, sometimes acting as cheaper short-term substitutes (one recent example is mephedrone).²⁰⁰

The entrepreneurs and experts interviewed for this research also suspected that statistics presenting a decline in cocaine use might be misleading. They revealed various market fluctuations in both price and purity, yet emphasised that the demand for cocaine has been steadily increasing over time, especially the demand for high quality cocaine. This suggests prevalent yet underestimated practices of cocaine consumption in the UK today. Rather, it could be argued that recreational stimulant drug use – particularly that of cocaine – has become normalised in the UK context.²⁰¹ Indeed, some have argued that the size of the cocaine market cannot be precisely quantified and that there still exists a sizeable, growing and increasingly valuable market for suppliers.²⁰²

In terms of supply, it is well known that most cocaine is cultivated in South America, specifically in Colombia, Bolivia and Peru. Often it enters the UK via the Netherlands and Spain, having been initially smuggled into Europe by means of established trade routes from South America through the Caribbean or West Africa (Figure 14).

The following modes of transport used by suppliers targeting the UK market were highlighted by UK-E2:

- By sea: merchant vessels and container shipping, with the product cut across various commodities, containers of variation and vessels of 500

¹⁹⁷ Kilmer and Pacula, *Estimating the Size of the Global Drug Market: A Demand-Side Approach*, 32.

¹⁹⁸ Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*, 79.

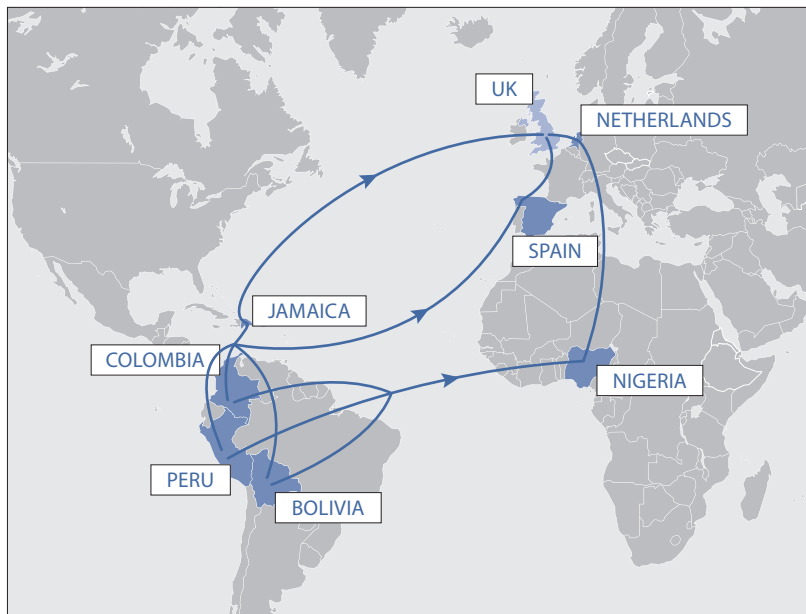
¹⁹⁹ A. Topping and A. Hern, "UK Buying More Legal and Illegal Drugs Online, Survey Finds", *The Guardian*, April 14, 2014.

²⁰⁰ See A. R. Winstock et al., "Mephedrone, New Kid for the Chop?", *Addiction* 196, no. 1 (2010): 154-61.

²⁰¹ See J. Aldridge, F. Measham, and L. Williams, *Illegal Leisure Revisited* (London: Routledge, 2011).

²⁰² Kilmer and Pacula, *Estimating the Size of the Global Drug Market: A Demand-Side Approach*.

FIGURE 14. TYPICAL ROUTES OF COCAINE FLOW INTO THE UK



Source: UNODC quoted in BBC, "Flows of Drugs to UK", BBC, 2007.

tonnes reported; speed boats; and luxury yachts.²⁰³

- By air: executive jets; light air crafts dropping cargo before landing; and smaller aircrafts landing in regional airports.
- By land: road (car, lorry, bus); national and international rail – the Trans-Siberian railway now being utilised as a faster and more effective way in the process of shipping illicit goods from the Far East to the UK; and postal and courier services delivering parcels (this is particularly apparent in the context of the emerging online trade).

Recent figures show a reduction in the number of seizures of cocaine in the UK. Although in 2012 cocaine remained the

most seized drug in England and Wales (80% of which was seized by the UK Border Agency rather than local police), the figure has been steadily declining since 2008 – 2009 when the highest number of seizures were recorded during the time of peak use.²⁰⁴ UK-E2 highlighted the negative impact of changes to the border agency and enforcement structures, particularly since the formation of the Serious Organised Crime Agency (SOCA). Formed in 2006 as a "non-police agency", which pooled the investigative team responsible for drug trafficking at HM Revenue and Customs and the National Criminal Intelligence Service among others,²⁰⁵ the expert noted that SOCA's formation had diluted enforcement numbers and expertise. The UK-E2 interview also revealed:

- various institutional changes to the UK Border Force since 2004 that have reduced the number of customs officers;
- customs officers no longer being present around the clock at British airports;
- the sheer size and volume of containers entering the UK.

According to the expert, these factors have resulted in a substantial decrease in drug seizures and a decline in the overall effectiveness

²⁰³ See also V. Dodd, "Cocaine Worth £300m Found on Luxury Yacht in Southampton", *The Guardian*, August 03, 2011.

²⁰⁴ G. Arnett, "Drug Seizures Drop in England and Wales: Falls in Cannabis, Cocaine and Heroin", *The Guardian*, November 01, 2013.

²⁰⁵ See D. Hobbs, "It Was Never about the Money": Market Society, Organised Crime and UK Criminology", in *New Directions in Criminological Theory*, ed. S. Hall and S. Winlow, Routledge (London: Routledge, 2012), 259.

of drug enforcement practices. Therefore, changes to the policing of organised crime and drug trafficking could be the primary factors behind the decline in cocaine seizures in recent years, rather than a slowdown in supply and demand.²⁰⁶

Another reason for the decrease in seizures is that continued diversification of trade routes and techniques have begun to reshape the supply chain. Container shipments are still the predominant method, with ports in the Netherlands and Belgium heavily implicated in the cocaine trade.²⁰⁷ This is a major link in the supply chain of synthetic drugs between South American production centres and the UK, with “Dutch and Belgian warehousing operations playing a crucial role in trading directly with UK national middle market brokers”.²⁰⁸ Moreover, Eastern, South-eastern and Central European states have become increasingly associated with the trade.²⁰⁹ Increased seizures have been noted in Greece, Romania, Bulgaria and the Baltic countries.²¹⁰ As mentioned above, the emerging trend of online trading (on the surface web and deep web) and home delivery of smaller, retail-level quantities of cocaine in post parcels also presents an emergent and largely unknown dimension of the cocaine trade in Britain.

Market structure and actors

In order to gain an accurate understanding of the market structure and the actors involved in cocaine supply in the UK it is necessary to point out the distinct stages of the operation. These can be defined by a four tier classification found by Pearson and Hobbs:²¹¹

- Importation: consisting mainly of traffickers involved in the importation of cocaine.
- Wholesale: those involved in selling larger quantities of cocaine.
- The middle market: the drug brokers existing between importation/wholesale and retail level dealing.
- The retail level: drug dealers who sell direct to consumers.

For the Matrix Knowledge Group,²¹² the market is structured according to the area covered by an operation. Therefore, alongside the four tiers are variations in market level and reach:

- International: those crossing borders and importing from abroad.
- National: dealers distributing nationally across towns and cities.
- Local: traders buying and selling in smaller defined areas.
- Retail: street level dealers.

²⁰⁶ See also Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*, 2.

²⁰⁷ Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*; EMCDDA, *European Drug Report 2013: Trends and Developments*.

²⁰⁸ Pearson and Hobbs, *Middle Market Drug Distribution*, 21.

²⁰⁹ EMCDDA, *European Drug Report 2013: Trends and Developments*.

²¹⁰ P. Kostakos and G. A. Antonopoulos, “The ‘Good’, the ‘Bad’ and the ‘Charlie’: The Business of Cocaine Smuggling in Greece”, *Global Crime* 11, no. 1 (2010): 34-57; EMCDDA, *European Drug Report 2013: Trends and Developments*.

²¹¹ Pearson and Hobbs, *Middle Market Drug Distribution*; see also Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*; McSweeney, Turbull, and Hough, *Tackling Drug Markets and Distribution Networks in the UK: A Review of the Recent Literature*.

²¹² Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*, 17.

Both sets of classifications are not fixed, however, and distinctions can become blurred at various levels and stages of an operation. For example, an individual or group may be importing from abroad *and* selling wholesale quantities of cocaine nationally. Alternatively, a national dealer may also be involved in distributing cocaine regionally or locally.

Some operations lack organisation, as evidenced by the case in which a man travelled to South America alone, bought some cocaine, and brought it back to the UK in a small talcum powder bottle he had ingested (UK-E5). In this case a direct connection to a crime group was not necessary and the process was relatively disorganised. Therefore, it is important to point out that the structures of the British cocaine business vary. As the Matrix Knowledge Group found, actors involved in supply can work as “sole traders”, as part of a “small to medium enterprise”, or as part of a “collaborative network.”²¹³ The market is therefore best described as a horizontal structure. From the levels of production through to consumption different flexible networks of both organised and ‘disorganised’ individuals and groups are involved in the process. Although some degree of hierarchy may be present at various stages of an operation, overall, these are networks with variations in structure and scale in terms of the actors involved, the quantity and quality of the product they are distributing and the geographical area they cover. Therefore, descriptions of cocaine businesses as ‘cartels’ headed up by a ‘drug lord’ were seen as inaccurate stereotypes by our experts and entrepreneurs. On many occasions connections exist only between small numbers of individuals along the supply chain. One key finding of the cited Matrix Knowledge Group study was that individuals involved in drug supply have information about the market level in which they operate, yet know little when it comes to the market overall. Indeed, individuals working as middle level drug brokers do not want their retail level buyers to contact their wholesale supplier directly, which could have the effect of pushing the brokers out of the market.

Although the cocaine trade is a transnational trade, local and regional markets are better placed for this analysis of the British cocaine trade.²¹⁴ In particular, the UK’s big cities are crucial to the functioning of the supply chain. The primary city associated with the illicit drugs trade is London, with Liverpool, Birmingham, Glasgow and Manchester also playing significant roles. In terms of cocaine, Liverpool is an important node in the market; operators in the city have established themselves as major national distributors.²¹⁵ This fact was confirmed during a number of interviews. According to UK-E2 and UK-E5, once cocaine reaches the UK there are a number of hotspot regions, where corruption at ports is widespread and cocaine more easily smuggled. Of particular importance are the ports of Liverpool and Glasgow. UK-E4 spoke specifically about the importance of regional and local levels, mentioning Liverpool. Two criminal entrepreneurs – UK-C2 and UK-C3 – gave details about the size of the market and price and quality of the products available in Manchester, where a number of dealers from smaller towns and cities

²¹³ Ibid., 32.

²¹⁴ See Pearson and Hobbs, *Middle Market Drug Distribution*.

²¹⁵ Ibid., 38.

in Northern England buy their products direct from wholesalers and middle market brokers before transporting it to their own local market to cut and sell. In this respect, along with international traffickers (usually smuggling cocaine into the UK by sea), national and regional drug couriers and local level runners (often transporting by road) play important roles in cocaine operations in the UK. For example, the researchers found transactions between wholesale actors based in Manchester and Yorkshire and middle level brokers in North East England who transport by car or train and supply the product to a number of street dealers or customers in Newcastle upon Tyne. Warehouses in towns near major transport routes and larger cities are also utilised for storage, and actors will be geographically situated in these aforementioned areas in order to maintain the smooth operation of the supply chain.

Various actors are involved in the British cocaine market and they perform different roles. The study by the Matrix Knowledge Group paints a comprehensive picture of the various roles involved at different levels of the cocaine trade in the UK, which can include the following:

- international transporter;
- legitimate professional (e.g. accountant, solicitor);
- drug courier;
- money collector;
- money counter;
- money deliverer;
- tester;
- transporter/runner;
- specialist;
- mixer;
- corrupt law enforcement staff;
- storer.

According to their research, a dealer's main activities include 'drug purchase, storage, domestic and international logistics planning, domestic delivery and sale... drug cutting activities, marketing or post sale customer services'.²¹⁶ The interviewed dealers regarded transportation, storage and sale as the most important tasks.

In keeping with previous research, our data identifies differences in the operations at retail level, which can consist of various markets.²¹⁷ Criminal entrepreneurs UK-C3 and UK-C4 operated a closed market, selling exclusively to friends who had placed orders. UK-C1 was semi-open, selling to friends and also to people in bars, clubs or after-parties. Finally, UK-C2 sold online and to friends. There are also profitable prison drug markets to consider, and where it has been noted that connections are often made between suppliers and dealers at various levels of the trade.²¹⁸

²¹⁶ Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*, 33.

²¹⁷ See McSweeney, Turbull, and Hough, *Tackling Drug Markets and Distribution Networks in the UK: A Review of the Recent Literature*, 29.

²¹⁸ Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*; G. Hales and D. Hobbs, "Drug Markets in the Community: A London Borough Case Study", *Trends in Organized Crime* 13, no. 1 (2010): 13-30.

In terms of market entry, our data corroborates findings from previous research.²¹⁹ Initial market connections can be made through family, friends, school, neighbourhood, ethnicity, or criminal background (sometimes while an individual is serving a prison sentence). One expert (UK-E4), discussing a personal contact involved in the trade, identified his imprisonment as “the making of him”, which refers to the increased criminal business opportunities he found among his fellow inmates. The role ‘clubbing’ and night-time leisure pursuits can perform in facilitating connections between dealers has also been noted;²²⁰ this was confirmed by UK-E1, who expressed how connections in the cocaine trade can often be made on “nights out”.

Overall, there is no specific demographic involved in cocaine supply in the UK. However, some patterns have emerged in specific regions or levels of the trade. For example, the role played by Colombians based in London, who control a large amount of the bulk shipments of cocaine entering the country, and that of Caribbean based teams, usually involved in “small but often” loads trafficked via air, have been noted.²²¹ The policy report by the UK Drug Policy Commission²²² outlines the following patterns with regard to the UK cocaine trade:

- The role of Colombian traffickers who dominate the international supply of cocaine to Europe.
- The involvement of Spanish criminals involved as middle market dealers who receive shipments from outside Europe and distribute them to the UK.
- The roles of white British traffickers as suppliers of powder cocaine from Spain and the Netherlands to the UK.
- West Indian traffickers involved in cocaine supply, most of which is intended to feed the UK’s crack cocaine demand.

Our data suggests that British crime groups and families are still involved in the importation and wholesale tier of the cocaine market.²²³ White-British crime families were mentioned in particular as wholesalers by one retail level (UK-C1) and one middle level (UK-C4) entrepreneur. These families or groups are not exclusively white. British-Asian networks of investors and dealers were also mentioned by UK law enforcement. Often it is through a connection to such a family or group that a retail level dealer can gain access to cocaine. The link is not always direct; a partner in a scheme of smaller retail level operators may have a direct connection through school, neighbourhood or family and will arrange supply for the group, as was found to be the case with UK-C1. UK-C3, who is based in a smaller English city, revealed that he was buying direct from a dealer in Manchester. The interviewed UK-based

²¹⁹ Pearson and Hobbs, *Middle Market Drug Distribution*; Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*; Hales and Hobbs, “Drug Markets in the Community: A London Borough Case Study”.

²²⁰ Pearson and Hobbs, *Middle Market Drug Distribution*.

²²¹ *Ibid.*, 21.

²²² McSweeney, Turbull, and Hough, *Tackling Drug Markets and Distribution Networks in the UK: A Review of the Recent Literature*, 27.

²²³ See also Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*, 88.

online dealer UK-C2 provided the researchers with access to a range of sites and sellers on the “deep web.” The internet gives a retail dealer the opportunity to widen his customer base, and online trade could reduce the need for a middle level broker, because importers/wholesalers have the ability to sell direct to the consumer. However, it may be the case that the internet is simply mirroring street-level dealing and offering a similar business-to-consumer transaction, but with less risk and increased anonymity.

A two-tier powder cocaine market that has developed in the UK in terms of differentiations in purity and price was also discussed with both experts and criminal entrepreneurs. The first tier is a “pure” and more expensive high-end market, while the secondly is a low-end, cheaper market for product cut to a high degree with active pharmaceutical ingredients (APIs) such as benzocaine; sometimes with purity levels as low as 2 or 3 per cent at street level. Whereas one entrepreneur spoke of deliveries of kilos of high purity cocaine worth thousands of pounds being dropped over the fence of a wealthy customer’s house by transporters linked to wholesalers, highly cut ounces and grams are also sold to numerous users at street level by dealers, or among friends by ‘facilitators’. Most of the interviewed criminal entrepreneurs noted two purity levels, where they were buying or cutting their product in order to sell at two prices to different customers. This dual market is explored in more detail in the sections below.

Overall, studies to date have noted that the UK cocaine market has a complex and fluid structure.²²⁴ Likewise, our data found that the market is structured by flexible and often loosely organised criminal networks.

Financing and financial management

Because of the complexity and variation in its structure, the cocaine market in the UK is financed in a number of ways. Investment practices in this market are flexible, messy and continuously mutating. As UK-E5 pointed out, there are “degrees of participation” and a “spectrum of organisations” in the cocaine trade. The upshot is that money comes from a range of different places. Some operators finance operations collectively, others individually. Some are involved sporadically, whereas others continually operate and reinvest. The following sections will draw specifically on the primary interview data and findings from previous studies conducted in the UK in order to describe the financing and financial management of the British cocaine market.

Sources of capital for criminal operations. Profile of financiers in criminal operations

Whether a group or individual is operating at the level of importation, national or local level dealing, in the first instance they must secure

²²⁴ Pearson and Hobbs, *Middle Market Drug Distribution*; Zaitch, *Trafficking Cocaine: Colombian Drug Entrepreneurs in the Netherlands (Studies of Organized Crime)*; M. Kenney, “Architecture of Drug Trafficking: Network Forms of Organisation in Colombian Cocaine Trade”, *Global Crime* 8, no. 3 (2007): 233-59; Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*.

some start-up capital. A variety of financial and non-financial means are typically used in order to initiate and sustain cocaine supply in the UK at various levels of the market.

Capital beyond the economic

According to all interviewed experts and criminal entrepreneurs the importance of social capital (i.e. connections and relationships) and symbolic capital (i.e. trust and reputation) were equally, if not more, important than economic capital in initiating and sustaining a cocaine operation.

All criminal entrepreneurs mentioned the importance of acquaintances and trust to their operations. One expert (UK-E4) also spoke fervently about the levels of trust on display. It is through social and symbolic capital that an actor can connect with a supplier, secure product on credit, and build up a reliable long-term customer base that provides a quick turnover. The importance of a reliable customer base was also highlighted by all other retail level entrepreneurs, including the online dealer. For example, along with acquaintances and trust, UK-C1 spoke of “being able to get rid of a certain amount quickly” as the most important need for sustaining his operation. Slowing down and diminishing the reliability of distribution to end-users at the local level would disrupt the smooth operation of the whole trade.

Moreover, drawing upon his law enforcement experience, UK-E1 noted that financial capital is not necessary to enter the business. Rather it is “reputation, reliability, an initial connection, and a will to make money”. In these instances, when an individual enters the market they start by buying small amounts of cocaine on credit and, ensuring they pay back on time, begin a rolling credit with suppliers, while simultaneously building their reputation. This supports the contention made by the Matrix Knowledge Group that:

“...for many individuals a combination of their life situations, and relatively easy access to friends and contacts in the business, meant that barriers to entry were very low. Furthermore, access to start-up capital was not considered a barrier to entry because of the wide availability of credit.”²²⁵

An academic expert (UK-E5) noted an interview with a dealer who had a family connection and used her social capital, a level of trust and her labour power to sell in order to enter the market. Therefore, an individual’s labour can also be used as a non-financial form of initial capital. Another example was that of a mule who was initially employed by his cousin (an independent trafficker). After successfully completing his first job he became involved in the business more regularly. The lower levels of the trade seem to work with entry-level distributors entering the market and connecting with large numbers of local suppliers who are willing to take small credit risks. This arrangement spreads the overall risk and incentivises small-scale distributors with the

²²⁵ Ibid., 24.

possibility of using their social networks to make profits and eventually move up the supply chain.

“Chipping in:” acquaintances and group investment schemes

On many occasions initial operations include friends and partners who work and invest collectively in a cocaine business. They will pool their money together to “bulk-buy” more product at a lower price. Three specific examples illustrate this practice:

- The first involved a criminal entrepreneur (UK-C3) investing with a good friend who had a larger legitimate income. They were splitting the cost 50/50 with the investing friend requiring double on his investment without touching the drugs.
- Next, UK-C1 was a partner in a group of retail level dealers collectively “chipping in” to purchase larger amounts of cocaine at a discounted price. The group were purchasing from a crime family one of the partners had a direct link with via an old school friend.
- A third criminal entrepreneur (UK-C4) was also investing with a small group of four or five “players”, some of whom originally met 20 years ago as members of a commercial burglary team. There was some fluidity within the group, with different individuals being involved in different deals, but the core of the unit comprised of the entrepreneur and two men who had all been involved in criminal activities in the past.

According to UKE4 it is also common for two or so otherwise separate groups to “chip in” and secure a larger amount of cocaine to sell.

Finally, a South Asian network of cousins was mentioned by a law enforcement respondent. Kinship networks played a role in investments in legitimate and illegitimate businesses, including cocaine supply. Here, the close kinship structure and a culture of reciprocity helped to initiate and sustain a successful cocaine operation.

Legitimate money and loans

Legitimate money coming from a variety of avenues can also fund cocaine operations. As mentioned above, one example from the data is that of a British Asian group. A businessman from the group invested money from his taxi company, from property that he owned and, combining this money with small loans from his cousins, began to import cocaine from a Spanish dealer.

According to UK-E1, legitimate businessmen who own restaurants, pizza shops, and taxi companies have been known to become involved in the cocaine trade. They tend to use the proceeds from their legal businesses as start-up capital in a cocaine operation, and then launder the criminal proceeds by reinvesting the money back into their legal businesses. Therefore legitimate businesses can act as both start-up capital and money laundering schemes in the British cocaine trade. The same expert also mentioned that large scale money laundering is done

through acquisition of property. Trusted accountants are used to sustain and conceal the operations, yet another example of the crossover with legitimate businesses involved in the cocaine trade in the UK.

Another expert (UK-E5) gave an example of two legitimate businessmen who trafficked cocaine “on the side”. Here their legitimate businesses – a carpet business, an antiques import business and a property development business – generated initial start-up capital, provided ways of cleaning up criminal profits and knowledge and awareness of import/export procedures. In the loosest sense, these examples highlight the involvement of “organised” crime groups who finance operations, which often include people with legitimate business portfolios.

Legitimate start-up money invested in the cocaine trade does not always come from the proceeds of commercial business. UK-C1, who became involved in cocaine dealing with a group of friends who were buying from a crime family, used his student loan of £1,200 as his initial start-up capital. Over a 7 year period he received a loan every 3 months, which helped him to sustain and reinvest in his drug business. Student life was also mentioned by the same entrepreneur and law enforcement respondent (UK-E1) as a good way to make connections with suppliers and build a customer base. Furthermore, the online wholesaler UK-C2, who had a connection from his previous involvement in dealing ecstasy, sold his car to fund his initial operation. He also ran a legitimate online business selling e-cigarettes, and occasionally money shifted between the capital and profits from both online businesses. In general, information from the interviews suggests a blurring between legitimate and illegitimate capital investment in cocaine.

Criminal careers, illegitimate money and loans

Criminal sources of investment and reinvestment also act as the financial capital for cocaine businesses. According to the interviewed experts, some cocaine deals are financed with the proceeds of armed robberies and sold stolen goods. For instance, UK-C4, who was also involved in burglaries, financed his cocaine operation directly through his criminal activity, alongside his ability to secure product from suppliers on credit due to the reputation he had built up throughout his criminal career. Another high profile importer known to UK-E4 used his criminal expertise, contacts made in prison, proceeds from crime and prior involvement in drug markets to facilitate his cocaine supply. Again, some of the criminals involved grouped together to invest in cocaine.

A particular operation known to UK-E4 involves a criminal group currently importing large amounts of cocaine into the UK via Spain (especially Tenerife) and Amsterdam. They supply to several regions across the UK via intermediaries. These entrepreneurs do not rely solely on cocaine and are involved in various legal and illegal operations. For example, amphetamine supply and manufacture was mentioned as a “big earner”. Some of the key players were also involved in large scale cannabis cultivation. Moreover, several individuals had legitimate concerns, including tyre and exhaust fitting centres, fruit and vegetable shops,

property portfolios, hotels, public houses, and guest houses catering for social security residents.

A law enforcement expert, UK-E1, mentioned cocaine dealers who diversify their illegitimate businesses and investments. For example, many known criminals who are involved in buying and selling stolen goods, particularly high-end expensive goods such as top of the range cars, also deal in cocaine. Again, there was a blurring of the legal and illegal because some of the same criminals also had legal business portfolios that they were using to launder their crime money. This included shops and rental properties, and particularly small cash-only businesses such as nail salons, barbers, car washes, and auto-repair shops.

Profile of financiers

Although investment comes from a range of sources and there is no fixed profile of a single typical investor, the following were identified as common sources of investment: legitimate business people; criminal entrepreneurs/financiers reinvesting in illegitimate operations; local crime families with connections who exert force; friends and/or family collectively investing in a cocaine business. In terms of criminal financiers, two experts spoke specifically about individuals with criminal histories who, having “made it” and moved into the legitimate business world, continue to finance cocaine deals. Often they will be known to drug dealers from childhood. One such individual in Northern England owns a very successful chain of used car retail outlets.

Settlement of payments

In the cocaine trade settlement of payments depends on several factors:

- whether the payment is being made upstream or downstream;
- whether there is a pre-existing relationship;
- the level of trust between the actors involved;
- the level of the trade in which they are operating.

According to UK-E3, upstream payments between producers/suppliers at different levels of the British cocaine business are usually organised in three ways: up-front, part-payment and payment on delivery. Still, it is rare to find either full up-front or on-delivery payments, but various ratios of part-payments are usually agreed. At the international importation level some groups/operations may settle a payment for a shipment in full in one nation state, then have different agreements set up for further distribution in other countries. This can include the use of front companies and/or off-shore bank accounts to transfer money and settle payments.

Once in the United Kingdom, UK-E4 suggested that large payments can be made up-front and often larger sums “on bail” or credit. As for employees facilitating payment arrangements, a runner is often used to transport money to and from locations and between groups. For example, one “firm” known to an expert in the North East of England, with strong

links to another in the South East, have been known to transfer both money and drugs via London Kings Cross station. As he explains:

“A runner would almost always be used to carry out such a task. Typically it would be someone lower down in the hierarchy, although they must be trusted. Often someone known from youth. Often an up-and-coming youngster who is in need of the money enough to take the risk, but not seen as desperate enough to try and rob monies or goods. Typical payments would be 500 to 1,000 pounds per trip – money or drugs at the same rate – depending on who the runner was.”

Therefore, payments to employees can be in cash or a share of the cocaine being imported/distributed. Downstream payments between customers and dealers are usually cash up-front, but on occasion there will be a certain amount of credit given. However, this credit is in cocaine not money.

The interviewed retail level dealers offered the following information about both upstream and downstream payment arrangements:

- **UK-C1**
 - **Upstream:** the first entrepreneur either paid up-front, or on credit with an agreement to pay back over a certain amount of time. Sometimes he would pay back his connection as and when he sold the drugs, i.e. a revolving credit agreement. He never borrowed money, only received drugs on credit. The bigger and faster his turnover and the more he gained trust, the larger the amount of cocaine he could buy at a discount and the greater the level of credit he could receive.
 - **Downstream:** he would ask for cash up-front, but would occasionally give a gram or two of cocaine to his friends on credit without interest. This would only be with trusted people to guarantee payment. He reported having only ever had to make a couple of threats to secure payment.

- **UK-C2**
 - **Upstream:** this entrepreneur dealt with a trusted supplier and sometimes was given product on credit. As he explains: “I see one main guy. Payments were always in cash. I could get some coke “on tick”²²⁶ because we go way back, I knew him as a kid and he trusts me. The terms were just like a kind of rolling credit. He never had to secure his payment because I wouldn’t mess about”.
 - **Downstream:** he would sometimes give customers cocaine on credit, but only trusted people. Moreover, the majority of his business was now online and he traded solely in bitcoin, whereby orders were not sent until the digital currency arrived in his bank account. For sellers, the deep web and digital currencies offer less risk in terms of securing payment from customers. The entrepreneur even mentioned the increasing popularity of private, invite-only and personalised sites now appearing on the deep web in which trusted online sellers and buyers do business.

²²⁶ British, informal – on credit or trust; from “tick” – a score or account.

- **UK-C3**
 - **Upstream:** only one supplier in Manchester and no credit allowed, only cash up-front.
 - **Downstream:** normally cash up-front, however he would infrequently give small amounts to very close friends on credit.

- **UK-C4**
 - **Upstream:** this entrepreneur has done deals in the past whereby he would pay a certain amount up-front, and also receive the remaining quantity of cocaine on credit from a dealer in Liverpool. Currently, he has the capital and buys his cocaine up-front from a wholesale dealer based in Yorkshire.
 - **Downstream:** at one point in his career he was selling over a kilo of cocaine every two weeks. Now, he sells to a “select group of customers”, the money is usually up-front and only in ounce deals, never smaller.

In the cocaine business the cash flow needs to be constant and there is always a floating amount of debt and recovery. In order to guarantee payments many of the interviewed dealers, along with UK-E4 with personal experience in the market, spoke of trust as a key principle required to ensure a return of payment. These findings support of previous research²²⁷ in that threats and intimidation are part of the cocaine business but not routine. In other words, violence happens when things go wrong. As UK-C3 notes: “I only deal to trusted friends with jobs and cash, but if I have to, threats of violence or taking some collateral worth more than the debt such as an X-Box or a watch usually would do the trick to incentivise a payment”. One expert (UK-E5) also spoke of cocaine being sold at street level in return for stolen goods, one example being that of a shoplifter who traded a flat screen TV for 1 gram of cocaine worth 50 pounds. Therefore, how various dealers manage their payments and profits may also depend on the demographic profile of their customers.

However, sometimes things do not go to plan, and in order to guarantee that payments will be settled cocaine dealers may use violence or intimidation, recover assets, or sell on debts. The law enforcement experts spoke of cases where the use of violence, threats, recovering property/assets, and selling debt to enforcers had taken place. “Some people employ a ‘facilitator’ or ‘enforcer’ and pay a fee. Others may sell the debts on. It all depends on the amount needing to be recovered. If it goes to a local loan shark the interest will be big” (UK-E1). A similar observation was shared by UK-E3: “A UK dealer may have networked and made an agreement with an importer but something goes wrong, they are ripped off or the product intercepted. They may use violence or threats... or sell this debt on to a heavier handed group or individual to enforce the debt, say a 40 thousand pound debt sold half return.” In other words, the enforcer keeps half of the money they recover.

²²⁷ See Pearson and Hobbs, *Middle Market Drug Distribution*. M. Soudijn and P. Reuter, “Managing Potential Conflict in Illegal Markets: An Exploratory Study of Cocaine Smuggling in the Netherlands”, in *Further Insights into Aspects of the Illicit EU Drugs Market*, ed. F. Trautmann, B. Kilmer, and P. Turnbull (Brussels, 2013), 345-60.

Costs of doing business

There are variations in the costs involved in various stages of cocaine operations, from the start-up capital needed to purchase the product through to transportation, distribution and sale. They will not be fixed and will vary over time, and across the levels and stages of the operation. Although estimates were not provided, according to UK-E3, costs for trafficking and dealing cocaine can include:

- Staff costs;
- Corruption costs – “organised criminals approaching customs officers with money problems;”
- Transportation costs;
- “Sweeteners” – this could include paying someone assisting with the load of a freight;
- Chemist costs – used to test purity;
- Drug debts/enforcement costs;
- Interest charges – for example, if imposed on a promised time of delivery that is missed;
- Information – for example, paying for relevant information about a competitor, business opportunities or law enforcement actions.

Indeed, these are flexible networks of actors and costs can differ depending on the actors involved and level of the business in which they are operating (importation, middle market, or retail market). Data collected from law enforcement highlighted the following specifics in terms of costs:

- It costs approximately £500 per kilo of cocaine in Colombia, but in the UK an importer can pay £30,000 – £40,000 per kilo.
- The price changes depending on seizures, purity and locale.
- Shipment costs can vary in accordance with the means of transport used and volume of cocaine being shipped.
- Drug couriers can be paid as much as £500 – £1,000 per job.
- Money counters and collectors may receive £300 – £500 per day.
- In one case the money collector was receiving 2-3% of an international transaction.
- Around £500 can secure the support of corrupt law enforcement in a country such as Guinea Bissau.
- In the UK corrupt officials may be paid to turn a blind eye.
- Younger entrepreneurs are often paid to monitor storage facilities or to find out information about operators in their area.
- Trusted people can be used as drivers, being paid £300 per day to chauffeur high level dealers.

Again, the fluidity of operations and costs is apparent. Previous research has analysed the costs involved in one British cocaine business in which two main partners were involved in buying cocaine from international Colombian traffickers before selling wholesale in the UK (Table 10).

The costs of this particular operation will no doubt have shifted alongside corresponding fluctuations in the market. However, the example highlights

TABLE 10. COSTS, REVENUES AND PROFITS OF ONE BRITISH COCAINE BUSINESS

	Cost (£)	Profit (£)
Buying 10 kilos wholesale in London	180,000*	
Main courier (salary & expenses)	800	
Money collector (per day)	250	
Money counter (per day)	250	
Money deliverer (per day)	250	
Driver (per day)	200	
Total known costs	181,750	
Revenue (per 10 kilo transaction)		220,000
Gross Profit		40,000
Net Profit		38,250

* 10 kilos costing £18,000 per kilo.

Source: Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*, 34.

the staff needed to head up an operation at national wholesale level and proves that sizeable profits can be made by UK-based importers and wholesalers of cocaine.

However, not all staff are paid. UK-E5, who has knowledge of drug mules involved in the cocaine trade, explained that some work for free, for example to pay off debts. Others may be paid in cocaine (a chunk of the shipment for them to sell and/or use), or cash. This may be paid up-front, or on delivery. Various business deals are arranged according to the needs of the individuals involved.

There are smaller costs associated with the retail level of the business. The interviewed retail level dealers highlighted the following expenses:

- Fuel/local transport costs;
- Mobile phone bill;
- Scales;
- Packaging;
- Cutting agents (whether more expensive APIs such as benzocaine at approximately £1 per gram, or a cheap agent such as Glucose for a little as £0.006 per gram).

The online dealer (UK-C2) also spoke specifically about moisture barrier bags and alcohol used to wash the outside of a package before delivery via post to prevent detection. Online orders also involve postage and packaging charges; however, these would be costed into the retail price paid by customers.

TABLE 11. MONTHLY COSTS AND PROFIT MARGINS OF A CRIMINAL ENTREPRENEUR*

	Cost (£)	Profit (£)
Cocaine (1 ounce)	700	
Fuel	100	
Mobile Phone Bill	30	
Cutting Agents	5	
Packaging	5	
Total Known Costs	840	
Revenue**		2,037.6
Gross Profit		1,337.6
Net Profit		1,197.6

* This calculation does not include profit lost through his own use.

** C3 sold 0.8 gram for £60.

Source: UK-C3 interview.

In terms of the cocaine they bought, the interviewed criminal entrepreneurs were paying between £500 and £1,600 per ounce, depending upon their relationship with the supplier and purity levels. Some sold the product on without adulterating it and others cut it, usually into two purity levels, which they would sell at two different prices. For example, UK-C3 travelling to Manchester was making monthly trips and spending around £100 on fuel, but the product he bought was cheaper and better quality than that available in his home town. Two purities were available to him at £500 and £700 per ounce and he would also occasionally cut the product he bought with

glucose, and had the most profitable operation at retail level.

Furthermore, UK-E4 identified a middle level entrepreneur who supplies two purities of powder cocaine in ounces and half ounces to a select group of customers. As he explains: “He buys 9 ounces of high quality cocaine from a contact in a rural part of the North East. He pays £15,000. He adulterates 6 of the 9 ounces with lactose and caffeine powder at a rate of 3, 2, 1. He sells this for £800 an ounce. The remaining three ounces are less savagely ‘cut’ at 1 to 1. He sells these as ‘pure’ for £1,500 an ounce. To further emphasise the ‘purity’ of this cocaine he presses it into hard blocks using a press and hammer. For big amounts dealers use industrial hydraulic presses designed to push pistons out of car engines.”

These examples emphasise the higher profit available once cocaine is cut, and the tiered market that has appeared in the UK in terms of different purity levels. Therefore prices of the drug itself vary and value is added, along with a range of other costs. Actors and costs associated with the trade vary according to the stage and level of the operation.

Profits and profit sharing

The UK is an end user market for cocaine, therefore the drug is at its highest price, having increased incrementally as it moves through a variety of places and complex stages in the supply chain. There are variations in mark-ups and profit margins throughout the stages and operations involved. The example in the previous section highlights that considerable profits

TABLE 12. COSTS AND MARK-UPS PER KILO OF COCAINE AT SPECIFIC POINTS ALONG THE SUPPLY CHAIN IN THE UK

Point in supply chain	Cost per kilo	Mark-up
Production	£325	
		550% mark-up
In South America	£2025	
		280% mark-up
In the Caribbean	£7800	
		292% mark-up
UK wholesale	£30,800	
		89% mark-up
UK retail	£51,850	

Source: Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*, 18.

can be made at the wholesale level of the cocaine business in the UK. This is also true at the level of importation.

One law enforcement expert (UK-E3) noted that on average an “original block” of 1 kilo of high quality cocaine is worth approximately £40,000 once it reaches the UK market. He explains: “If you import a block you may sell in full, or usually have a small number of one-off deals and cut product by one third with APIs to make 3 times the profit.” Once cocaine reaches the UK, the profits of criminal entrepreneurs can fluctuate and vary depending on a number of factors: availability, demand, quantity, quality of the product (purity before and after adulterating), customer base, and risk of seizures or arrests.

TABLE 13. MARK-UPS IN THE BUYING AND SELLING OF COCAINE BY UK CRIMINAL ENTREPRENEURS*

	UK-C1	UK-C2	UK-C3	UK-C4
Buys	£960 per ounce	£800 per ounce	£700	£15,000 per 9 bar (9 ounces)
Sells	£40 – £50 per gram	£50 (to friends) £70 (online) per gram	£60 per 0.8 gram	£23,400 per 9 bar**
Mark-up	47.6% @ £50 per gram	147.6% @ £70 per gram	191%	56%

* UK-C1, UK-C2 and UK-C3 work at the retail level, while UK-C4 is a middle level dealer.

- ** UK-C4 splits his 9 ounce deal into 2:
- He cuts 6 ounces into 18 ounces ‘3, 2, 1’ with lactose and caffeine powder sold at £800 per ounce (44% mark-up);
 - He cuts 3 ounces into 6 ounces ‘1 to 1’ sold as ‘pure’ at £1,500 per ounce (80% mark-up).

Source: Interviews.

The variation in the prices that retail level dealers pay for ounces suggests that the levels of purity and adulteration of the cocaine they buy and sell also varies. Considerable profits can be made at the retail level with the right supplier and customer base, particularly if the actors involved cut the product to a high degree. Having said that, UK-C1, although having been involved in the business for over 7 years, hadn’t gained or invested his money and seemed to offer a typical example of a street-level dealer who had fewer opportunities to profit from the cocaine trade in the long term. He noted that he had simply “had a good time.”

This contention was supported by two experts (UK-E1 and UK-E5) who spoke of the “big money” available in operations over borders, but less profit available at street level. UK-E5 gave details of three specific cases, which offer an insight into the fluidity in levels and profits of cocaine operations:

“The biggest case I know was international and they were importing 2.5 to 5 kilos per month. Another was at street level, where a woman at the peak of her dealing was making £1,000 per month. However, another case was that of a female dealer who chose to do less. She made £300 per month because it was less bother and she was happy with her customers and how it fit with her lifestyle – she had kids and a job.”

The vast differences in terms of profit margins at retail level and a suggested drop in purity could be the result of criminal entrepreneurs who operate at street level further adulterating their products to increase profits.

Previous research also suggests that mark-up can depend on risk.²²⁸ For example, the risk of arrest at the level of importation results in larger profit margins when trafficking cocaine over borders. As Matrix Knowledge Group contends:

“Mark-ups in the illegal drugs market mirror the risks taken, and dealers reported that local and regional price rises of a ‘couple of grand a kilo’ can occur because of a large and effective enforcement operation affecting that part of the supply chain. However these limited effects are not enough to change price trends overall.”²²⁹

This risk-driven mark-up can have a knock-on effect in terms of purity and/or price along the supply chain to customers.²³⁰ One interviewed law enforcement officer suggested that profit margins depend on the original investment and level of risk: “Depending on what one invested in the first place. If one invested 50% they expect 50% of profits. That is of course in those cases that do not involve losing merchandise.”

Moreover, at wholesale and middle-level in the UK, prices and profits can vary depending on the size of the local markets and the availability of cocaine. One entrepreneur (UK-C3) based in North East England was buying in Manchester in “ounce deals” cheaper than another entrepreneur (UK-C1) based in the same city who bought from a local dealer. He was also selling 0.8 as 1 gram deals, which leads to a further increase in the mark-up (see above). Therefore a dealer buying wholesale in a larger market such as Manchester or Liverpool, but selling in a smaller city or town, can secure a higher profit margin.

In terms of profit-sharing, experts suggested that some actors may be involved in group investment schemes in which they seek a percentage return similar to their original investment. However, we have found that most cocaine entrepreneurs work on an individual basis. For instance, UK-E5 spoke of street level dealers who decide what to do with their own product – how much they cut it, who they sell to and so forth – and

²²⁸ N. Dorn, L. Oette, and S. White, “Drugs Importation and the Bifurcation of Risk: Capitalization, Cut Outs and Organized Crime”, *British Journal of Criminology* 38 (1998): 537-60; Matrix Knowledge Group, *The Illicit Drug Trade in the United Kingdom*.

²²⁹ *Ibid.*, 10.

²³⁰ Dorn, Oette, and White, “Drugs Importation and the Bifurcation of Risk: Capitalization, Cut Outs and Organized Crime”.

what they do with the return. Therefore flexible networks of individuals may invest in cocaine to sell, yet profit from it on an individual basis. All the entrepreneurs we interviewed profited individually. Furthermore, our interviews emphasised that profits were usually spent on a conspicuous lifestyle (buying expensive goods such as cars and holidays), reinvesting in the cocaine business or laundering money by investing in legitimate businesses or property. UK-C1 spent his profits solely on his lifestyle and his own cocaine use.

Access to capital in critical moments

As is the case with high-risk criminal operations, it is not uncommon for actors involved in the cocaine trade to require immediate access to substantial amounts of capital in critical moments; for example, if a shipment is seized or an arrest is made. Highlighting similarities with the processes used to obtain capital in order to initiate and sustain a cocaine operation, the information we gathered during the in-depth interviews with experts and criminal entrepreneurs in the UK suggested the following ways in which cocaine dealers acquire access to such capital in critical moments:

Securing cocaine from a trusted source on credit. Entrepreneurs, academic experts and law enforcement all spoke of the role past associates and connections in the cocaine trade can play in critical moments if an individual needs to access capital in the form of an amount of cocaine on credit. One entrepreneur (C4) – who having been arrested and sentenced to six years began to buy cocaine entirely on credit through an old associate on his release – explained that this may be at a higher price at first: “he wasn’t doing many favours with the prices mind, I was paying a little bit over the odds, but beggars can’t be choosers”.

One expert (UK-E4) also noted the role played by “a help out”, in other words a past associate, friend, and/or supplier who can “offer a decent amount of gear totally on bail with no up-front payment.” Moreover, UK-E1 was quite adamant that re-entering the market after an arrest is relatively easy if you have the right connections: “You can re-enter using connections and reputation more than money. Product on tick from friends for example. Then establish yourself back in the market”.

Therefore, just as was found with regard to securing initial start-up capital, connections, reputation and trust play a fundamental role in a cocaine dealer’s ability to access capital in critical moments in the British cocaine trade.

If arrested, a trusted partner acts in your absence to continue operations. Similarly, UK-E4 described cases in which individuals involved in the trade were able to begin dealing immediately after release from prison because a trusted associate had kept their business in operation during their time away: “Usually this involves a trusted accomplice keeping the business going in his absence”.

Selling labour. Two experts (UK-E3 and UK-E5) mentioned individuals simply selling their labour by making themselves useful to existing operations in order to re-enter the market. One specific example involved an individual working as a mule to “get back in the game” after 2 kilos of cocaine they were responsible for delivering was “lost.” Although the mule denied his involvement in the missing shipment, he chose to work again to gain entry back into the business, to build his reputation and to pay off the debt.

Selling assets. At retail level, dealers have been found to sell assets in return for some cocaine. UK-C2 sold his car and used the proceeds to invest in cocaine. Some may exchange their assets directly in return for some product.

Using financial capital from other legitimate or illegitimate businesses. If an individual or group involved in a cocaine operation has a business portfolio (illegitimate and/or legitimate), he or she may borrow and move capital between businesses in order to gain access to funds when necessary. This also links to the simultaneous role that legitimate businesses can play in money laundering. For example, the online dealer (UK-C2) also runs an online e-cigarette business.

Loan sharking in the context of Britain’s cocaine market was little discussed at the interviews. Two experts (UK-E3 and UK-E5) in particular noted that loans are used and definitely part of the process, but that the term is probably not applicable as an accurate description of a direct link with the initial financing of a cocaine operation.

UK-E3 suggested that loan sharks are not normally connected to the international trafficking level. Instead there are loans, drug debts and criminal investments that can vary considerably. He noted the following:

- Drug debts: “some broken agreements – promises of quantities, quality, time frame, prices – end with debts which can be sold on to enforcers who have different repayment plans and agreements in place, which can include violence.”
- Criminal investments: “Original agreements between actors may also include arrangements put in place in case something goes wrong. For example a discount on the next shipment and/or risk spread across investors, whereby one person pays 40% and the other 60% in order to spread costs if the product is intercepted”.

Having said that, it became clear that national and local level cocaine dealers can sometimes become involved in loan sharking and that loan sharks and drug enforcers can play crucial roles in terms of debt recovery. It was found that the following specific practices are common with regard to loan sharking and enforcement:

- Enforcers buy debts from cocaine dealers in return for a percentage of the recovered capital.
- Loan sharks mainly target vulnerable users not cocaine dealers.

- Importers are exclusively involved in cocaine, not loan sharking.
- At the middle and retail level, cocaine dealers may also become involved in loan sharking because it is seen as lower risk.
- Loans sharks involved in cocaine supply may use the proceeds from loan sharking to fund or sustain a cocaine operation. However, others operate both businesses separately.
- Most often loan sharks offer money at a high interest but this is agreed on a personal basis.
- Penalties for missing a repayment can include added interest, background threats, asset recovery (from the individual in debt or their family or friends) and violence (sometimes extreme).

4.3. BULGARIA: MONEY FOR DRUGS, MONEY FROM DRUGS – THE MANY FACES OF A CRIMINAL BUSINESS

Introduction

Over the course of the last twenty years Bulgarian organised crime has moved into all lucrative drug markets both on national level and in Europe. Since the end of the communist regime, drug trafficking and drug distribution have always been among the major sources of revenue for Bulgarian organised crime. The geographical location of the country on the Balkan route for smuggling of heroin from Afghanistan to Western Europe has pre-determined the involvement of Bulgarian organised crime in the drug trafficking networks. In the nineties Bulgarian OCGs mostly facilitated the international heroin trafficking networks, but they gradually shifted to supply of the domestic market and playing more important role in the heroin trafficking in Europe.²³¹

Bulgaria along with Turkey was also known as one of the major producers of illicit captagon²³² tablets in Europe. Captagon trafficking towards the Near East countries exploited the heroin trafficking routes and Bulgarian OCGs often used to exchange captagon for heroin. Recently, OCG have moved out the captagon production to Near East countries and closer to their end markets, as a result of which mostly small-scale production of amphetamines for the domestic market remained in Bulgaria.²³³ In the last ten years Bulgarian OCGs have also actively been penetrating the cocaine trafficking market. Joint police operations on EU level revealed that there are Bulgarian criminal entrepreneurs on the highest levels of the cocaine trafficking rings supplying tonnes of cocaine to Western Europe directly from South America.²³⁴

The Bulgarian markets for illicit drugs emerged with the fall of the communist regime in the beginning of the nineties and soon became a source of profits for organised crime. It all started with heroin, as the

²³¹ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*.

²³² Captagon (Fenethylamine) is an amphetamine-type stimulant.

²³³ Ibid.; CSD, *Organised Crime in Bulgaria: Markets and Trends* (Sofia, 2007).

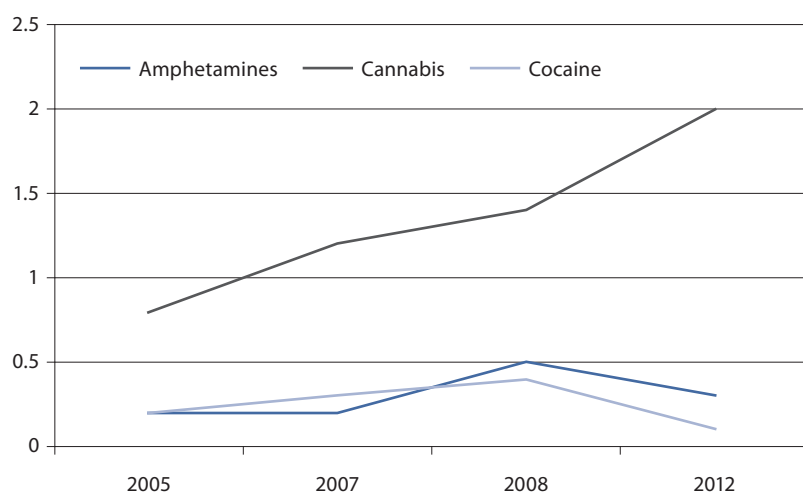
²³⁴ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*; UNODC, *The Illicit Drug Trade through South East Europe* (Vienna, 2014).

location of the country along the Balkan Route provided for unlimited options of supply at a fairly low price. The rapid expansion of heroin use in the beginning of the nineties secured an exponentially growing demand, fuelled by the vast number of dependant customers. The heroin consumption reached its peak in the end of the nineties and eventually started to decrease, impelling OCGs to shift their interest to amphetamines, cannabis and eventually cocaine. However, in the meantime the heroin trade moulded the shape of the entire drug market for more than a decade – strict territorial zoning and few hierarchically structured big organisations dominated the market.²³⁵ This changed in the last seven years, when the markets gradually turned to a more fragmented state with many competing medium and small players.²³⁶

Market overview

The domestic Bulgarian drug markets are relatively small compared to the drug markets in Western Europe. A recent estimation drawing on the EMCDDA official statistics assessed the market value of four major drugs – heroin, cannabis, cocaine and amphetamines.²³⁷ The heroin market comprises of ten to twelve thousand users and is estimated at €14-28 million on an annual basis. The regular cannabis users in Bulgaria are estimated at 55,000 – 88,000, whereas the recreational cannabis users amount to another 51,000 – 83,000. The estimate of the overall value of the cannabis market is €41.4-€92.6 mln. Furthermore, the regular cocaine users are 4,000 – 8,000 persons, while the recreational users are 20,000 – 40,000. The value of the illicit cocaine market is estimated at €22.3-€80.3 million. Moving to synthetics drug market, the number of the synthetic drugs users is around 46,000 people and the value on annual basis is €31.3-€78.8 million.

FIGURE 15. PREVALENCE OF DRUG USE AMONG ADULTS (15-64 YEARS OLD) IN BULGARIA, 2005 – 2012



Source: EMCDDA, *Data and statistics*.

Since these are the first estimates of the volumes and the value of the markets, it is not possible to use the data as an indicator for the trends over the last 20 years. However, the available data on the prevalence of use among the general population can be used as proxy indicator for the consumption and therefore about the trends of the volumes in the various drug markets.

The most recent – 2005 – data for heroin use in Bulgaria suggest 20,000 – 30,000 users.

²³⁵ CSD, *Organised Crime in Bulgaria: Markets and Trends*.

²³⁶ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

²³⁷ Ibid.

However, expert assessments state that by 2011 the consumption had halved, so the actual number of users should be closer to 10,000 – 12,000 people.²³⁸ More recent data is available on the consumption of cannabis, amphetamines and cocaine. The EMCDDA statistics show that for the period 2005 – 2012 the numbers of adults (15 – 64 years old) who have used cannabis in the preceding month had doubled from 0.8% to 2%. The number of people who have used cocaine in the preceding month had been rising steeply for the period 2005 – 2008 (from 0.2 percent to 0.4 percent), but sharply declined in 2012 to 0.1 percent. At the same time, from 2005 to 2008 the share of all adults that had used amphetamines in the preceding month more than doubled from 0.2% to 0.5%, although subsequently declined to 0.3% in 2012.²³⁹

Market structure and actors

Bulgarian organised crime groups are active at all levels of illicit drugs trafficking including production, importation, wholesale and retail level. At each of these supply chain levels, OCGs operating on different scales can be identified – from OCGs of few persons producing or moving small quantities to OCGs producing or moving hundreds of kilos. These facts suggest that specific segmentation exists at each level depending on the scale of operation of the OCG. In order to account for the specifics of these segments at each of the levels of the drug supply chain, these segments would be generally referred to as low, middle and high corresponding to low-scale, medium scale and large scale of operation at each of the supply chain levels. Additional details will be provided for each of the segments in order to more precisely illustrate, what is defined as low, middle and high segment.

Production level

Cannabis consumption is not only the largest in the country in comparison to all other drugs, but also the fastest growing in the recent years. The cannabis market in Bulgaria is really diverse and not all of it is controlled by the organised crime. The bulk of the demand is met by domestically produced cannabis. Both regular users and organised crime groups are involved in crop cultivation. With the rapid development of the technology for indoor growing, many regular users started to grow marijuana to meet their own consumption, as well as to supply their close friends. This trend is increasing in the last years due to the easy access to quality cannabis seeds over the internet and the easy access to cheap equipment for indoor cultivation (BG-E4, BG-E5). The users-growers usually operate on a small scale (grow up to 10 plants at a time) and comprise the **low segment** of the production.

However, organised crime also has considerable interest in this fast growing market, so many drug wholesalers and retailers have invested in indoor or outdoor cannabis plantations. The criminal entrepreneurs

²³⁸ A. Rusev, P. Gounev, and T. Bezlov, "European Lessons from the Bulgarian Serious Organised Crime Threat Assessment", in *Human Dimensions in Organised Crime, Money Laundering and Corruption*, ed. P.C. van Duyne et al. (Nijmegen: WLP, 2013), 95-120.

²³⁹ EMCDDA, *Data and statistics*. <http://www.emcdda.europa.eu/data/2014>

operating in the **middle segment** of cannabis production usually grow relatively bigger quantities (up to 500 plants), which are intended for the domestic market (BG-E1, BG-E5). Often retailers or wholesalers are the ones who invest in such plantations in order to secure steady supplies for their street dealers.

The high segment is related to large-scale indoor or outdoor growing (more than 500 plants), which often is intended for exportation (BG-E1, BG-E3). Two distinct *modi operandi* can be identified. The first method involves OCG groups renting land, greenhouses or abandoned houses to set indoor or outdoor cannabis plantations. These plantations are mostly set for large-scale growing, as it would be hard to trade such volumes at the domestic market, so the quantities produced are usually destined for abroad. An example of such operation was provided when SANS busted a greenhouse plantation on 5,000 sq. m. in the Pazardzhik region with a yield amounting at 1000 kg dry cannabis mass (BG-E3). The OCG that established the plantation had been financed by a Dutch citizen, so the end product was intended for the Dutch market.

The second method of operation is typical for the South-western region of Bulgaria and in particular for the mountain regions of Ograzhden and Belasitsa, which have been the major producing regions for cannabis in the last 25 years. The crops are cultivated outdoors by local villagers and the trade is controlled by several large wholesalers that finance the farmers and subsequently sell the drug to retailers from all parts of the country. This method for outdoor growing brings just one yield per year, but requires comparatively lower costs, so the big wholesalers are able to maintain the prices at half the level of greenhouse or indoor cultivated cannabis. For example, the wholesale price of 1 kg of cannabis in Petrich (a town in South-western Bulgaria)²⁴⁰ is €1,500-€2,500, while the wholesale price of indoor grown cannabis starts at €5,000 (BG-E3).

Amphetamines and methamphetamines are the second most used drugs in Bulgaria and therefore one of the key markets for organised crime. The supply of the drugs is predominantly domestic and usually wholesalers invest in establishing such drug labs and subsequently trade the product to the retailers (BG-E2, BG-E3, BG-E4). Although, the golden times of large-scale production of amphetamines destined for trafficking abroad seem to have waned, many small-scale producers regularly feed the market with illicitly manufactured amphetamine and methamphetamine.²⁴¹

In the last years OCGs from the Sofia region (Sofia, Pernik, Kostinbrod) have established themselves as major producers of amphetamines, whereas OCGs from South-eastern Bulgaria (Sliven, Yambol) have become

²⁴⁰ The town and region of Petrich emerged as an important drug trafficking hub in the 1990s, which has been documented in numerous media reports. Many big traffickers of cannabis, heroin and cocaine who have been prosecuted in the last 20 years in Bulgaria originate from this region.

²⁴¹ CSD, *Organised Crime in Bulgaria: Markets and Trends*; EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*.

known for production of methamphetamines (BG-E3, BG-E5). Most of their facilities can be classified as “kitchen labs” and produce small batches (from 0.3 to 1 kg) on request, so the criminal entrepreneurs rather occupy the low or middle segment. The precursors are mainly supplied through ordering the needed chemicals online or purchasing over-the-counter medicines from pharmacies. Some OCG groups provide precursors through cross-border smuggling – i.e. smuggling of ephedrine or ephedrine-based medicines from Turkey (BG-E1, BG-E4).

Importation level

The involvement of the Bulgarian OCGs in the trafficking of heroin and cocaine in Europe and beyond has been growing in the last years, although their role remains primarily that of facilitators. Looking at cross-border-trafficking of heroin in Europe, Turkish and Albanian criminal networks are still the incontestable leaders via the notorious Balkan Route. Turkish crime networks are also active in moving back along the Balkan Route amphetamines and ecstasy towards the Near East. The large-scale importation of cocaine from South America is primarily dominated by the Colombians, although other Latin American (Mexican, Venezuelan, Peruvian, etc.) and Nigerian groups are contesting their role. European OCGs such as Italian, Spanish, and Western Balkan have also established themselves as significant importers of cocaine.²⁴²

Considering the relatively small domestic market in Bulgaria, most of the organised crime groups involved in heroin or cocaine trafficking provide transportation of the drugs from countries where the drugs are produced or stockpiled to the lucrative Western European markets. The majority of the interviewed law enforcement experts concurred that the Bulgarian OCGs usually operate on a fee-for-service basis for other criminal networks operating on international level. Typically, when acting as facilitators, the OCGs provide services like identification and recruitment of drug couriers and cash couriers, establishment of fictitious export-import companies, providing safe storage and repackaging.

However there are also organised crime groups, who act as small scale importers of heroin and cocaine for supplying the domestic market and work on their own behalf. Recently, a Bulgarian OCG was detected involved in a large scale importation of cocaine from South America acting not as subsidiaries, but on their own account.

Three segments need to be distinguished at importation level. The **low segment** comprises of small scale importers smuggling drugs for the domestic market. The **middle segment** is the criminal entrepreneurs providing logistical services on a fee-for-service basis for bigger international criminal networks, as well as the suppliers of bigger quantities of heroin and cocaine for the domestic market. Finally the **high segment** is the OCG organising large-scale importation of drugs from the source countries to the Western Europe markets.

²⁴² Ibid.

Low segment – small scale importers

Both heroin and cocaine are imported on a small scale in Bulgaria. In the last 6-8 years, **heroin** has become mostly the drug of the poor and marginalised social groups, especially Roma. Hence, many Roma are involved in heroin trade on all levels, including importation. Certain Roma neighbourhoods like Stolipinovo in Plovdiv and to some extent Maksuda in Varna have turned into giant warehouses for heroin storage and wholesale. Many families from these neighbourhoods are involved in small scale heroin trafficking from Turkey and smuggle from 1 to 5 kg per trip across the border (BG-E3, BG-E4, BG-E5). The typical profile of the importer is a person running small family merchandise business, who regularly travels to Turkey in order to supply various commodities.

Small-scale importation is also common at the **cocaine** market, where an increased number of cases are reported for using postal services for smuggling drugs (BG-E5). The cocaine is ordered online, the payment for the delivery is settled through companies like Western Union, while the drug itself is physically delivered through the postal services. The quantities smuggled with this method are rather small 50-100 grams.

Middle segment – OCGs facilitating cross-border trafficking

In the last 25 years, many Bulgarian OCGs have been detected as facilitators of heroin and cocaine cross-border trafficking – mainly through organising the transportation of the drugs across one or more borders, providing warehousing and repackaging.²⁴³ In many cases, these OCGs get paid in kind with a share of the smuggled drugs, which they subsequently can sell at the domestic or other market (BG-E2).

Facilitators pursue different methods of operation. Smuggling overland in cars or trucks from Turkey to Bulgaria or other European country is the preferred modus operandi for **heroin cross-border trafficking**. The role of the criminal entrepreneurs is to identify and recruit the drivers, as well as to secure the modified vehicle with concealed compartments. Sometimes part of their role is to ensure the safe crossing of the border through bribing the border guard and customs personnel (BG-E1, BG-E2, BG-E4, BG-E6).

Cocaine cross-border trafficking is usually carried either via air or via sea from South America to Western Europe. Bulgarian OCGs are active in recruiting and managing air couriers, yacht skippers or commercial sea vessel crews (BG-E1, BG-E2).

High segment – large-scale drug trafficking

For many years it was largely accepted by law enforcement experts and academics that Bulgaria is predominantly a transit country and local organised crime groups were merely facilitators of the Turkish and Albanian criminal networks. This notion has been contested in

²⁴³ Ibid.

the last years, when large-scale schemes for trafficking of heroin and cocaine were dismantled. The 2013 joint report of EMCDDA and Europol acknowledged that in the last years Bulgarian OCGs have also entered into the large scale trafficking of cocaine from South America to Western Europe, as well as trafficking of heroin along the Balkan route.

Comments from law enforcement experts on some of these cases provide important insight in the profile and modus operandi of these big players. Generally these are persons running big legitimate businesses associated with logistics, transportation, import and export of various commodities. Often their business is not limited in only one economic sector and they control numerous companies, which also allows them to effectively launder the proceeds from the drug trafficking. Unlike the players from the low and middle segment, the actors in the high segment employ means such as setting up of front companies run by straw men, fictitious import and export trade transactions or concealment of the trafficked quantities within legitimate trade shipments for smuggling of hundreds of kilograms of cocaine and heroin (BG-E2, BG-E4).

Wholesale and retail distribution

The domestic drug markets currently comprise of numerous independent players and most of them are specialised in a certain segment – cannabis, amphetamines, cocaine or heroin. The big hierarchical structures and the strict territorial zoning, which dominated the drugs markets up to 2008, in the recent years have been replaced with numerous small wholesalers and retailers. This tendency is most visible at the **heroin market**, where in the recent years the consumption has mostly shifted to the marginalised Roma communities.²⁴⁴

Heroin distribution happens also outside Roma communities, although the declining heroin consumption has pressed many of the wholesalers and the retailers to supplement with or shift their activities to other drugs such as amphetamines and cannabis. For example this is the case in Sofia, where currently many medium to small-size OCGs are active on the drug market and in many cases they control street dealers selling heroin, as well as dealers selling amphetamines and cannabis.²⁴⁵

The domestic cocaine market in Bulgaria is even smaller than the heroin market given the current retail price, which makes it inaccessible for most of the drug consumers. Therefore patterns of the distribution are totally different from that of the other illicit drugs. It is concentrated around the expensive night clubs in the big cities (Sofia, Plovdiv, Varna, Burgas) and the big summer and winter resorts (Albena, Golden Sands, Sunny Beach, Bansko, Pamporovo, Borovets). This is why the distribution is heavily dependent on the collaboration of the club owners, as well as on the private security companies that usually are key for access in these entertainment venues (BG-C1, BG-C2, BG-C3). Hence some OCGs have

²⁴⁴ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

²⁴⁵ Ibid.

secured the access to clubs by obtaining contracts for the provision of security services. There are also cases where the club owners themselves decide to organise or get involved as partners in the sales (BG-E1, BG-E4, BG-E5).

Cocaine dealing is also often linked to prostitution rings, where it is offered to the clients as a lucrative bonus. Cocaine traders also try to herd up wealthy customers, which are offered high quality product in order to keep them loyal.²⁴⁶ The data from the filed interviews indicates that the importers and big wholesalers are based in the capital Sofia and they supply the local retailers in the other parts of the country (BG-C1, BG-C2, BG-E1, BG-E5).

Cannabis distribution is not dominated by big players, but rather by numerous small and medium sized groups, which distribute the drug practically in all cities competing with each other for clients. Often cannabis distribution goes hand in hand with the distribution of synthetics – amphetamines and methamphetamines. The bulk of the sales are arranged via telephone and delivered to the customers keeping great level of caution (e.g. using code words, never handing the drug to the customer and instead leaving it in a concealed place, etc.). The organised crime groups also rely on recruiting youngsters as dealers in order to exploit their friend networks at school. In some cities the organised crime groups are trying to exert control over certain territories and readily fight turf wars to push out competitors or independent dealers.²⁴⁷

The **distribution of amphetamines and methamphetamines** to a large extent resemble the modus operandi typical for the cannabis distribution and often they go together – i.e. OCGs operate in certain districts of the city and actively subduing or pushing out competition, sales are typically arranged via telephone or exploiting extended friend networks through recruiting students as dealers.²⁴⁸ However some OCGs also pursue the club distribution model, which is common for cocaine distribution in Bulgaria (BG-E3, BG-E5). Heroin retailers also often sell amphetamines or “pico”²⁴⁹ along with the heroin (BG-C5, BG-C6).

Financing and financial management

Drawing on the interviews, certain similarities and differences between drug markets have been identified as regards criminal finances. The specifics of a drug market apparently have direct influence on criminal finances. The type of drug traded impacts costs and profits due to the differences in prices. On the other hand, the level in the supply chain along with the segmentation of the market entail far more reaching differences in sources of financing, access to capital and settlement of payments reflecting the level of market risks born. At production, wholesale and importation level financial resources seem to play significant

²⁴⁶ CSD, *Organised Crime in Bulgaria: Markets and Trends*.

²⁴⁷ Ibid.; CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

²⁴⁸ CSD, *Organised Crime in Bulgaria: Markets and Trends*.

²⁴⁹ A slang word used in Bulgaria, Slovakia, the Czech Republic and other countries for “cooked” methamphetamine hydrochloride; in English it is known as “crystal speed”, “meth”, “ice”, “glass”, etc.

role for market entry and operation, whereas at retail level initial capital has minor importance for market entry and operation. However, the collected data show that at all levels barter arrangements and in-kind payments also are common practice. Notwithstanding the significance of financial capital, social capital in terms of trusted relationships and reputation seem to be far more important at all levels of drug trafficking. Social capital and reputation not only allow for entering in a given criminal network and establishing business relations with suppliers and customers, but also allows for access to credit (i.e. money loan or trade credit) in order to start a drug trade business or ensure financing in critical moments.

Sources of capital for criminal operations. Profile of financiers in criminal operations

Social capital as a substitute of financial capital

Both interviewed law-enforcement experts and criminal entrepreneurs agreed that social capital (i.e. established connections and trust) and reputation are key for entering or ascending in drugs markets. Trusted relationships, often built on friendships and acquaintances forged during prison time, seem to be a common gateway into drug trade. This seems to be especially the case with the retail and the production level. Subsequently reputation and tenure in the business pave the way to ascending in business, as they open up opportunities for more profitable partnerships and direct access to valuable contacts (i.e. brokers, suppliers and investors).

Hence, it is common among entrepreneurs entering the drug market at retail or production level to begin their career without any start-up capital. Various arrangements exist that alleviate the problem with lack of own start-up capital – a good reputation or a surety can provide for **goods on credit** on a revolving basis. Several interviewed drug entrepreneurs shared that they have started their business through getting the drugs on a revolving credit arrangement – i.e. the drugs are paid once the whole quantity or part of it has been sold (BG-C1, BG-C2, BG-C3, BG-C4).

Similar arrangements have been cited in regards to production. For example, a “meth cook” is provided with all the necessary equipment and precursors in exchange of share of the quantities produced (BG-E4). Analogous cases were also cited about cannabis growers, where the grower is provided with the seeds, the equipment and money for the related expenses (utility bills, fertilisers) and, in addition, can keep part of the yield in exchange for his work and willingness to take the risk (BG-E1, BG-E3).

Criminal proceeds as a source of capital

Whereas social capital is of key importance for entering market and securing start-up capital especially at the retail levels of drug markets, wholesale and importation levels presume dealing on a bigger scale and with larger quantities. Doing business at that level also implies certain

payments to fee-for-service providers that cannot be postponed in time (drug mules, couriers, stash keepers, debt collectors, providers of money laundering services, corrupt law enforcement officials). Therefore besides social capital it also requires more substantial financial resources in order to enter or operate on the market at that level.

The majority of interviewed law enforcement experts concurred that the notion of “self-growth” captures the way criminal entrepreneurs enter the market at higher levels, i.e. the criminals enter the market at lower levels and gradually work their way up or expand activities reinvesting the revenues of the drugs traded. A typical example is an OCG that have started as facilitators of cross-border trafficking through provision of transportation and other logistic services on a fee-for-service basis and with accumulating capital and contacts moved on to organising their own importation (BG-E2). This model was to some extent confirmed in several of the interviews held with criminal entrepreneurs (BG-C1, BG-C2, BG-C6). For example one of the heroin retailers (BG-C6) shared how he has started working as a “stash keeper”, gradually moved to retail distributor working for one of the big OCGs dealing in drugs in Sofia and ended up as a sole trader working on his own.

Although ‘self-growth’ seems to provide a plausible explanation of the sources of financing for entering or expanding activities at the wholesale and importation levels, it appears to be an oversimplification. Apparently, criminal entrepreneurs do use criminal proceeds for financing their drug market operations, but these funds are not necessarily from drug trafficking. For example, it was reported that some drug entrepreneurs resort to burglaries, robberies or other crimes in order to secure the needed financing to purchase drugs (BG-E3).

Furthermore, law enforcement experts shared that many of the criminal entrepreneurs operating on wholesale and importation level are career criminals with established reputation in their city and accumulated capital from previous criminal activities. They can be described as high-risk entrepreneurs with extensive criminal background, that readily invest this **accumulated criminal capital** in various high risk and highly profitable activities – sex trafficking, drug trafficking, payment card fraud, tobacco smuggling, real estate fraud, etc. (BG-E3). It is not uncommon for some of them to be ex-members of the former racketeering structures known as “grupirovki”,²⁵⁰ which used to dominate the organised crime markets up to 2008 – 2009 (BG-E1, BG-E4, BG-E5, BG-E6). They capitalise on their reputation and social capital in order to take a stake in the drug trade – e.g. to buy and sell drugs on wholesale or to set up and run transportation of drugs through the country or to some other EU country. Subsequently the proceeds from the drug trade could be invested in some other criminal activity, as these entrepreneurs are constantly looking to seize the next high profit opportunity.

²⁵⁰ The so called “grupirovki” were the first powerful organised crime groups in Bulgaria, which emerged in the early nineties and started their criminal activities with wide use of violence and extortion. Most of them established private security and insurance companies as fronts for their extortion. Subsequently, most of them developed extensive crime portfolios including drug distribution, prostitution, contraband, etc.

It should also be noted that many of these high-risk entrepreneurs also invest in legal businesses that are used for money laundering or for facilitation of their criminal activities (BG-E2, BG-E3). Subsequently this leads to mixing of the illegal and legal revenues, which blurs the boundaries between the legal and illegal sources of capital for financing of the drug trafficking activities.

Other criminal sources of financing were also indicated, such as drug producers securing the needed financing from drug retailers/wholesalers by getting an advanced payment for certain quantities (BG-E2, BG-E3).

Legitimate sources of financing

Along with the widely discussed criminal sources of financing, legitimate sources also appear to be common at all levels and segments of the drug markets. For example, it was pointed out that in many of the small-scale cannabis growers (user-growers), who comprise the low segment of cannabis production, invest money from **own personal savings or from small consumer loan**, as the investment needed is as low as few hundred euros (BG-E5).

Similar investment strategies were reported about the low segment of the heroin importation. The small-scale importers from the Roma communities (i.e. from Stolipinovo in Plovdiv or Maksuda in Varna) usually run some legal or semi-legal commerce, associated with regular trips to Turkey for purchase and delivery of various commodities such as clothing, shoes, household goods, etc. Given the small amounts of heroin trafficked (from 0.5 to 5 kg), they usually need to invest small amounts of money – usually €3,000-€9,000 to purchase the drug. So, it is not uncommon for them to raise these sums from **the revenues of their legitimate business or within their extended family circle**. Once started, the heroin trade generates enough revenues to self-sustain the enterprise (BG-E4, BG-E5).

Use of legitimate sources of financing was also reported for the high segments of production, wholesale and importation levels of the drug markets. For example, in Plovdiv and Varna the law enforcement experts reported cases about entrepreneurs with well-established restaurant and agriculture businesses who invested legal revenues in large-scale cannabis growing (BG-E4, BG-E5).

Large scale drug importers were also reported to invest legitimate (or at least laundered) revenues in their operations. It is common for the big players to use legitimate businesses as a cover up for their drug trafficking operations. Often the settlement of payments is also concealed as legitimate bank transactions, which necessitates the use of legal sources of money. Thus, drug trafficking, money laundering and legitimate business operations are interlinked and it is hard to tell the source of capital invested in the drug trafficking operations (BG-E2, BG-E5). An example was one of the biggest Bulgarian OCGs, which has turned into a big supplier for cocaine from South America to Italy. The leader of the OCG also controlled a number of legitimate businesses,

which were used as means for money laundering and cover up for the drug trafficking operations (BG-E2).

Criminal joint ventures

The interviewed law enforcement experts also provided examples, where drug entrepreneurs form partnerships with another criminal or legitimate businessman in order to raise the needed financial resources. Apparently, these criminal joint ventures can be observed on all levels of the drugs markets, but are more common when it comes to large scale operations. Such joint ventures not only allow criminal entrepreneurs to secure additional financing when needed, but also to share the financial risk of a given drug trafficking operation. These partners could act either as full-fledged partners taking care of some part of the operations, or as investors which provide financing for a share of the expected profits (BG-E2, BG-E5).

Whereas career criminals would rather involve other criminal entrepreneurs, large scale drug importers with own legitimate businesses could also attract as partners legitimate businessmen from their business circles. This was the case of a large cocaine trafficking enterprise in which the kingpin had enrolled some of his close partners that had legitimate business ties with him in his cocaine trafficking operations as investors (BG-E2). In a similar case, a big wholesaler controlling part of the retail distribution in Plovdiv and his partners owned several trendy night entertainment venues in the city and decided to invest part of their legal revenues to set a cocaine distribution network in the city (BG-E2).

Access to capital in critical moments, loan sharking

Apart from start-up or operational capital, drug entrepreneurs also need access to financing in critical moments – when the drugs are confiscated by the police or stolen by competitors, in case of incidental order for larger quantities, police arrest leading to litigation expenses or the need to use corruption (BG-E3). Drug entrepreneurs seem to employ various approaches to deal with such situations, which generally seem to repeat to some extent the already described models for access to financing.

Firstly, drug entrepreneurs rely on their own resources. According to the interviews, many of the criminal entrepreneurs, even the low-level retail dealers, put aside some of their revenues in a “rainy day” fund to meet such incidental expenses. The majority of interviewed criminal entrepreneurs admitted to have such money set aside (BG-C2, BG-C3, BG-C4).

The second option is to turn to their wider social network to raise money, if they cannot meet such expenses with their own resources. However, there is an important difference between raising money for incidental expenses and rising of external capital for starting or sustaining drug trafficking activities. Raising start-up capital is most often associated with equity financing, where the investor provides financial capital in return of share of profits, but also shares the financial risk with the entrepreneurs.

On the other hand, when criminal entrepreneurs have to raise funds in order to meet incidental expenses in a critical moment, they are rather looking for a loan and are supposed to pay certain interest for it.

Apparently, there are two main options to get a loan under such circumstances – to borrow from someone from their own extended social network or to borrow from a loan shark. Either way, incidental borrowing of money appears to be troublesome and expensive undertaking. All interviewed drug entrepreneurs shared that even when they **turn for a loan to someone from their criminal network**, they are typically supposed to repay the money with certain interest. However, in many cases the interest would be lower compared to the one that a loan shark would charge (BG-C3). In any case, getting a loan even from a **loan shark** requires certain reputation or at least having a surety (BG-C5). Furthermore, loan sharks usually ask for some kind of collateral and lack of such could lead to charging interest of up to 100% per day (BG-C1).

For smaller sums, retail drug dealers also turn to **pawn shops** or may ask for **extending their revolving credit for drugs**. These options are also bound with additional costs, as in both cases the dealer would be demanded to pay some interest (BG-C5).

According to law enforcement experts, mostly entrepreneurs operating on retail level and small scale importers and wholesalers need external financing for covering incidental costs. Large scale drug traffickers usually have more assets and funds set aside, so they are a lot more prepared to cover such incidental expenses (BG-E3).

Settlement of payments

Along with the sources for securing of capital, the other important aspect of criminal finances is the settlement of payments. Drug trafficking entrepreneurs employ various modes of payment and payment arrangements. The identified modes of payment include in-kind, cash and non-cash payments, whereas payment arrangements could be broadly classified as advanced payment, cash up-front, revolving credit and multi-step arrangements.

Modes of payment

Contrary to the widespread view about drugs trade as entirely cash-driven business, the collected data points to a much more complex reality. Certainly cash payments dominate drug trafficking, but equally common at certain levels of the supply chain seem to be barter exchanges, as well as non-cash payments such as bank transfers, money transfers through Western Union/Money Gram.

Settlement of payments in cash is a rule between retailers and users, as well as between retailers and wholesalers (BG-E1, BG-E4). At importation level cash payments to suppliers seem to be more common for heroin trafficking, as in most cases the drug is purchased from neighbouring

Turkey. Interviewed law enforcement experts reported that this finding is corroborated by seizures of large sums of cash at the Bulgarian-Turkish border (BG-E2). Importers also pay in cash to various contractors and facilitators they collaborate with for the smuggling – couriers, truck drivers, corrupt officials (BG-E2, BG-E5, BG-E6). The settlement of payments with local drugs producers such as cannabis growers is also done in cash (BG-E3).

However, criminal entrepreneurs at production, wholesale and importation level settle part of their **payments in kind**. Plausible explanation for use of such practices is that barter payments have the advantage to allow for equal distribution of risk between the involved parties and decrease the risk the money to be detected or seized by law-enforcement authorities. These barter payments can take different forms. In one of the cases described in the interviews, in a group for large-scale cultivation and subsequent trafficking of cannabis an investor provided the initial financing and the cannabis seeds, but the rest of the players were supposed to contribute by taking the risk of apprehension by the police and performing certain aspects of the operation. All actors were supposed to be rewarded with a share of the yield (BG-E3). Similar arrangements were described in cases with producers of methamphetamines (BG-E4) and with a group involved in smuggling and transportation of drugs (BG-E2). Other barter schemes practiced by wholesalers and importers involve exchange of one type of drug for another – e.g. amphetamines for heroin (BG-E4, BG-E6).

Non-cash settlement of payments seems to be typical for cocaine trafficking and generally for large-scale drug trafficking entrepreneurs. As cocaine is usually purchased in Spain or Latin America settlement of payments in cash would require taking greater risk for moving the cash across multiple borders. Therefore various methods for non-cash payments are applied. Some small scale traffickers smuggling cocaine via post or through drug mules settle their payments by Western Union/Money Gram transfers, which are typically sent to a straw person (BG-E4, BG-E5). This allows for greater anonymity, although sometimes the sum has to be split in several smaller transfers in order to circumvent the anti-money laundering restrictions.

Concealing the drug trafficking behind legitimate commercial operations and dealing in bigger quantities require large scale traffickers to transfer money only through bank transactions. In order to imitate normal payments for delivered services or goods they might use legitimate companies or register shell companies (BG-E2, BG-E3, BG-E4, BG-E5). Sometimes they are also using sophisticated schemes to hide the suspicious nature of these transactions – e.g. such financial transactions run through several different banks and involve various account holders including offshore companies.

Payment arrangements

Besides mode of payment, the other important aspect concerning settlement of payments is the payment arrangements between the involved

parties. According to the interviewed experts payment arrangements vary quite a lot at the different levels of the drug trade.

Advanced payments require that one of the parties makes a payment in advance and receives the drug later in time. Such payment schemes were reported, when settling payments between producers or importers and wholesalers (BG-E3). An example of advance payment scheme was given in regards to the cocaine traffickers that smuggle the drug by post – in order to receive the drug they usually prepay the amounts via Western Union (BG-E5). Similar arrangements were reported in regards to cases where wholesale or retail drug entrepreneurs pay in advance to cannabis growers for a pre-agreed quantity of the yield (BG-E2). Drug couriers also often receive part of the payment for their services in advance, while the rest is paid after the drug is delivered to the destination point (BG-E2).

Cash upfront implies that payment is done at the same time when the drug is delivered to the other party. Cash upfront arrangements are typical for transactions between user and dealer. They are also common between retailer and wholesaler or between wholesaler and importer (BG-E3, BG-E4). Some of the interviewed entrepreneurs, that have operated as independent drug entrepreneurs at retail level reported that in the recent years many wholesalers that used to supply drugs on revolving credit, started to demand upfront payments (BG-C5, BG-C6). According to the interviewed law enforcement experts, in most cases importers purchasing heroin from Turkey also pay the quantities upfront (BG-E2, BG-E4).

In a **revolving credit** the price is paid once the drug or part of it is produced and/or sold. Upfront payments between wholesalers and retailers are the rule with few exceptions – when the street dealer works directly for (or is controlled by) the wholesaler or when the two parties have cooperated for a long time and there is trusted relationship established (BG-E1, BG-E3). Several criminal entrepreneurs that have worked as street dealer for a given wholesaler, reported that they typically received the drug on a revolving credit arrangement, but were supposed to account all money for the quantities sold, before receiving their share of the revenues (BG-C1, BG-C2, BG-C3, BG-C4).

Multistep payment arrangements refer to various payment schemes, where the flows of money and drugs are not directly linked and even may take place independently. Such arrangements were described in relation to large-scale drug trafficking networks, where payments between partners involved are done via multistep bank transfers and often involve certain money laundering operations. These multistep arrangements make it difficult to define whether the payments are done in advance or subsequently (BG-E2).

Costs of doing business

Analysis of criminal financing for initiating and sustaining criminal activities is not possible without taking into account the size and types of costs

at the various levels of drug trafficking. It is precisely the size of costs that determines the amount of capital needed to enter or operate on a drug market at a given level. Although type of costs may be more or less similar at a given level of the supply chain across the different drugs markets, the size of these costs vary not only across markets, but also depending on modus operandi and scale of the drug trade. Moreover, each drug entrepreneur operates in a specific setting (local demand for a certain drug, number of regular clients, level of competition, etc.) and has some discretion on how to organise his own business and therefore his expenses. Drawing on the interviews conducted, the type of costs and approximate level of required investment for market entry at different levels of the drug markets can be reconstructed.

Costs related to production

Drugs production in Bulgaria is mostly related to cannabis cultivation and amphetamine manufacturing. Costs related to cannabis cultivation vary widely depending on the method of cultivation (in-door, greenhouse or outdoor) and scale of production. The costs for cultivation usually relate to purchasing of seeds, fertilisers, specialised equipment for indoor cultivation (lamps, heaters, humidifiers, etc.), as well as for covering utility bills. In addition to that, large scale indoor growing also involves costs for rent of the apartment or house and ventilation systems in order to eliminate the strong odour. Large scale outdoor growing incurs costs such as covering rent of greenhouses or land, as well as contracting greenhouse keepers or farmers. Different costs brackets were reported depending on the scale of production. Usually large scale in-door growing requires larger initial investment compared to similar size outdoor plantation (BG-E2). The investment for small scale indoor cultivation using a tent kit (5-25 plants) was indicated at approximately €1,000 with fertilisers and utility bills included (BG-E5), whereas the investment for a large scale greenhouse cultivation (growing 500-800 plants at a time) was estimated at approximately €10,000 (BG-E1).

Costs related to amphetamine and methamphetamine manufacturing usually include expenditures such as purchasing of “cooking” equipment and precursors, utility bills, rent for suitable house, etc. According to the interviewed law enforcement experts, the manufactured quantities are usually small – up to 1 kg per batch and most of the operating illegal laboratories may be classified as “kitchen” type. They do not operate on a regular basis, but rather “cook” on demand (BG-E2, BG-E5). Depending on the precursors used and the scale of production the size of the initial investment required varies. The experts cited sums such as €500-€1,000 invested for a batch of 300-500 grams (BG-E5) and €2,000 invested for a batch of 4-5 kilograms (BG-E3).

Costs related to importation

Entering the market at wholesale or importation level is associated with higher costs compared to the retail level. Apart from the costs for purchasing the drug, the operational costs at importation level are usually related to transportation costs and fees for the actors that provide

the logistics. For heroin trafficking, which is predominantly smuggled overland, costs include expenditures such as purchasing of the drug, modifying a suitable vehicle for the transportation and paying to the drug courier (the driver of the vehicle), as well as bribes to certain customs and border guard officers. Usually for smaller amounts of heroin (5-15 kg) the fee for the driver is a fixed amount (€500-€1,000). For bigger quantities the practice is to pay a certain percentage (about 10%) of the market value of the drugs (BG-E1, BG-E2, BG-E3, BG-E5, BG-E6). Therefore, considering the transportation costs and the wholesale price of €9,000 per kilo for the heroin in Istanbul,²⁵¹ the investment for entering the market at importation level when smuggling on average 8 – 10 kg per operation can be estimated at €90,000-€100,000. Certainly, small scale importers, smuggling up to 1 kg of heroin could manage with €5,000-€10,000 (BG-E4).

Little information was provided on cases of large cocaine trafficking carried out by Bulgarian OCGs, so it is difficult to gauge the size of investment needed to enter the market at that level. Most cases cited in the interviews were related to OCGs providing logistics and transportation through organising drug couriers that smuggle the drugs by air. Law enforcement experts reported that the typical quantities smuggled by a single courier were up to 5 kg and the remuneration was about \$1,000 per trip. In addition to that the organisers also cover all costs related to the travel and accommodation of the drug mules, which add another \$1,000 per trip (BG-E2, BG-E3). Therefore one such OCC operating with 10-15 drug couriers at a time is supposed to secure about \$20,000-\$25,000 in order to set up a single trip.

Cost related to wholesale and retail distribution

Certainly retail level entrepreneurs need least start-up capital compared to other levels of the drug market. Moreover, if the retailer starts as part of a larger OCG, he actually does not need to invest any money. The drug is supplied on a revolving credit basis and many of the accompanying costs are covered by the ringleader. In this case the retailer is supposed to pay for the drugs after the provided quantities are sold. On the other hand, typically he is supposed to account for his sales on a regular basis and work exclusively with the drug supplied by his wholesaler. He does not have permission to cut the drug and is also usually supposed to pay back a certain share of his profits as a form of interest on the credit provided or as a protection fee (BG-C1, BG-C2, BG-C3, BG-C4).

Often, the independent retailers also manage to secure the drugs on a revolving credit arrangement, especially if they have the right connection or well established reputation. The majority of criminal entrepreneurs, which have been interviewed were operating on retail level and reported that they sell about 100-200 grams per week of heroin or cocaine depending on the number of their clients. The wholesale prices reported in the interviews were €12.5-€14 per gram of heroin, €40-€45 per gram of cocaine, €5 per gram of cannabis and €2 per gram of amphetamines

²⁵¹ UNODC, *The Illicit Drug Trade through South East Europe*.

(BG-C1, BG-C5, BG-C6). Therefore it is easy to estimate that in order to secure 100-200 grams a retailer would need to invest €1,200-€2,800 for heroin, €4,000-€9,000 for cocaine, €500-€1,000 for cannabis and €200-€400 for amphetamines.

In addition to the costs for supplying the needed quantities, independent retailers may also incur additional expenditures such as paying to certain people to keep the drugs, paying someone to cut it and pack the doses, paying street pushers, paying couriers to deliver the drug to the street pushers and collect money. They also have to cover various accompanying costs for gasoline, prepaid telephone cards, etc. (BG-C5).

Profits and profit sharing

The profits of OCGs in illegal drug markets seem to depend on many factors – type of drug traded, position in supply chain, level of autonomy, scale of operation. Several cases are outlined below with estimates for profits of entrepreneurs operating on different positions of the supply chain and trading heroin, cocaine and cannabis. Generally it seems that retail level profit margins in a given market are lower than the profit margins on importation level, which supposedly reflects the levels of risk they face.

Case 1

The first example is drawing on interviews with a **heroin retail level dealer who** described himself as an independent sole-proprietor working with 3 street dealers (pushers) beneath him. He reported that roughly

TABLE 14. HEROIN RETAIL LEVEL DEALER (INDEPENDENT)

Known costs	Value per gram	Value per average sale of 150 grams/week
Heroin	€12.5	€1,875
Stash keeper	€0.5	€75
Packager	€0.5	€75
Courier (delivers the doses to the pushers)	€0.5	€75
Pusher (sells the drug to the end users)	€1	€150
Other costs (prepaid telephone cards, gasoline, cutting agent, etc.)		€50
Overall costs		€2,300
Sells the heroin at €30 per gram		Revenue – €4,500 Profit – €2,200 (49% profit margin)

Source: Interviews with BG-C4 and BG-C6.

half of the money he made from each gram of heroin covered all his expenses and the other half remained as a profit for him. The retailer also reported that he purchased the heroin for €12.5 per gram and sold it at €30 per gram, without cutting it. Assuming that he sells about 100-200 grams per week, it could be calculated that his weekly revenue should be €3,000-6,000 (see Table 14).

Case 2

Apparently profit margins at **importation level of the heroin market** are much higher. The wholesale price of heroin in Istanbul is about 26,000 TL or roughly €9,000 per kg,²⁵² while the wholesale price in Bulgaria is about €16,000.²⁵³ Interviewed police experts reported that the most common transportation method for heroin smuggling is by car. The average shipment per trip is 2-3 kilos and might reach up to 50 kilos (BG-E6). The overall investment for such a trafficking operation would be about €93,000 for 10 kilos and would bring three times higher revenues. According to the experts, the big profits are usually ensured through cutting the imported drug in 1:1 ratio. Taking into account the available data, it could be estimated that the profit of a single smuggling operation doubles the money invested (see Table 15). Admittedly, this simple calculation neither takes into account other possible costs like bribes, costs for bringing the cash out of country, etc. Yet, it still illustrates well the profit margins at this level of the illegal market.

TABLE 15. HEROIN IMPORTER

Known costs	Value	Value for 10 kg smuggled per crossing
Heroin (wholesale price Istanbul)	€9,000 per kg	€90,000
Modified vehicle with concealed compartments	€2,000	€2,000
Driver (drug courier)	€1,000	€1,000
Overall costs		€93,000
Sells the heroin at €16,000 in Bulgaria after cutting it 1:1	€16,000*2 = €32,000 per kg	Revenue: €320,000 Profit – €227,000 (71% profit margin)

Source: Interviews with BG-E6, UNODC.

²⁵² Reitox National Focal Point-Turkey, *2013 National Report (2012 Data) to the EMCDDA: Turkey* (Ankara: Turkish Monitoring Centre for Drugs and Drug Addiction, 2014).

²⁵³ UNODC, *The Illicit Drug Trade through South East Europe*.

Case 3

Cocaine is about four times more expensive than heroin in Bulgaria and apparently this **pushes retail level cocaine dealers** to work on a considerably lower profit margins compared to heroin dealers. Moreover, they usually trade with their clients in various nightlife venues (night clubs, bars, etc.), which are guarded and therefore a dealer needs secured access to these venues (BG-C1, BG-C2, BG-C3). This is why most cocaine

dealers usually operate within larger OCGs, which can provide for such access. From the interviews with the criminal entrepreneurs was really hard to determine the number of clients and quantities sold per day, as apparently in some days of the week they tend to sell more and in some less. One of the cocaine dealers (BG-C1) reported that he purchases the cocaine at €45 per gram and sells it at €70 per gram. His weekly revenue was roughly €10,000 or in other words he was selling over 140 grams per week. The profit margin can be estimated at 28% or about two times lower compared to the heroin dealer from Case 1 (Table 16).

TABLE 16. COCAINE RETAIL LEVEL DEALER (PART OF LARGER COCAINE ENTERPRISE)

Known costs	Value per gram	Value per average sale of 150 grams/week
Cocaine	€45	€6,750
Protection	€5	€750
Other costs (gasoline, etc.)		€50
Overall costs		€7,550
Sells the cocaine at €70 per gram	€70	Revenue: €10,500 Profit: €2,950 (28% profit margin)

Source: Interview with BG-C1.

Case 4

Bulgarian OCGs that are involved in **cocaine importation** in most cases only provide logistic support to larger criminal networks and do not invest their own financial resources for purchasing the drug (BG-E2, BG-E3, BG-E4). Common modus operandi is OCG recruiting drug couriers to smuggle cocaine by air from South America to Western Europe. The interviewed law enforcement experts report that such logistic services are usually rewarded either with 10 per cent of the market value of the drug, or with 30 per cent of the quantity smuggled (BG-E2). The drug couriers usually smuggle between 1-5 kilograms of cocaine (BG-E4), which in South America is worth about

\$5,000-\$7,500 and in Western Europe roughly €40,000 (BG-E2). If we assume that such OCG recruits 15 drug mules monthly and ten of them reach the destination with 1 kilogram without being intercepted, this provides for €40,000 monthly or 38 per cent profit margin (Table 17).

TABLE 17. COCAINE TRAFFICKER (PROVIDES ONLY LOGISTICS FOR SHARE OF THE COCAINE)

Known costs	Value per trip	Value per 15 drug mules/ month
Drug mules	\$1,000	€10,000
Transport, accommodation for drug couriers	\$1,000	€15,000
Overall costs		€25,000
Receives 10% of the market value of cocaine trafficked – 1 kg, which is about €40,000		Revenue – €40,000 Profit – €15,000 (38% profit margin)

Source: Interviews with BG-E4 and BG-E2.

Case 5

One of the most profitable criminal undertakings in Bulgaria seems to be cannabis growing. Unlike the small-scale indoor growing that is often done by user-growers, large-scale growing is typically organised criminal activity. A case reported by one of the law enforcement experts (BG-E1) sheds light on the revenues and profits of a large-scale greenhouse plantation. It was a joint enterprise of 2 drug dealers and an owner of mushroom plantation. The farmer provided the greenhouse and looked after the plants, while the drug dealers provided the financing of €10,000 for the seeds, fertilisers and additional equipment. The partners in this criminal enterprise had an arrangement that each of the sides (i.e. the drug dealers and the farmer) will receive half of the yield. When the police busted the greenhouse they uncovered 500 cannabis plants in it. It is hard to come with a precise estimate of the yield of these plants, as the saleable material yielded per plant depends on variety of factors such as density of planting, growing period and application of nutrients. The yield could vary from 35 grams per plant for indoor growing with high planting density up to 1 kilo for outdoor growing with low planting density.²⁵⁴ Thus, a conservative estimate would assume 100 grams yield per plant. The wholesale price of the cannabis is €5 per gram (BG-C5), so the expected revenue from this greenhouse for the 2 entrepreneurs is €125,000 from one harvest, which indicates 92% profit margin (Table 18).

²⁵⁴ J. Caulkins, *Estimated Cost of Production for Legalized Cannabis*, RAND Working Paper, 2010.

TABLE 18. CANNABIS GROWING ENTREPRENEUR (GREENHOUSE GROWING IN COOPERATION WITH A FARMER)

Known costs	Value	Value per 400 plants
Selected seeds (500 seeds) + equipment + fertilisers + utility bills for 4 months)	€10,000	€10,000
Greenhouse keeper share	½ of the yield	
Overall costs		€10,000 + ½ of the yield
Revenue calculation: 1 plant → 100 grams/500 plants → 50,000 grams	½ of the yield → 25,000 grams x €5 → €125,000	Revenue – €125,000 Profit – €115,000 (92% profit margin)

Source: Interview with BG-E1.

Investment strategies of criminal entrepreneurs

The investment strategies of the criminal entrepreneurs differ depending on the scale of profits. The retail level dealers apparently have lower profits and therefore most of the money is spent on **personal expenses** such as cars, lavish lifestyle or gambling (BG-C1, BG-C2, BG-C4, BG-C6). Along with that many of them admit of putting money aside in a “rainy day fund”, which is not necessary a bank deposit (BG-C2, BG-C3, BG-C4).

It seems common to invest money in the same (BG-C1) or other **criminal businesses** such as cannabis growing (BG-E1), amphetamine labs (BG-E2, BG-E4), sex trafficking or skimming (BG-E3), illicit tobacco trade or loansharking (BG-C5).

Investments in the legitimate economy and money laundering seem to be more common at wholesale and importation level, although some of the interviewed retail level entrepreneurs also reported such practices, yet on a smaller scale. Typically, the bulk of these investments did not involve sophisticated money laundering techniques, except in the few cases of large-scale drug trafficking that were mentioned (BG-E2, BG-E4). **Investing in real estate** seems to be favoured by many criminal entrepreneurs, not only on wholesale and importation level (BG-E2), but also on retail level (BG-C1, BG-C3, BG-C6). Often the property is purchased on the name of someone else such as relatives or a straw person in order to avoid detection by the authorities. Other strategies that were reported included investments in a café (BG-C3), in a family grocery business (BG-C2) or in agricultural business (BG-C4). The purpose of such investments seems to be two-fold – to secure initial capital for some legitimate business and to use such cash-intensive businesses to launder the profits from the drug trade.

Law enforcement experts reported that typically criminal entrepreneurs involved in large-scale drug trafficking alongside their criminal businesses also run large legitimate businesses, which are used both for a cover-up and for money-laundering (BG-E2). A particular large scale cocaine trafficking case was discussed, where the ring leader was also involved in wide range of money laundering activities and invested in a number of legal businesses such as hospitality industry, construction, financial services, international transportation services and logistics (BG-E2). The criminal network was involved in trafficking of tonnes of cocaine from South America to western Italy in partnership with figures from the Italian 'Ndrangheta. The legitimate businesses were used for a cover up of the smuggling of drugs through legitimate commercial transactions, as well as for concealing the payments and laundering the proceeds of the cocaine trafficking. A similar case, although on a much smaller scale, took place in Pazardzhik where a small cocaine importer invested his profits in a company trading with computer parts, which was later used as a cover up for importing small quantities of cocaine from the Netherlands (BG-E3).

4.4. ESTONIA: BETWEEN EAST AND WEST

In 2005, Estonian law enforcement declared tackling drug-related crimes to be one of its top priorities. The number of registered drug crimes has been growing along with the growth of the economy, peaking in 2008 after which it started to decline. Research data on drug users show quite similar trends.²⁵⁵

In the past 20-25 years, drugs have remained an important part of the criminal underworld in Estonia. The actors on the market, however, have changed, especially in last 10 to 15 years. Nowadays, the market is more fragmented, there are more ad-hoc groups, temporary projects and single entrepreneurs. Old traditions and authorities – although still playing an important role – lose their power. New actors come to replace them who are more flexible, mobile, and use modern technologies.

Market overview

The overall turnover of the Estonian drug market in 2008 was estimated to be in the hundreds of millions of euros – according to Kaido Kõplas, Senior Superintendent of the Narcotic Crimes Department at North Police Prefecture, “only 1% of the amount of drugs circulating on the market in Estonia is confiscated. It means that the turnover of the six most popular drugs is EEK 4.5 billion [€290 mln]. If the other segments are added, the level of EEK 5 billion would be easily exceeded.”²⁵⁶

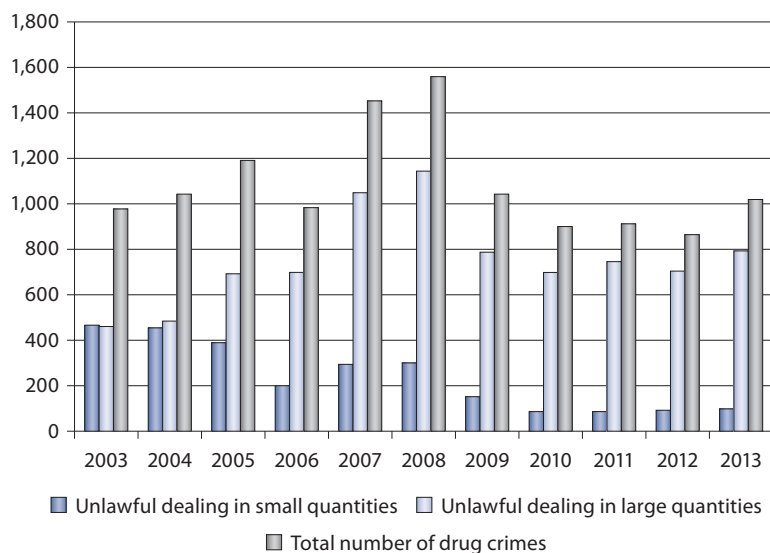
In recent years, the police have shifted their attention from small quantities of drugs to the handling of large quantities (under Estonian law, large quantity

²⁵⁵ Reitox National Drug Information Centre-Estonia, *2013 National Report to the EMCDDA (2012 Data): Estonia* (Tallinn: National Institute for Health Development, 2013).

²⁵⁶ Quoted in K. Koovit, “Estonian Narcotics Market Turnover Exceeds EEK 5 Billion”, *Baltic Business News*, October 03, 2008.

means the amount equal to at least 10 doses). In 2013, large quantity crimes were the majority – 795 of the overall of 1,019 registered drug-related offences – a trend that has been around for several years (Figure 16).

FIGURE 16. DRUG-RELATED OFFENCES IN ESTONIA, 2003 – 2013



Source: Justiitsministeerium [Ministry of Justice], *Kuritegevus Eestis 2013 [Crime in Estonia 2013]*, Tallin, 2014, 52.

The Estonian national report to the EMCDDA, states that 69 domestic and 10 international joint operations were carried out in 2012 to reduce the supply of drugs. The total amount of illegal income confiscated in 2012 was €1.5 million, which is almost double the amount of 2011.²⁵⁷ In terms of confiscated narcotics, the dynamics for the different kinds of drugs varied (Table 19). One of the most significant reductions since 2007 occurred in the seizures of hashish.

The purity of drugs has also been changing: for cannabis it has increased since 2010; while the most common tetrahydrocannabinol (THC) content in hashish was 5% in 2011, it rose

TABLE 19. AMOUNTS OF CONFISCATED NARCOTIC SUBSTANCES IN ESTONIA, 2007 – 2012 (KG)

	2007	2008	2009	2010	2011	2012
Cannabis resin (hashish)	155.4	48.5	19.2	14.6	45.6	4.7
Cannabis leaf (marijuana)	8.1	24.2	7.1	14.8	53.5	25.1
Cannabis plants	8.1	23.2	17.2	10.8	29.3	6.06
Heroin	5.7	0.1	3.9	0.004	0.05	0.0004
Cocaine	13.0	3.6	5.0	217.7	0.8	3.4
Amphetamine	56.3	23.3	55.9	47.7	41.6	14.2
Methamphetamine	0.02	37.7	0.001	0.5	1.5	27.1
GHB	26.4	7.7	25.1	16.1	13.5	28.9
Fentanyl/ 3-methylfentanyl	1.3	1	1.8	0.5	0.9	1.7

Source: Estonian Forensic Science Institute 2013. Quoted in Reitox National Drug Information Centre-Estonia, *2013 National Report to the EMCDDA (2012 Data): Estonia*, 60.

²⁵⁷ Reitox National Drug Information Centre-Estonia, *2013 National Report to the EMCDDA (2012 Data): Estonia*, 59.

to 11% in 2012. The purity of marijuana improved in 2012: while the average THC content in marijuana was 11% in 2011, it increased to 13% in 2012. As regards price, cannabis products have kept their 2010 levels, and the mean price of marijuana was €20 for a gram in both 2011 and 2012. The mean price of hashish in 2012 was €7.²⁵⁸

According to the law enforcement interviewees, hashish along with cocaine are the drugs smuggled in large quantities via Estonia and trafficking in hashish is one of the most profitable drug crimes.

“Hashish is quite an interesting drug, it passes through Estonia in tonnes, but it is not distributed on the streets in Estonia (EE-E2).”

Another expert confirms it:

“If we are talking about transit, it is definitely hashish. Almost all marijuana is brought to Estonia from the outside, but in case of marijuana we cannot talk about big sums of money or organised crime. As for the big actors, they are definitely into hashish and cocaine, this is what brings the money (EE-E7).”

The World Drug Report notes the signs of a possible expansion of the cocaine market in Baltic countries, including Estonia. Estonia, Latvia and Lithuania had a peak in cocaine seizures in 2010 including significant quantities being trafficked by sea. Some cocaine is smuggled further to Eastern Europe and possibly Scandinavia. Estonia also reported recent increases in the use of cocaine in its own consumer market.²⁵⁹ The EMCDDA report for Estonia notes that the price of cocaine increased a little in 2012 compared to 2011. While the street price of cocaine was €90-110 in 2011, it ranged between €80 and €120 in 2012. The most common purity of cocaine increased as well, from 26% to 36% of pure substance per gram. The range of cocaine purity was 7-83%.²⁶⁰

In the spring of 2014, however, law enforcement interviewees estimated that the amount of cocaine on the market was not high and that the supply chains for cocaine were so long that this reflected on the quality of the drug. “There is some cocaine on the streets but it is of very poor quality (EE-E7).”

According to the World Drug Report 2013, Estonia has one of the highest rates of injecting drug users – 1.5% of the adult population. In recent years, heroin has been less available, and the most popular drug to inject nowadays is fentanyl. In Estonia, the annual prevalence of fentanyl use in 2008 was reported to be 0.1%, but it was 1.1% among males aged 15-24. Seventy-six per cent of users registered for treatment took fentanyl.²⁶¹ Its street price in 2012 was €7-10 per dose, the same as in 2011. “The most common purity level of fentanyl in 2012 was 6% of

²⁵⁸ Ibid., 61.

²⁵⁹ UNODC, *World Drug Report 2013*, 45.

²⁶⁰ Reitox National Drug Information Centre-Estonia, *2013 National Report to the EMCDDA (2012 Data): Estonia*.

²⁶¹ UNODC, *World Drug Report 2013*, 16.

pure substance per gram (variability range 0.2-10 per cent). The most common purity of fentanyl has increased 3% from 2011.²⁶² According to interviewed criminal entrepreneurs dealing in fentanyl, prices for fentanyl increased in 2011, when the euro was introduced as currency in Estonia, and has not changed since then.

Market structure and actors

Key actors of the criminal market

Based on the interview data, it is possible to divide drug market's actors into three categories: individual entrepreneurs, ad-hoc groups and criminal organisations.

Individual entrepreneurs. Those are people who learn from mass media or from some acquaintances about prices and availability of drugs. They decide to make additional money and get involved in the business. One such example is EE-C3 interviewed in Viru prison. The man had a full-time job as a miner but his family income was low and he decided to make some extra money. He knew some people who sold drugs (respondent says there are plenty of such people in North-Eastern Estonia, no problem to establish a contact). He worked alone, without any partner and was selling only one type of drug: fentanyl. He bought it in bulk, re-packaged and sold further either to retailers (3-4 grams) or to individual customers. The amounts he bought were about 100-200 grams. Similar cases were also described by the law enforcement interviewees:

"We had such cases: two guys, about 20-30 years old, put some money together and bring 2,000 pills and 2 kg of amphetamine. There were other cases as well, when a truck driver brought 15 kg of cannabis from the Netherlands (EE-E2)."

Also, according to EE-E7, a lot of drugs are moving to Estonia via mail packages, typically ordered by individual entrepreneurs.

Ad hoc or project-based groups are another type of actor on the drug market. The groups are based on social relationships (friends, acquaintances, prison mates, etc.) where each member has some special skills or contacts that are useful. If the criminal transaction is successful, the group – with the same or varying members – could get together again for a different job.

"This [drug market] is fragmented and divided among different groups. Usually, there is no hierarchical structure leading to a criminal boss. If we look at organised crime as a whole, we see first of all ad hoc groups – they come together to complete a job; project based (EE-E6)."

"There was this case of three friends, all university graduates, who trafficked cocaine from the Netherlands to Estonia in shipments of about 200-250 grams. It was 90% purity but they cut it 4 times and

²⁶² Reitox National Drug Information Centre-Estonia, *2013 National Report to the EMCDDA (2012 Data): Estonia*, 61.

got a whole kilogram that was eventually sold further. Two of them started the business, then the third, who was from a rich family, lent them money. When the two ran up a large debt, the 'financier' decided to get involved in the drug business himself to get his money back (EE-E4)."

EE-C3 is an example of a person belonging to a group which stays together for longer periods but they complete only one task and do not know what other people in this network are doing. The role of EE-C3 was to collect money from the customers and bring it to a certain person in the network but he never touched drugs and did not want to know much about it.

Organised criminal groups are also involved in trafficking, and this is an increasing trend. It is these groups that shape the illegal drugs market in terms of price, quality and other aspects (EE-E4). Their international outreach covers the Netherlands, Germany, Poland, Lithuania, Latvia and Estonia (EE-E5).

The organised crime situation has changed considerably in Estonia within the last 10-15 years. At the end of the 1990s, organised crime groups were relatively stable, had a hierarchical structure and were often named after their leader or locality from which the core member of the criminal group came from. The market was partitioned, conflicts settled through a mutual fund²⁶³ which was the kept by the "authority" of the criminal world. Nowadays, according to the experts, this phenomenon still exists – maintained mostly by old-timers' in their 50s-60s – but has lost its power.

Traditional groups, however, are still playing important role on the illegal drugs market. Experts mentioned the involvement of Azeri groups, Chechen groups and also some old groups from the 1990s, or at least what is left of them. The Azeris are not trusted by the Estonians, while the Russian-speakers stick together as they do not understand Estonian (EE-E6).

Offenders who served time in prisons abroad, for example in Germany or the Netherlands, use connections created there to establish new criminal networks and traffic drugs either to Estonia or other countries where the profit is bigger (EE-E5).

Supply chains

The following drugs supply chains were outlined by the experts and criminal entrepreneurs during the interviews:

- **Cannabis** trafficked from the Netherlands to Estonia. The drugs are carried by road transport mainly and, in small quantities, are also ordered by mail (e-trade). Some larger shipments stay in Estonia, some are trafficked further to Russia.

²⁶³ Referred to by the Russian slang word *obschak*. More on this on pp. 158-159.

- **Hashish** trafficked from Bolivia/Morocco to Spain/the Netherlands and then transit through Estonia to Russia/Finland/Sweden/Norway. Hashish is rarely brought for consumption in Estonia. Usually, it passes via Estonia on the way to the Scandinavian countries or Russia. EE-C2 was serving time for smuggling hashish (he mentioned 12 kilos) from Estonia to Russia. He did not reveal any information about the starting point of the trafficking route. During the interview, however, he mentioned that he has visited several times friends in Dutch prisons that could be indicative of the routes of drug trafficking.

“It used to be the Nordic countries but this has changed, now it is Russia – today it is very popular to transport to Russia, because there is a big market. Hashish is sent there and money consignments of up to half a million are coming back from there to be laundered in Europe (EE-E7).”

- **Amphetamine** follows several routes: from the Netherlands /Germany/ Denmark via Estonia to Finland/Sweden; from the Netherlands/ Germany/Denmark to Finland/Sweden; from Russia to Finland.

“Those routes vary. Based on the latest cases, it could be said that sizeable shipments go directly from the Netherlands to the Scandinavian countries and are distributed there. Estonians are involved in this trafficking but only money goes to Estonia. Drugs do not come here, they carry the drugs over there, because it is more expensive there. Estonians, as well as others, organise it (EE-E4).”

- **Cocaine** is trafficked from Latin America to Europe (e.g. by Estonian couriers) by plane from different parts of Europe to Estonia (plane, road transport).

The organisation of drug trafficking chains via Estonia varies. In some cases, the criminals carry out the trafficking from the beginning to the end themselves; in others, the whole operation is co-organised by criminal entrepreneurs who do not travel themselves.

“There are different types. The first type has its main organisers in Russia, and they have contact persons in Spain, in Estonia, and intermediaries in Lithuania; they would meet somewhere in Latvia. Everything is very well organised and they know what they are doing; they deal exclusively in drugs. Then there are the ‘tough guys’ who start from scratch, raise some money and move into trafficking stuff.

“There was this case where they wanted to bring cocaine hidden in coffee beans. People from the Netherlands and Estonia were involved and the stuff was brought from Venezuela. These were coffee packages smelling like coffee and one can make coffee and drink it. It was established that that 50 kilos of cocaine was hidden among those coffee beans. Some of the people involved were not aware and in good faith thought they were transporting coffee. The

shipment was aimed for the Netherlands market, but it was first brought to Germany, and then shipped via Estonia (EE-E7)."

Financing and financial management

Sources of capital for criminal operations

The source of capital for initiating the business varies from one kind of actor to another.

For solo entrepreneurs the initial capital often comes from either **savings** they made from legal income or from some form of **credit** they take. For example, EE-C3 invested his legal income as a miner into a fentanyl business. Experts mentioned several cases when money came from a legal business; others would borrow money from friends or relatives. Several experts also mentioned quick cash loans being used to buy the first shipment of drugs. The initial capital required is about €3,000 for a kilo; if sold in 10 or 100 gram portions the profit would be 2-3 times that amount (EE-E2).

For both ad hoc groups as well as more organised criminal groups, money can come from sources of credit such as small bank loans or quick cash loans. However, quite often the money they invest into the drug business comes from other illegal activities, e.g. organised shoplifting, prostitution, robbery or any kind of criminal activity (an example is a group shuttling to Finland for thefts, EE-E7). According to expert interviewees, criminal groups rarely specialise in a certain type of criminal activity but are rather quite opportunistic – they would engage in any kind of business – legal or illegal – that would bring them considerable income. Drugs are a particularly profitable enterprise and thus one can hardly find any group who would not be somehow involved in drug-related crimes.

There are, of course, the professional criminals who re-invest their illegal income into drugs trafficking but, unlike smaller or ad-hoc groups, do not traffic themselves, preferring the role of financiers. Some of their initial capital was made in the 1990s in the legal economy, and so to "save their bacon" they do not commit crime themselves but just finance it (EE-E6).

Financing could be advanced by **middle-level entrepreneurs**. An example is EE-C1 who served his first time in an Estonian prison. After his release, one of his prison mates contacted him, asked him to arrange a shipment of fentanyl and gave the whole amount of money in advance. Operators such as EE-C1 do not usually know where the money comes from or the origin of the drugs; they are just a link between the client and the provider. In case of longer supply chains, the pattern is quite similar: the one on the demand side (the client of the shipment) invests the money into the chain. While Estonians would organise it, the money could originate either from Russia or Finland or other destination country. "It is not possible to get drugs from another country on credit (EE-E2)."

There were also some cases when a **legal business** was involved in drug trafficking operations. Experts reported cases when a company that was

in a financially dire situation would improve it by investing into drug trafficking and re-investing the profit back into the legal business. In one instance, a legally operating company in Estonia “organised a shipment from Spain to Russia via Estonia. They got €100,000 in profit which was invested back into the company. As long as things went well with the legal business, they were not getting involved in drugs, but when the company started going downhill financially, they went for another shipment (EE-E7).”

Another financing scheme is **blackmail**. Criminals would collect discrediting information about a legitimate business or even create a situation that would force the business into some kind of wrongdoing. Examples could be a case of corruption when a company pays a government official a bribe to win a tender, or evade taxes, or a businessman would cause a traffic accident while being drunk and then claim his driver was behind the wheel, etc. Then criminals would blackmail the businessman and in exchange for not reporting this case to the police would demand an investment into a drug smuggling operation. To pay up, the businessman is forced to do some “creative accounting.” If the trafficking is successful, the criminal entrepreneurs would return the money and even share some profit with the businessmen, thus making the ties between two parties even stronger. This creates a spiralling engagement since the criminals now have even more compromising information about the businessman. This can go all the way to bankrupting the business. Government officials can also be blackmailed in such ways.

Settlement of payments

The drug market operates mostly in cash. Starting from the small dealers and ending with big traffickers, cash in euros is preferred. Law enforcement experts confirmed that cash operations are the main form of payment. If bought on credit, drugs would cost much more than if the price is paid directly in cash. For example, if a whole kilo of amphetamine is bought it costs €3,000-€3,500, but if paid only after it is sold to end customers the price doubles (EE-E4). With each step down the distribution chain the use of credit increases; for example, “they would give 50 grams on credit and in the evening they would come to collect the price (EE-E5).”

Financing schemes depend on the relationship between the first person in the supply chain and the criminal group owning the drugs. Buying drugs on credit happens among entrepreneurs who have high degree of trust among themselves – **trusted criminal partners could get up to 50 kilos on credit**. Usually, however, “they would pay half price in advance (in cash); when the drugs are ready for shipment they would pay the rest of the money (EE-E5).” Another arrangement is to pay the whole sum in advance and then bear the distribution risks. Sometimes, the distributor would pay the amount and then would be informed where to go to pick up the merchandise.

Sometimes payments are made either in goods or in services. According to EE-C3, sometimes customers offer stolen goods or gold or other

valuables. He suggested that on occasion the amount of cash could be too big and he remembers going around with two bags full of cash (although the €500 banknotes solve this problem). Therefore, certain valuables (e.g. diamonds) would be also acceptable although to sell these further would be too risky.

Drugs can also be exchanged for services, for example, providing couriers for trafficking or providing information from stolen credit cards. Couriers would be paid but at least the buyer finds the ones who are willing to risk. "For example, a supplier gives a kilo of cocaine and gets 5 couriers for it (EE-E5)."

When drugs are bought on credit, the payment deadlines are quite short. In the case of small-scale retailers when the sums of money are not so large, the sanctions for not meeting the deadline may be quite mild. For example, if EE-C1 would not get paid for the drugs he provided he would just avoid any further business with that person; no violence would be used.

In case the criminal is arrested and cannot pay the money back, an interest rate would be charged for the duration of the prison time, although there could be an agreement for a certain interest-free period (EE-E6).

When something goes wrong with a sizeable shipment and the courier or the organiser of the shipment cannot return money to the person/group who financed the drug trafficking operation, various sanctions may be applied. It starts with financial sanctions – a high interest rate would be added to the initial debt and a new, rather short deadline set. If it is breached, the person would be threatened or violence would be used against him/her; on rare occasions the violence goes to extremes. Sometimes the issue would be settled by a mediator (usually a criminal authority) who decides what sum of money shall be paid (EE-E5).

The typical interest rate is around 20% for the operation but there have been some very high interests charged – 10% or 15% a day. The large loans are usually guaranteed by a surety and it is the surety, not the creditor who ensures that the debtor pays. The surety can choose to receive valuables from the debtor but would then have to sell them for cash to pay the creditor (EE-E5).

Criminals' mutual fund

Criminals' mutual fund or "obschak" ("ühiskassa" in Estonian) is a phenomenon in the Estonian criminal world that deserves special attention. The word obschak comes from Russian and means "common cashbox" and is related to the criminal subculture in Russia, namely to the so-called "thieves-in-law", a phenomenon that emerged in the middle of the 20th century. Obschak "governs the criminal community based on a functional-territorial principle. The obschak has a designated person in charge of a specific spectrum of criminal activity, as well as for a certain territory of operations. These persons collect taxes from the

individuals and businesses which are under organised crime protection.”²⁶⁴ Kostjukovskii²⁶⁵ defines *obschak* as a common till; today, it is often just a bank account or a fund, sometimes even legally registered as a business company. Money from the fund goes to support imprisoned criminals and their families, and also to expand the criminal enterprise.

“What distinguishes Estonia from other [European countries] is that we have the influence of Russian organised crime. Starting with the *obschak* and all other things associated with it – criminal codes of conduct, etc. This influence is smaller than in Latvia but it is still tangible. The further we go into the west of Europe, the less we see of it (EE-E6).”

As far as Estonia is concerned, “a unique situation in the Baltic Sea region has formed where the nucleus of the underworld is one person surrounded by a dozen persons belonging to his immediate circle... [The leader] solves disputes, usually making sure that both parties are happy and that [mutual fund] is also happy. ... With money from this fund, current expenses and lawyers’ fees are paid and those in prison are helped.”²⁶⁶

The mutual fund in Estonia differs from the *obschak* in Russia in the functions it performs. From the end of the 1980s, when the organised criminal groups from Russia (e.g. Solncevo group, Kemerovo group, Krasnodar group) came to Estonia, the mutual fund was not only a form of insurance. The mutual fund in Estonia was also a regulatory mechanism of the criminal underworld – it was a kind of “round table” or a criminal council rather than simply a cash till or monetary fund. The leader of the mutual fund played role of criminal’s world moral authority, judge and mediator. The disputes between groups and spheres of influence were settled by the leader of the mutual fund. In the 1990s, the mutual fund already played an important role in the architecture of organised crime in Estonia.

According to law enforcement interviewees, today the position of the mutual fund has changed. Although those who some years ago came from Russian prisons and established a criminal hierarchy are still around, they are in their 60s and their influence is declining. There is no longer an undisputed criminal authority, as the criminal world is very much fragmented and the new generation of criminals do not find this organisation useful. Experts were also sceptical about the extent to which the mutual fund is invested in the organisation of crimes, particularly drug trafficking. It is possible that some money goes to the organisation of trafficking but its share of the market is not significant. It is also questionable to what extent the mutual fund fulfils its main function – financial support of imprisoned criminals and their families.

²⁶⁴ S. Cheloukhine, “The Roots of Russian Organised Crime: From Old-Fashioned Professionals to the Organized Criminal Groups of Today”, *Crime, Law and Social Change* 50, no. 353-374 (2008): 360.

²⁶⁵ Kostjukovskii, Y. *Организованная преступность в России на примере Санкт-Петербурга [Organised Crime in Russia: The St. Petersburg Case]*, 2000, <http://www.narcom.ru/publ/info/542>

²⁶⁶ R. Pullat, “Criminal Hierarchical Structures: Models of Organised Crime in the Baltic Sea Region”, *SIAC-Journal – Zeitschrift Für Polizeiwissenschaft Und Polizeiliche Praxis* 2 (2009): 24-30.

The influence and role of the mutual fund in those matters is declining. An important function of the mutual fund that has been maintained is dispute settlement as it is the service that criminals or criminal organisations are willing to pay for.

Costs of doing business

A significant expense in drug trafficking is incurred by transportation and couriers – vehicle purchase or rent, airplane tickets, hotels, etc. EE-C3, for example, claims that car maintenance and petrol were notable costs for business. He also mentioned paying sums of money to other criminals for a version of the protection racket: a fee for being “left alone.” Such payments to criminal authorities are among the costs related to the drug business. This is why “at some point quite a few [solo entrepreneurs] join some criminal group, because they need some kind of security (EE-E4).” As for more established groups, they “need to share some of their profit just for the opportunity to run their business[...] This share is not very big, up to 10% (EE-E7).”

Experts estimate that some money is paid to the mutual fund as well. Few pay on a regular basis, others only when a dispute needs to be settled.

Another cost of doing this kind of business is corruption. EE-C3 who trafficked big shipments of hashish to Russia mentioned corruption in Russia being the main expense: “You need to pay everyone there.”

Profits and profit sharing

Criminal entrepreneurs operating on the lower level of the hierarchy claim they make €2,000-3,000 per month. An entrepreneur dealing in fentanyl mentioned that income was enough to cover everyday expenses.

“There was this group in which the organiser was from Estonia (he was the ‘brains’), the money handler was from Lithuania, the customer was from Russia and the one who prepared the shipment was in the Netherlands. They earned between €20,000 and €50,000 per month. [...] 100 kilos [of drugs in Morocco], costs around €35,000. If shipped to Russia, it would fetch €140,000-150,000. If transportation costs are deducted, this brings about €100,000 in profit. The initial €35,000 is not very difficult to raise for groups or larger scale entrepreneurs. The solo entrepreneurs cannot invest this kind of money. Thus, they are trying to get the drugs on credit, or they are trying to cut the stuff – buying 90% cocaine and trying to make it 10%. By bringing in 100 grams and cutting it to 300-400 grams, they could get €10-15,000 profit (EE-E7).”

When shipments are organised by Estonian criminals but go from the Netherlands or Spain to the Scandinavian countries or Russia, the only profit that stays in Estonia is the facilitation fee. “Some couriers’ fees or

facilitators' fees are €50,000-€100,000 only. The big money goes back to Western Europe.

"While the majority of criminals are in it for the expected lifestyle enhancement (expensive cars, jewellery, etc.), some criminal entrepreneurs sought to invest their profits in legal businesses. "When we had here the financial boom, construction and so on, bigger drug criminals become involved in the construction business and invested all their money there (EE-E7)."

Since today the profits are not particularly large and mainly spent on a lifestyle, not much money laundering is involved. Neither the experts, nor the interviewed criminal entrepreneurs considered this topic important. According to the head of the Financial Investigation Unit, the share of drug related crimes in the whole load of their work is insignificant.

Access to capital in critical moments

Access to capital in critical moments does not generally differ from the general financing mechanisms of drug trafficking. According to law enforcement experts, the sources of credit for drug shipments could be either a criminal group with significant cash flow or loan sharks. The number of loan sharks in Estonia is not exactly known but experts estimate it to be few dozens of people. These operate at all levels: "while one can get a €30,000 credit from bigger loan sharks, smaller operators lend, for example, €500 and want €700 back in a week (EE-E5)." Some are in this business because they do not want to get involved in crimes but make a profit by financing it.

The procedures of taking credit from such a "criminal bank" are actually very similar to the procedure of getting credit from a legal bank. Once a criminal has an idea about a criminal operation, he presents this idea to the creditor who then decides whether the idea is feasible, what the risks are, etc. "There are those who would like to know every detail of the plan – what will be done and how it will be done. Everything should be described in the details and then this project will be evaluated – whether it is profitable and workable. Then there are creditors who just give the borrower a deadline; if he misses the deadline, he pays an additional 20% a month. This kind of creditor does not care where the money goes (EE-E5)."

A criminal usually turns to a criminal group or illegal banker only if they already know each other from previous operations. If a person is looking for a loan for the first time or if the creditor and the criminal entrepreneur do not know each other, they need a facilitator. This facilitator plays the role of a surety. His task is to bring the donor and the recipient together, and guarantee the deal. If something goes wrong with the credit, the surety is responsible that the donor receives his money back. It is he who communicates with the recipient and collects money if something goes wrong. In other words, the illegal credit system operates very similar to its legal counterpart.

Loan sharks have been known to use signed contracts with the borrowers, even notary certified. Contracts contain quite harsh conditions, including mortgaging the debtor's property or a fine of up to €1,000 if the payment is late or the debtor is out of reach (EE-E7).

4.5. SPAIN: SOUTH AMERICAN CONNECTION

Introduction

Cocaine trafficking is one of the most developed illegal markets in Spain. Its expansion began in the 1980s when Galician groups (specialists in the illicit tobacco trade) redirected their activities to cocaine trafficking. At the time, Colombian criminal entrepreneurs wanted to bring their merchandise to the European market and Spain was considered the best place to start. A number of factors facilitated the Colombian alliance with Spanish organised groups: similar culture and language, Spain's geographical position in Europe and the experience of Galician groups in other types of contraband (tobacco and other products).²⁶⁷

Organised crime groups based in Galicia had vast experience navigating in the North-Western coast of Spain and most had legal infrastructures in the fishing industry. That expertise and foundations were a useful platform to help Colombian importers transport cocaine. Conversely, Colombians needed Spain to enter the European market and the alliance was necessary to start the illegal trade. That is how Galician organised crime groups became specialised in the transportation from open sea to the coast. Colombians paid 50% in cash and 50% in kind (ES-E4), which the Galician groups would sell directly at the local market (ES-E2).

Spain has traditionally been an important European entry point from countries of origin (Colombia, Peru and Bolivia). From 1990 to 2000, Spain was the most important transit point in the European cocaine market due to the alliances with producer countries. However, in recent years, the situation has changed considerably due to a number of factors:

- Colombians and other South American organised crime groups have established **stable infrastructures in Europe and Spain**, thus the relationship with Spanish groups is no longer of the essence.
- The **routes and means of transportation of cocaine have diversified**, which has led to a reduction in the quantity of the substance arriving at the Galician coast. It is currently more common to use containers arriving at the main Spanish ports of Algeciras, Valencia and Barcelona, and other alternative routes with other key points of transit.
- Policies have been introduced which reinforced the fight against organised crime, especially drug and human trafficking. This reinforcement (by sea and land) has led to a decrease in the amount

²⁶⁷ L. De la Corte and A. Giménez-Salinas, *Crimen.org. Explicación y claves de la delincuencia organizada [Crimen.org. Explanation and Keys of Organised Crime]* (Barcelona: Ariel, 2010).

of cocaine passing through Spain, generating two more prominent **alternative routes as a result of the stricter supervision by the Spanish authorities**: through the countries in Western Africa, such as Guinea Bissau and Senegal, Nigeria and Ghana, and Mali and Mauritania (African organised crime groups have increased their transit infrastructures and international contacts in the last decade); direct transportation by air or sea to the countries of destination.²⁶⁸

The consumption of cocaine in the two major cocaine markets – North America and Western and Central Europe – decreased between 2010 and 2011, but these markets together represented approximately half of the number of cocaine users globally. Spain has the highest consumption rate on the continent and it has also been the European country with the highest number of seizures since 2000, followed by Portugal and the Netherlands.²⁶⁹ Nevertheless, there was a decline in seizures in Spain from 50 tonnes in 2003 to 20 tonnes in 2011, and a decrease in annual prevalence of cocaine use from 2007 to 2011 (3% in 2007 to 1.2% in 2011).²⁷⁰

Market overview

In spite of the recent changes, cocaine trafficking is still the most significant illegal market in Spain, according to the volume of organised crime groups detected (around 40% of the total organised crime groups detected by the police every year), the quantity of cocaine seized in Spain (an average of 40 tonnes per year, from 2006 and 2012²⁷¹), the amount of money laundered by organised crime groups and the substances seized by the police.²⁷² It is also the illegal market with the most sophisticated means and one that creates most collateral crime such as violence, money laundering, local corruption, etc.

According to data published by the Spanish Ministry of Interior in March 2013, drug trafficking generated €15.7 million in income per day, i.e. around €5,717 million per year. 27% of the organised crime groups detected in Spain in 2012 were involved in cocaine trafficking.²⁷³

Market structure and actors

In cocaine trafficking, the most relevant groups are from Colombia; they ship the cocaine from Venezuela, Argentina, Brazil or the Caribbean countries. Colombians were traditionally in charge of production, Venezuelans of transport and the Spanish organised crime groups specialised in transportation to the coast. Nowadays, things have changed and Colombians are well positioned in Spain to control the global supply chain.

²⁶⁸ UNODC, *The Globalization of Crime. A Transnational Organised Crime Threat Assessment* (Vienna, 2010); Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment* (The Hague: Europol, 2013); Europol, *EU Organised Crime Threat Assessment* (The Hague: Europol, 2011).

²⁶⁹ UNODC, *World Drug Report 2013*, 43.

²⁷⁰ *Ibid.*, 44.

²⁷¹ UNODC, *World Drug Report 2013*; UNODC, *World Drug Report 2014* (Vienna, 2014).

²⁷² Data from unpublished reports of the Ministry of Interior regarding organised crime.

²⁷³ RTVE, "El tráfico de drogas genera en España 15,7 millones de euros de beneficios al día [Drug Trafficking in Spain Generates €15.7 million Daily]", RTVE, April 18, 2013.

Several years ago, large Colombian importers were capable of managing the supply chain from the location of origin to the place of destination. Today, the illegal market is fragmented and there are many small groups throughout the business: importers, wholesalers, transporters, dealers by land, distributors, retailers, etc.²⁷⁴

Retailers represent 60% of the cocaine traffickers detected by the police. They acquire the cocaine from local wholesalers to be sold to the final consumer. In some cases, cocaine is acquired by stealing it from other traffickers. Some of them have direct contact with South American importers, thus they can acquire cocaine directly from them and send it to Spain by post or personal couriers.

Wholesalers represent around 5% of the cocaine traffickers detected by the police in Spain. They supply large amounts of cocaine to Spanish or European groups (the Netherlands, the United Kingdom or France) to be distributed in the local market.

Importers are around 35% of the cocaine traffickers detected. They introduce vast amounts of cocaine in Spain directly from producer countries:

- by sea through other South American countries or transit countries (containers or to the Galician coast);
- by air from South American countries or intermediary countries to Spain;
- by air through personal couriers or post.

Importers have generally been Colombian, which is the second most prevalent nationality in organised crime groups detected in Spain (30%), following the Spanish nationality (70%).²⁷⁵ Regarding the number of individuals apprehended by the police, Colombians represent 10% and Spanish 40%. Intermediaries and distributors are also usually Colombian or Spanish, with the number of Mexicans on the increase. Recently, several large operations have revealed the Mexicans as main importers of cocaine into Spain.

Legitimate companies can be useful in the cocaine business to conceal the transport or other illegal activities and to launder the criminal income. The following are the most common methods of using legitimate companies:

- Using a **front company** (i.e. export and import companies) owned by the criminal group at the locations of origin (Colombia or a transit country) and of destination. Small groups create small companies or use outsourcing methods to develop auxiliary services (transport, money transfers, etc.).

²⁷⁴ L. Giménez-Salinas et al., "The Profile of a Sample of Criminal Organisations in Spain during the Last Decade", in *Human Dimensions in Organised Crime, Money Laundering and Corruption*, ed. P. C. Van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2013), 121-48.

²⁷⁵ These figures may exceed 100% because some organised crime groups may be ethnically diverse (data from the Ministry of Interior).

- Establishing a **new company**. The cost of incorporating a company is around €3,000 and the sellers provide support and assistance to change the management, to substitute shareholders, etc. Nevertheless, these new businesses are less common when cocaine is transported from South America to Spain. The lack of track record of a new company can raise suspicion in borders or ports.
- Using **legitimate companies in difficulty**, the owners of which can provide a safe cover for traffickers. Colombians or producers have their own companies and have recruiters to find business people with financial problems and in vulnerable situations. In these cases, it is harder for the police to detect the connection with drug traffickers.

As regards the means of transportation, the typical interchange at open sea is by using fishing boats. Under this procedure, groups from Galicia have traditionally been in charge of cocaine transportation from open sea to the Spanish coast. They have fishing licenses and use them to conceal their illegal activity. In the case of transport by containers, the “rip-on/rip-off” method is applied which involves the use of an import-export company that is unaware of the transportation. This method is applicable when the criminal organisation has a major contact in the ports of origin and destination that can introduce the cocaine in the port of origin and take it out of the container (rip it off) when it arrives at the port of destination. The method has been subject to an intense seven-phase investigation in Spain involving port workers. It is also used to send the illicit revenue back to the country of origin.

Financing and financial management

According to the interviewees, the amount needed to start a business in cocaine trafficking is not significant. The usual way to initiate is to start gradually, by dealing in small amounts of cocaine. It is also common when large sums are needed, to create a pool where some criminal entrepreneurs invest small amounts to pay for transportation and importers to send the cocaine to Spain. It is exceptional to use loans or sizeable investments; sometimes credit is extended in the form of a small amount of cocaine, which allows the person to enter trafficking.

Sources of capital for criminal operations. Profile of financiers in criminal operations

There are a number of ways in which criminal operations in cocaine trafficking are launched. **Relationships of trust** among members of the same family, friends or professional colleagues with the big importers from Colombia can be the starting point. Such relationships resulting from previous business relations can offer an opportunity to request an amount of cocaine to make sufficient money for starting a trafficking business. For the traffickers from Colombia the product has no value until it enters Europe. An advance in the form of a small amount of cocaine to provide an opportunity to start trafficking is not a problem for these criminal entrepreneurs. Trust is a very important starting condition because it is difficult to enter the market without a business patron or financier. Cocaine is mostly paid for in advance, so it is necessary

to have money for transportation and to pay intermediaries. When a relationship of trust is established the product can be obtained and paid for when the deal is concluded.

Another way to develop a cocaine business is from the bottom up. Some members of a group start by selling small amounts of cocaine, and gradually begin to import cocaine directly from South America. Initial funds could derive from legal sources or even public funding. In one particular case, the Guardia Civil came across a criminal group that applied for funding from the European Commission to run fishing farms in Morocco and once they received the funds, they moved into cocaine trafficking.

As mentioned above, in exceptional cases managers of legitimate businesses going through difficult economic times and in need of money get involved in drug trafficking to salvage their companies. Civil servants have also been known to move into organised crime, such as Don Lucho, a member of the Colombian intelligence service who became the leader of a criminal organisation.

The sources of capital to start criminal operations differ for importers, wholesalers and final retailers.

Importers. As mentioned above, previously Colombian traffickers used to pay 50% in cash and 50% in kind; the situation is completely different now, with each illegal organisation using its own income to fund its business. Colombians and other South American groups are the most powerful organisations financially, having the capacity to fund or invest in other types of legal and illegal markets. They have their own infrastructures and their own money to be laundered or invested. They tend to use their own members to collect the money, but then use specialised organisations to send the illegal income from Spain to Colombia using various methods (more on this in the following section).

Wholesalers. The investigations by the Spanish authorities reveal that the wholesalers do not have the financial capacity to make large investments. They provide logistics or transportation for a share of the smuggled drugs. If they send money to Colombia, they usually divert part of it to make arrange a boat or for other logistical purposes. The revenue is used to fund the next deal.

The wholesalers sometimes create cooperatives. These are not created during the first phase of the business but when a business is already under way. Spanish wholesalers who have contacts in Colombia or another country of origin usually try to set up cooperatives. If they are sure they have a client to whom to sell the amount of cocaine offered, they use a cooperative to share the expenses of sending the cocaine to Spain.

Retailers. Their funds derive from income earned, except when they have relationships of trust with importers guaranteeing that they can borrow some amount of cocaine.

Settlement of payments

Payment arrangements are typically upfront; exceptionally, when there is a relationship of trust, some groups may receive cocaine on credit and pay after they sell it. In such cases, as a precaution against default, a representative of the creditor could visit the borrowers home to “get to know” his/her family or a member of the borrowers group could be held as collateral. In case of small amounts of drugs coming by air, the money is usually paid using money transfer companies.

Payments are made in cash or in kind (drugs or other products). Transporters (Galician dealers) are paid usually with drugs to be sold in Spain to distributors. Payments in cash are always managed by the criminal organisations and then the money laundering is outsourced to organisations specialised in sending criminal proceeds to the countries of origin, compensating illegal funds or creating new companies. Colombian organisations usually contact money launderers in Colombia and issue instructions on how to proceed.

The most common ways of payments and money laundering in the cocaine trafficking market are the following:

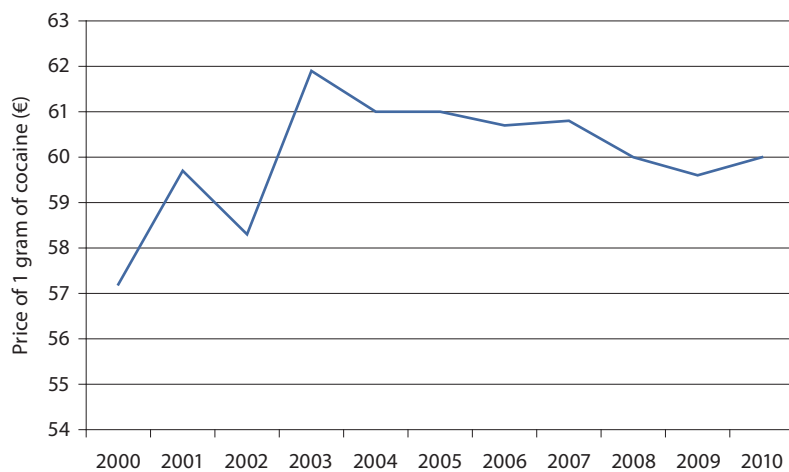
- Transfer of money by means of **personal couriers** and by transit (containers, etc.) as with any other type of commodity.
- **Money transfer companies** (Western Union, etc.) or call box. Those systems are used by organised crime members to send personal money to their families. Large criminal organisations move large amounts of money when they have extensive networks in Spain and Colombia. Groups specialising in this type of transfer on a larger scale use fake identities and contacts at locations of origin and destination.
- **Compensation-type money transfers.** A typical compensation system is the hawala which involves two intermediaries (hawaladars) at the locations of origin and destination. Colombians and Spanish cocaine traffickers use hawala for moving money, in many different ways. Under this type of system, if a person in one country wishes to send an amount of money to a person in another country, the transfer is made through intermediaries in each country in order to avoid traceability. In country A, the intermediary receives the money from person A, and in the country of destination the money is sent to person B by the intermediary in that country. The money is then exchanged between intermediaries.

Currently there are other compensation systems that use goods rather than money. These are more complex because the intermediary of the broker needs to use the services of a businessperson in the country in which the import-export activities take place. There are many ways to do this, but the most common when a broker who works for cocaine traffickers offers to pay the invoices of a legitimate company (for merchandise) with a reduction on the actual price. The drug broker settles the invoices using money coming from drug dealers and the company pays the broker the price including a reduction on the amount

to be paid for the merchandise. There are brokers all over the world that search for legitimate companies to repatriate illegal funds from destination countries.

Costs of doing business

FIGURE 17. DYNAMICS OF PRICES OF COCAINE IN SPAIN, 2000 – 2010



Source: Observatorio Español sobre la Droga y las Toxicomanías, *Situación y tendencias de los problemas de drogas en España*, 210.

Information on the expenses involved in cocaine trafficking is difficult to come by, although there are some indicators at certain stages of the business. Shipment costs, for example, vary considerably depending on mode of transportation, amount of drugs, distance, etc. According to the National Drugs Plan, the average **prices of the various volumes of cocaine are:**

- 1 kg of cocaine at source country: €6,000.
- 1 kg of cocaine in Spain: €32,000-€34,000.
- 1 gram in retail: €60.²⁷⁶

As expected, each intermediary involved in bringing the products to Spain generates an

added cost on the initial price. Figure 17 shows the evolution of prices of 1 gram of cocaine from 2000 to 2010. There has been a stabilisation of prices since 2005.

Profits and profit sharing

Information concerning profit sharing is not available. In general, traffickers and wholesalers invest in Spain using the following methods:

- Small financiers or retailers seek to create legitimate companies to conceal their activities.
- Large groups of traffickers have the following laundering strategies:
 - using legitimate companies to mix legal and illicit money;
 - using fake purchasing contracts;
 - using front men or lawyers in some companies;
 - using insolvent companies to launder money by giving them a loan to be paid by employees' salaries;
 - purchasing art and/or jewellery;

²⁷⁶ Observatorio Español sobre la Droga y las Toxicomanías, *Situación y tendencias de los problemas de drogas en España*, (Madrid, 2011).

- using failing businesses;
- using contracts with compensation clauses.

The most powerful groups of Colombians send the illicit money back to Colombia, which is then invested in companies in Spain following complex procedures and interposed companies, such as fake products, gold mines, etc.

Access to capital in critical moments and loan sharking

Organised crime groups often take advantage of critical situations to introduce legitimate partners into the business, which enables them to conceal transportation, to launder money and to cover up other illegal activities. If drug dealers need money, other members can help providing merchandise (cocaine) if they have a good relationship based on trust. At times it suffices to wait for the drugs to be sold and the amounts received from the deal are used to pay for the merchandise acquired. Because of that payments are usually done in advance or organisations always take security measures in order to assure payment (kidnapping, information about family, properties, etc.).

Organised crime groups of considerable financial capacity are always seeking companies or businesspersons in critical situations to offer loans in exchange for a favour: transport cocaine or money, launder money, etc. These groups have experts in finding and recruiting vulnerable companies or managers and offering them a way out of their difficult predicament.

4.6. FRANCE: CANNABIS REVENUE – MAJOR SOURCE OF FINANCING OF COCAINE TRAFFICKING

Introduction

France is an important consumption country but also a transit area for illicit drugs smuggled to the Netherlands, Belgium, the United Kingdom and Italy. As in most of the European countries, cannabis – herbal and resin – is the most widely available and accessible illicit substance. Herbal cannabis is the only drug produced directly in France, mainly by private individuals on a small scale, even if lately, an increasing involvement of criminal circles has been observed. However, cross-border trading of herbal cannabis from Belgium and the Netherlands is also reported.²⁷⁷

Cannabis resin on the other hand originates generally from Morocco and enters France through Spain. This market is today less dynamic: it is indeed highly impacted by the competition coming from herbal cannabis, domestic or imported one, but also by the increasing effectiveness of law enforcement operations. These two phenomena have huge implications on the costs which are growing and lead to a reduction of the profitability

²⁷⁷ EMCDDA, *European Drug Report 2014. Trends and Developments*.

of trafficking operations. Cannabis resin remains the main drug trafficked in France, even if some of the traditional cannabis resin trafficking groups are refocusing their activity on more profitable operations, such as dealing cocaine.

While contacts with the OCGs controlling cocaine production are not so straightforward, it is possible for French wholesalers to have direct connections with resin or herbal cannabis's producers. As resin production is located in Morocco, geographical and ethnic ties do exist with transnational wholesalers and avoid multiple intermediates to buy the product. And with cannabis herbal production increasingly located in Europe, a new world of opportunity will certainly change the economy of cannabis in Europe.

On the other hand, with the increase of cocaine consumption in France in the last 10 years, more small traffickers decide nowadays to shift to **trafficking cocaine using their cannabis profits**: it is indeed now very frequent to find cocaine in drug market places which used to be exclusively dedicated to cannabis business. The spread²⁷⁸ of cocaine consumption is now followed by a kind of democratisation of the cocaine retail marketplace.

Cocaine enters France directly from South America, lately from West Africa via sea routes or by courier from Belgium, the Netherlands and Spain. French overseas departments (Caribbean islands and French Guyana) are the main roads to import cocaine in Europe.

Cocaine circulates in two chemical forms: salt (hydrochloride) and base ("crack" or "freebase") forms. With regard to synthetic stimulants, they are mainly smuggled from Belgium, the Netherlands or Germany, though only in small amounts.

In 2010, a total of 157,341 drug-related offences were reported, 87.5% of those being cannabis-related, 6.8% heroin-related and 4.1% cocaine-related. A record number of 131,000 cannabis plants were seized in 2012. Cannabis resin has been decreasing since 2004, and the upward trend observed for herbal cannabis in 2010 – 2011 seems to have ended in 2012. The amount of cocaine seized in 2012 (5.6 tonnes) has also decreased compared to 2011 when a record 10.8 tonnes were seized.²⁷⁹

General population surveys²⁸⁰ carried out in France indicate that cannabis remains the most widely used illicit drug. Despite an increase in lifetime prevalence rates for cannabis amongst people aged 15-64 years old from 22.5% in 2000 to 32.1% in 2010, cannabis usage during the last year and last month has remained stable – 8.4% in 2000 and 2010 for last year, and 4.3% in 2000 compared to 4.6% in 2010 for last month.

²⁷⁸ As the increase of consumption prevalence after 2000 is impacting more middle and lower classes and youth (observed by the French Monitoring Centre for Drugs and Drug Addiction).

²⁷⁹ Direction centrale de la Police judiciaire [French national judicial police], *L'état des drogues en France 2013 [The State of Drugs in France 2013]* (unpublished, 2013).

²⁸⁰ Reitox National Focal Point-France, *2012 National Report (2011 Data) to the EMCDDA: France*, 2012.

Cocaine is the second most widely used illicit drug, with a lifetime prevalence of 3.7% in 2010 and its penetration has increased from 1.6% in 2000. Unlike cannabis, last year prevalence also indicates an upward trend (0.2% in 2000; 0.6% in 2005; 0.9% in 2010).²⁸¹

Among young people, the prevalence of cannabis and cocaine usage is much higher. In 2010, 45.1% of 15-34 years old people had consumed cannabis at least once in their life versus 6.0% for cocaine. For the same age group, last year prevalence was reported to be 17.5% for cannabis, 1.9% for cocaine and less than 1% for other illicit substances. Last month cannabis use for this age group was 9.8%.²⁸²

According to a European School Survey Project on Alcohol and Other Drugs (ESPAD) study conducted in 2011, 39% of young people aged 15-16 years have tried marijuana or hashish at least once in their lifetime (31% in 2007). Lifetime prevalence was 12% for inhalant use (same rate as in 2007) and 4% for cocaine (5% in 2007). The results indicated 35% penetration for last year cannabis usage and 24% for last month. Although lifetime prevalence of cannabis usage was the same for male and female students, male students slightly more frequently reported recent use of cannabis.²⁸³

Some data on drug use in recreational settings exists and indicates high consumption of cocaine powder in large dance events.

Market overview and prices

In France, the volume of annual cocaine market is estimated at around €800 million²⁸⁴ and €1 billion for the illicit cannabis market but such estimates need to be approached cautiously. A new evaluation of the value of the French illicit drug market is currently under elaboration.²⁸⁵

French cannabis and cocaine prices show that there are two very different business models. In the cannabis economic model, prices are in constant evolution. This phenomenon started in the mid-2000s when the Moroccan resin producers and retailers were struggling with herbal products competition in Europe.²⁸⁶

Retail prices for cannabis strongly increased between 2006 and 2013 with a 20% growth observed for both herbal and resin cannabis. At the wholesale level, only the herbal cannabis prices had been increasing (around 50% growth from 2006).

²⁸¹ OFDT, *Drugs, Key Data 2013* (5th edition, 2013).

²⁸² Ibid.

²⁸³ Ibid.

²⁸⁴ C. Ben Lakhdar, *La culture du cannabis en France: implications, volume et qualité estimés [Cannabis Cultivation in France: Implications, Volume and Quality Estimated]* (OFDT, 2009).

²⁸⁵ N. Lalam and D. Weinberger, *L'argent de la drogue [Drug money in France]*, (INHES), forthcoming.

²⁸⁶ C. Ben Lakhdar and D. Weinberger, "Du marché du cannabis au marché du THC en France. Implications pour le système d'offre et les politiques de lutte [From Cannabis Market to THC Market: Effects on Supply System and Public Policies]", *Revue Française de Socio-Economie [French Journal of Socio-Economy]* 7, no. 1 (2011): 125-47.

TABLE 20. CANNABIS PRODUCTS AND COCAINE PRICES IN FRANCE IN 2013 (€/GRAM)

	Retail prices	Wholesale prices	Import prices
Herbal cannabis	7-10 (8.5*)	4.5-7 (5*)	3-5 (4*)
Resin	5-8 (6*)	3-4 (3.5*)	2-2.7 (2.25*)
Cocaine	60-75 (65*)	35-50 (40*)	25-35 (30*)

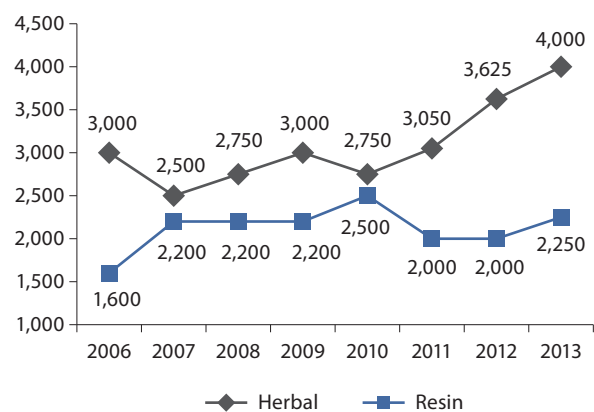
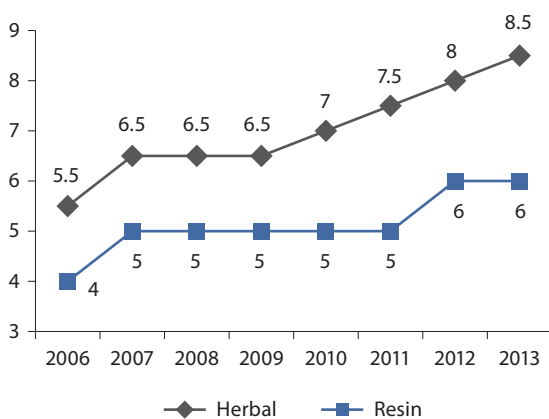
* median price.

Source: Office central de lutte contre le trafic illicite de stupéfiants (OCRTIS) [Central Directorate of Judicial Police], 2014.

To preserve the market share of Moroccan resin in France, cannabis producers had to improve significantly the quality of their product and had to obtain a better productivity with the same or a reduced amount of land plots to cultivate the plants.²⁸⁷ As a result, they had to invest in new cannabis varieties and to use intensive agricultural methods.

The difference between prices of herbal and resin cannabis grows more rapidly for wholesale than for retail, which indicates that it is much more profitable to sell cannabis resin than herb in France (Figure 18). Interviews confirm that OCGs specialised in Moroccan resin intend to propose in the future a very attractive resin to resist what was called “the green avalanche” in Europe.²⁸⁸

FIGURE 18. THE EVOLUTION OF RETAIL AND WHOLESALE CANNABIS PRICES IN FRANCE, 2006 – 2013



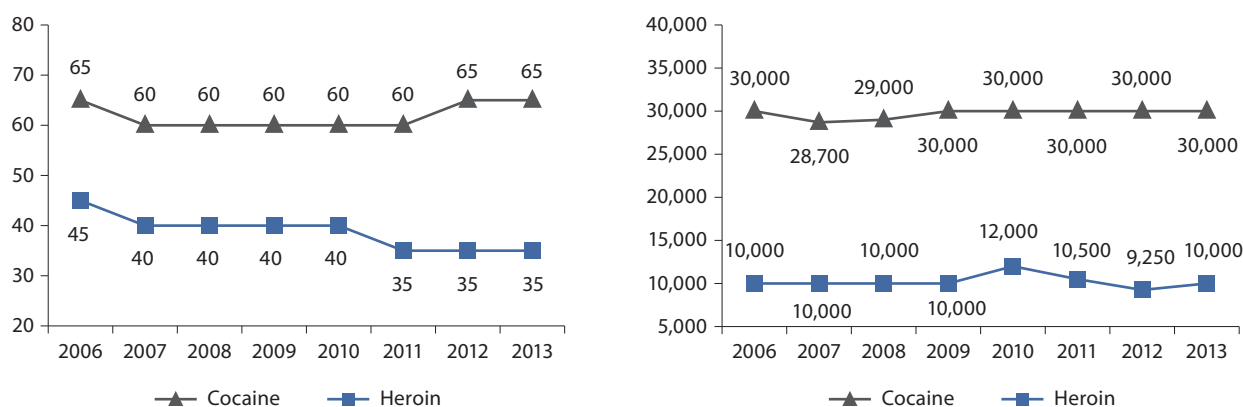
Source: Office central de lutte contre le trafic illicite de stupéfiants (OCRTIS) [Central Directorate of Judicial Police], 2014.

²⁸⁷ P. A. Chouvy and K. Afsahi, “Hashish Revival in Morocco”, *International Journal of Drug Policy* 25, no. 3 (2014): 416-23.

²⁸⁸ A.C.M. Jansen, “The economics of cannabis-cultivation in Europe”. Paper presented at the 2nd European Conference on Drug Trafficking and Law Enforcement. Paris, September 26-27, 2002.

In contrast, the retail prices of cocaine in France are stable and the changing variable is higher quality production (Figure 19). In order to adapt prices with supply and demand, the illicit market for cocaine prefers to adapt the share of cutting products than change the price.

FIGURE 19. THE EVOLUTION OF RETAIL AND WHOLESALE COCAINE AND HEROIN PRICES IN FRANCE, 2006 – 2013



Source: Office central de lutte contre le trafic illicite de stupéfiants (OCCRTIS), Central Directorate of Judicial Police, 2014.

Prices and purity

To better understand the structure of the illicit economy of cannabis and cocaine, price analysis is insufficient, but an analysis of the price data together with percentage of purity of the products is required.

TABLE 21. RETAIL AND WHOLESALE HERBAL CANNABIS PRICES AND PURITY IN FRANCE (2010 – 2013)

Herbal cannabis, retail	2010	2011	2012	2013	2010/2013
retail price (gram/€)	7	7.5	8	8.5	+21.4%
median purity per gram (%THC)	9	6.0	10	10	+11.1%
Herbal cannabis, wholesale					
wholesale price (gram/€)	2,750	3,050	3,625	4,000	+45.45%
median purity per gram (%THC)	11	12	15	15	+36.36%

Source: Office central de lutte contre le trafic illicite de stupéfiants (OCCRTIS) [Central Directorate of Judicial Police], 2014.

The average wholesale herbal price shows a significant increase since 2010, while the average retail price has been increasing also but at a slower pace (+21.4%). This indicates that the wholesalers are the ones who make a lot of money with the herbal cannabis products. At the retail level, it is much more complicated to obtain significant profits. This

result suggests that French illicit cannabis market's profit is important at the wholesale level and weak at the retail level.

TABLE 22. RETAIL AND WHOLESALE RESIN CANNABIS PRICES AND PURITY IN FRANCE (2010 – 2013)

Resin cannabis, retail	2010	2011	2012	2013	2010/2013
retail price (€/gram)	5	5	6	6	20%
median purity per gram (%THC)	10.5	10	20	20	90.5%
Resin cannabis, wholesale					
wholesale price (€/gram)	2,500	2,000	2,000	2,250	-10%
median purity per gram (%THC)	11	13	17	17	+54.6%

Source: Office central de lutte contre le trafic illicite de stupéfiants (OCRTIS) [Central Directorate of Judicial Police] 2014.

Surprisingly, the quality of resin products has significantly improved: 90.5% increase for the THC level between 2010 and 2013 for retail and 55% for wholesale. Compatibilities evidence from judicial cases on cannabis wholesale shows that the cheap quality of resin offers a very weak merge and high level quality resin are much more manageable. However, the majority of the stock sold is from the cheap quality and means that retailers need to sell a lot a quantity to be profitable in the “supermarket model” (see the section below).

TABLE 23. RETAIL COCAINE PRICES AND PURITY IN FRANCE (2006 – 2013)

Cocaine, retail	2006	2007	2008	2009	2010	2011	2012	2013	2006/2013
retail price (€/gram)	65	60	60	60	60	60	65	65	0%
median purity per gram (%)	28.5	21.7	28.6	26.3	28.5	17.8	23.6	46	61%
price index per gram (100% pure)	228	276	210	228	211	337	275	141	-38%

Source: Office central de lutte contre le trafic illicite de stupéfiants (OCRTIS) [Central Directorate of Judicial Police], 2014.

The analysis of the price indexed by kilo could be used as a proxy to estimate the virtual purity of a kilo of cocaine in France: the lower the cost, the purer the cocaine. At the importation wholesale level, there is no variation between the price and the purity: the local wholesaler adjusts the level of cutting to demand.

The reduction of the price between 2006 and 2007 indicates that the cocaine was sold with more cutting products at that period of time

to meet an increasing demand. After 2007, the evolution of the virtual pure price shows that the quantity of pure cocaine in France had been increasing until 2010. After 2010, the repetition of the phenomena (2-3 years cycle) confirms that the transnational wholesalers have the ability to adapt the cocaine offer to local demand.

TABLE 24. WHOLESALE COCAINE PRICES AND PURITY IN FRANCE (2006 – 2013)

Cocaine, wholesale	2006	2007	2008	2009	2010	2011	2012	2013	2006/2013
wholesale price (€/kilo)	30,000	28,700	29,350	30,000	30,000	30,000	30,000	30,000	0%
median purity per kilo (%)	59.8	67.8	65.1	62.4	58.9	61.5	67.8	60	0%
price index per kilo (100% pure)	50,167	42,330	45,084	48,077	50,934	48,780	44,248	50,000	0%

Source: Office central de lutte contre le trafic illicite de stupéfiants (OCRTIS) [Central Directorate of Judicial Police], 2014.

Market structure and actors

The latest (2005) estimate of the value of the annual cannabis market in France puts it at €832 million,²⁸⁹ which makes it the first illicit drug market. With its estimated €800 million a year, cocaine is the second illicit market in France. Because of high retail prices, a growing demand and its ability to be cut, cocaine is perceived as the best value product.

Qualitative data indicate that the French illicit market is divided into two main organisational models: the **network model** and the **supermarket model**.²⁹⁰

Find better customers: the network model

The network model is the one which enables the trafficker's profit to be optimised; to this end, a good network of clients is needed. In Paris, the best model is surely when the drug dealer sells the cannabis in the richest part of the city (centre of town) and buys it in the suburbs. With this model, it is possible to do more than 150% mark-up on the cheapest cannabis resin quality.

In the French urban tradition, the richest population lives in city centres and the poorest in the suburbs: this explains why in a city like Paris, the variation of the cannabis price can be described as a concentric circle. In the suburbs, cannabis prices are cheaper than in the centre of the city because the importers stock the cannabis bought directly from Spain or

²⁸⁹ Ben Lakhdar, *La culture du cannabis en France: Implications, volume et qualité estimés* [Cannabis Cultivation in France: Implications, Volume and Quality Estimated].

²⁹⁰ May and Hough, "Drug Markets and Distribution Systems".

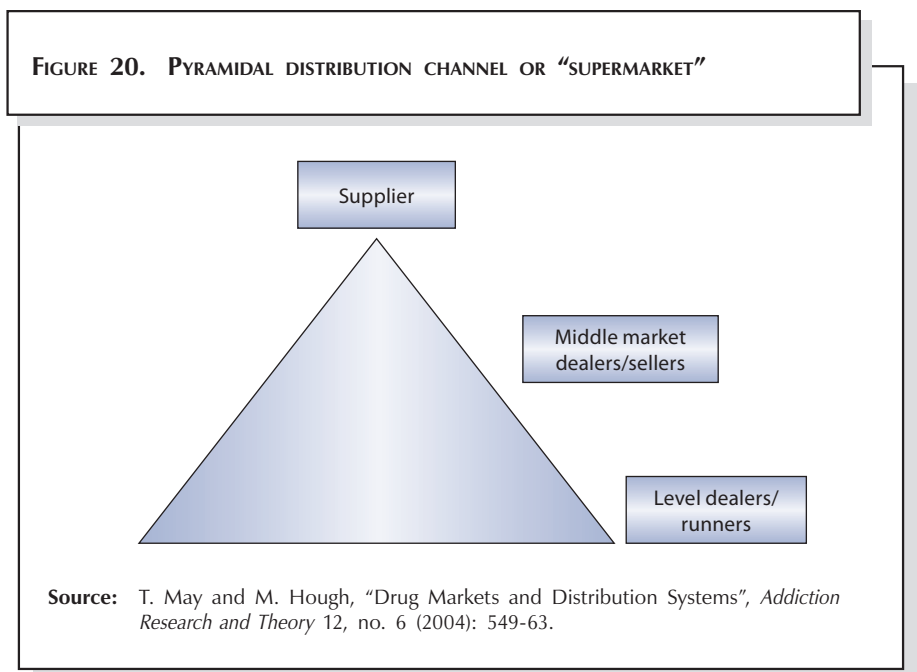
from Morocco. Otherwise, the higher price of retail cannabis is certainly in the centre of the town thanks to the richest customers who prefer to pay a higher price and avoid the risk of buying it on the street.

In theory, one of the best business models is to have access to the best prices in the suburbs and to use a network of customers living in the centre of French cities. In reality, there is a multitude of small drug trafficking agents in relationship one with each other who share the profits. As an example, an individual who knows how to buy at a lower cost in the suburbs will sell to someone living in the centre of the city. The second one will liaison with another player closer to the centre of the circle. The social and geographical proximity to wholesalers is the key factor to obtain good prices and to increase profits.

“When I went to the university, I met a lot of guys asking for cannabis and even cocaine. I understand they were used to pay for the weed around €10 a gram and I saw the opportunity: now, my sellers are in the cité²⁹¹ and I provide weed to the university’s smokers with much more profit” (FR-C1).

This virtual concentric circle shows the mark-up rate – from €3 for a gram in the cité to €6-€10 in the centre of Paris.

Selling volumes: the supermarket model



The other way to obtain higher profits is to sell significant quantities in the cité. As in a licit supermarket, this kind of trafficking is very effective: the large turnover ensures a good profit margin and customers know where to find their dope.

Drug dealers can optimise their profits with the economies of scale: the larger the quantity they buy and sell, the lower the price. Overall, the supermarket business model is more and more used for selling cocaine while the network market used to be the main model.

The importation and wholesale level

Cocaine importation is mainly carried out by sea routes (52% of the 5 tonnes of cocaine seized by the French police in 2012) and specifically

²⁹¹ “Cités” are public housing projects built in the 1950s and 1960s in the suburbs of main French cities, intended for working class and/or immigrants coming from former French colonies such as Algeria, Mali or Senegal.

by containers in important French ports such as Le Havre or Marseille. The two thirds of maritime seizures by French law enforcement confirms that French oversea territories – West Indies and French Guyana – are an important hub for cocaine trafficking.²⁹² Venezuela and the Dominican Republic have been identified as transit countries.

The main shipment method is in containers (hidden in goods like banana or in the structure of the boat) or by private yacht loading up to a tonne of cocaine with 1 or 2 members of the group and 1 or 2 skipper/sailors.

If, in terms of the number of seizures, the major part of the cocaine seized in France is coming by sea, the main part of quantity seized comes by commercial flights in major airports such as Roissy Charles de Gaulle. The most frequent *modus operandi* is through luggage or mules (“*ex corpore*” and “*in corpore*”) and comes directly or via West Africa or South Europe from American destinations like the Dominican Republic. The cocaine is also loaded on private aircrafts which can carry 1 or 2 tonnes directly to France.²⁹³

The way to reach the drug consumption area from European sea ports or airports is overland. A significant part of the cocaine importation for the French market is transiting through major western ports in the Netherlands or Spain and operated by major European OCG. A number of seizures on trucks or vans in the south of France had been sent to Italy or Switzerland.

The retail level

Cannabis comes mainly from Morocco and, increasingly, from France or other European countries.²⁹⁴ It first arrives by sea or air in Spain and then is carried out to France overland. The major importers for the French market are mainly French citizens living in Spain. They organize the importation, stock the product in Spain and sell the resin to French wholesalers. Commercial aviation is also used, mainly for the most expensive cannabis products like balls of 20% THC cannabis (very high quality) with a small size to be hidden in, for example, tomatoes cargo.

The diversification of products

Analysis of the markets in Marseille and Paris shows that some drug dealers can decide to make more money through the diversification of products. Between 2000 and 2005, a significant change has been observed on the French cannabis market involving massive diversification in cannabis products. This diversification consists of offering to consumers varying qualities of resin, some stronger than others and of providing more and

²⁹² Between 2011 and 2012, the French police seized more than two tonnes of cocaine shipped by sea (Direction centrale de la Police judiciaire [French national judicial police], *L'état des drogues en France 2013 [The State of Drugs in France 2013]*).

²⁹³ N. Lalam and D. Weinberger, *Illicit Drug Trafficking Using Small Airfields: An Exploratory Study* (INHES), 2013).

²⁹⁴ D. Weinberger, *Criminal Networks and Indoor Cannabis in Europe: Has the Phenomenon Reached France?, Drugs, International Challenges* (OFDT, 2011).

more herbal cannabis. At the end of the 1990s, the commercial resin was almost exclusive in the French market, while today the majority of the retail cannabis groups sell two different qualities of resin and a least one quality of herbal cannabis. Furthermore, a new trend is appearing in France: cocaine is more and more accessible and it is easy to find it in cannabis marketplaces (this was not the case before 2005). Today, some wholesalers based in Spain can provide both drugs – cannabis and cocaine:

“We don’t have any proof that Spanish wholesalers sell cannabis and cocaine in the same criminal industry but we know there is much more cocaine in Morocco than ever...” (FR-E6).

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

To start a small drug retail business, a small scale trafficker only needs to have a minimum amount of money. The usual way to obtain this initial capital is to make one or several small robberies:

“I decided to do a small robbery with a friend of mine. So, we found a small shop in the suburb, but not too close to my place. The shop was owned by an old woman, working alone, selling cheap watches” (FR-C1).

Indeed, the two guys robbed €3,000 from that small shop and invested it in 1 kg of cheap cannabis. Their business model was to sell it in their cité. As both of them were native of one of these cités, they knew how to control the access and could easily be informed about police raids. Being native of a cité also allowed them to be aware of the drug trafficking technics: thanks to their local roots, they had basic skills such as how to buy drugs, how to cut the resin, how to sell it and stock it. They were also able to control people working for them, the competition and to limit the risk of interception by police. This knowledge comes from the social proximity with the world of drug trafficking. In fact, the interviewed trafficker is the younger brother of a local famous trafficker currently in jail; his family happened to be very helpful for him to start his drug dealing, especially as he was able to ensure a good selling position in his cité.

Cannabis resin is the cheapest way to start drug dealing because the price is very low for a low quality type frequently call “com” (commercial). In Marseille, this resin is sold around €2 a gram in the street in the most popular drug hotspot, while the average cannabis price was estimated at €6 a gram in 2013. Thus, in Marseille, a beginner can start his dealing at a very low cost by kilo: around €1,200 – €1,500 and could obtain a 25-50% profit if he is able to cut²⁹⁵ the hashish without any loss.

²⁹⁵ The methods of cutting cannabis and cocaine are different: for cocaine, traffickers add products such as caffeine to increase the total weight; for cannabis, there is no product addition and cutting means preparing small portions. The cannabis cutting skill is very important for the trafficker in order to minimise the loss of product during the preparation of small portions.

The interviews indicated that a drug dealer can start his criminal career with a €500 minimum capital and buy 750 grams of commercial resin quality. With this stock, the drug dealer can optimise his profits by selling small quantities (2 to 5 grams) for €10 to €20 the piece.

“After a few months, when I had enough money, I decided to sell weed too because a lot of clients asked for it. To me it was more to gain the loyalty of the clients and to have a good reputation. With that, by word of mouth, there are more people coming to my sellers because they know I sell cheap resin and expensive weed” (FR-C1).

A retailer can start his own business with the cheapest resin and when having enough money can buy better quality (and more expensive) to satisfy his clients. However, starting with small capital is not possible with cocaine: in France, an OCTRIS study shows that the average wholesale price for cocaine is about €30,000 a kilo. Thus, to raise enough capital to organise large scale importation of cocaine, OCGs often resort to bank robberies: “The classic way to find several thousands of euros to buy cocaine in huge quantities is to organise a bank robbery or assault of a security van” (FR-E4).

The main factor influencing profits is the purity of the product. A trafficker who has a direct access to a producer country can buy a kilo of cocaine with around 90 to 96% purity; if he buys it in Spain, a transit country, the purity will be only around 60% and will decrease to 25 to 40% if the product is sold by French retailers.

The main method of financing drug trafficking in France is reinvesting the proceeds. Different cases indicate how the money is coming back to Spain, Morocco or the Andean countries and is reinvested in new purchases:

“In XXX case for example, the money coming from the cannabis business was partly laundered. But a significant amount was directly reinvested in a new cannabis purchase” (FR-E7).

“In Colombia, police found several containers full of money (dollars and euros) and part of it is reinvest to pay new containers full of cocaine for the US or Europe” (FR-E11).

Settlement of payments

Drugs on credit: a business model based on trust

For a young person starting a drug business, a way to obtain the first supply of drugs is to negotiate with established traffickers to obtain it on credit. For that, it is important to have good contacts, and trust with the trafficker involved. Social proximity is crucial to obtain this minimum level of trust: geographical, social, cultural ties facilitate this kind of business confidence. If a drug dealer lives in a cité with high intensity of drug dealing, his social network helps a lot. Everybody knows him, the

drug dealers or local wholesalers know his family, his residence and can easily decide to give him drugs on credit and to receive the cash later.

“A lot of the kids in the suburb decide to ask for 250 gram cannabis resin: they sell it and after a while, they reimburse the local wholesaler” (FR-E2).

Of course, any problem happening in this kind of commercial partnership could lead to violent enforcement, which entails certain costs: paying for protection, weapons, etc.

Interviews with law enforcement officers indicate that it is very frequent that the transnational drug trade works under a **50% payment rule**: for example, a drug dealer from Marseille pays only half of the amount at the delivery and pays the remainder after the sale. This unofficial rule allows the trafficker to limit the risk with a margin of around 50%. In addition, this ensures a kind of loyalty: the client will come back to the same trafficker in Spain to pay him back and buy a new quantity of the product. The rule is applied in both markets: cannabis resin and cocaine (the majority of French traffickers buy both products in Spain).

Costs of doing business

To obtain the highest margin, it is important for a drug trafficker to have good contacts in different countries: the price will not be the same if the cocaine is bought in producing countries (between \$1,000 and \$2,500 per kg), in transit countries (around \$18,000 per kg in Senegal) or in destination countries (around \$50,000 or €30,000 per kg). The southern coast of Spain is the most important wholesale marketplace for the continent where it is possible to find cocaine with around 60% purity and at a price cheaper than in France.

TABLE 25. AVERAGE INCOME IDENTIFIED IN A “SUPERMARKET” CANNABIS HOTSPOT IN THE SOUTH OF FRANCE (2012)

Type of job	Daily income in euros
Gatekeepers	80
Seller	150
Supplier	200
Bodyguard	200
Drug stocker	100

Source: Marseille police, 2014.

If traffickers want to buy the drug at a lower price, they need to take charge of transportation. French OCGs use the West Indies (Martinique or Guadeloupe), since these French islands in the Caribbean are very close to Venezuela by private plane and prices are 30% lower than in France.

An analysis²⁹⁶ based on an accountant’s book seized in Marseille shows that around 20% of the daily turnover is

²⁹⁶ N. Lalam and D. Weinberger, *L’argent de la drogue [Drug’s money in France]*, (INHESJ), forthcoming.

TABLE 26. AVERAGE INCOME BY TYPE OF JOB IN COCAINE TRAFFICKING IN FRANCE (2014)

Type of job	Remuneration
Cocaine mule (around 1 kilo)	€5,000
Cocaine pilot	€1,000 a kilo
Corruption in cocaine production countries (1 load)	€5,000

Source: Interviews.

for paying sellers, cutters, gatekeepers and bodyguards.

The level of remuneration of the various participants in cocaine trafficking was established during the interviews (Table 26).

A minority of French traffickers have direct access to cocaine producing countries such as Colombia or Peru. If they cannot pay the whole amount of money (for example €400,000

for 100 kilos of cocaine with more than 90% of purity), local producers can propose that they carry more cocaine and to sell it in France. To pay back, the French buyers will have to sell the extra quantity of cocaine at a price calculated as the wholesale price in France (€30,000). To ensure that, a member of the Colombian producer's organisation will stay in France with the French importers to control the transaction.

Profits and profit sharing

According to a qualitative study in Marseille, with a €3,000 initial capital two new traffickers were in a position to buy 1 kilogram of commercial resin and to sell it at around €5 retail price. Thus, for one kilo, they received €2,000 of profit, although it took them a whole month to sell their supply, and thus earned less than the minimal legal income in France which is around €1,100. But after a few sales and a some of capital accumulation, the 2 traffickers declare earning around €2,000 a month each with a seller working for them, paid €100 per day. As a result, to make trafficking profitable, they need to sell a minimum of 3 kilos of commercial resin to earn €5,000 a month.

TABLE 27. ESTIMATE OF THE NUMBER OF FRENCH TRAFFICKERS AND THEIR INCOME

	Number of traffickers	Annual volume of cannabis sold	Number of clients	Annual income (€)
Importers	689 to 1,504	132 kg to 308 kg	Around 10	253,000 to 552,000
Wholesalers	6,000 to 13 000	16 kg to 35 kg	Around 10	35,000 to 76,000
Retailers	58,000 to 127,000	Around 3.5 kg	3 to 8	4,500 to 10,000

Source: C. Ben Lakhdar, *Le trafic de cannabis en France: estimation des gains des dealers afin d'apprécier le potentiel de blanchiment* [Cannabis Traffic in France: Estimated Drug Dealers Benefits and Estimated Money Laundering Volume] (OFDT: La documentation Française, 2007).

With the right contacts, a cannabis drug dealer can decide to shift to selling cocaine because the profits are higher. With an average differential of 20% purity and a price around €30,000 per kilo, it is possible to obtain more than 100% profits. The majority of national wholesalers will cut a kilo to have two kilos with products such as phenacetin, lidocaine, mannitol (sugar) or caffeine. In other words, purity of cocaine is the variable of adjustment, not the price. With 80% cocaine purity, it is very easy to make two kilos and to obtain 100% profit. To make the additional kilos, they need to have a hydraulic press, a blender, some plastic packaging and of course the cutting products.

At the wholesale level, purity and prices are the most important variables to obtain a good profit. Because having the best contact in the producing countries boosts the profits, some European buyers live in countries such as Colombia, Peru, Venezuela, Brazil and the Dominican Republic. The leading criminal groups used to be from Italy – like the ‘Ndrangheta.

“A shipment of 1.3 tonnes of cocaine seized in Charles de Gaulle airport in a plane coming from Caracas was intended for Italy because ‘Ndrangheta was the buyer, it’s one of the few organisations with capacity to order this quantity of cocaine: you need also to pay people in both airports, it costs a lot” (FR-E03).

Since 2012, however, intelligence from producing countries identified a rising presence of Spanish, Russian and French OCGs. French groups which are able to import directly cocaine from producing countries are not the same as in the past: this segment of the market was only in the hands of traditional criminal organisations, direct descendants of the famous “French connections” from Corsica and the south of France (Marseille or Nice). Nowadays, new actors coming from the cités are much more involved in cocaine importation and have direct contacts in Colombia.

Access to capital in critical moments

Insufficient data was available on these issues but a few elements like human collaterals have been identified. In Colombia, French traffickers who do not usually have the whole amount to buy the entire quantity of drugs can ask for a money advance: in those cases, Colombian traffickers will keep a kind of human collateral – such as a family member – until they receive the total payment. In the case of conflict, the collateral will be killed.

While cocaine is only produced in the Andean countries (Peru, Colombia and Bolivia), the localisation of cannabis production inside French borders²⁹⁷ offered new opportunities for criminal investments. Thus, OCGs can now invest their profits in drug production sites inside Europe, especially for synthetics drugs and cannabis. For example, a

²⁹⁷ Weinberger, *Criminal Networks and Indoor Cannabis in Europe: Has the Phenomenon Reached France?*

large cannabis greenhouse paid by a local OCG was dismantled in the south of France in 2011:

“With €50,000, they paid a cannabis factory of 500 hundreds plants. This kind of investment is very lucrative because today it is possible to sell a kilo of cannabis herbal product for €4,000” (FR-E11).

4.7. GREECE: THE SOUTHEAST EUROPEAN PERSPECTIVE

Introduction

Cocaine trafficking involves criminal groups and networks of cooperation that cross national borders. For all information on the modus operandi of criminal groups of this kind, little is known on the financing of organised crime and the way criminal groups manage their profits from criminal activities. Overcoming this problem is not easy because information provided by government authorities is mainly focusing on the quantity of cocaine seized and evidence for the prosecution of the offenders. As a consequence the financing of cocaine trafficking is an issue of secondary concern insofar as, in most cases, it is not directly related to prosecution.

According to the 2014 European Drug Report, “Cocaine remains the most commonly used illicit stimulant drug in Europe, although most users are found in a small number of western EU countries. An estimated 14.1 million European adults (15-64 years) have ever used the drug; 3.1 million in the last year.”²⁹⁸

Peru and Bolivia are considered to be the most important producers of cocaine sold in the EU. Colombia is no longer the main departure point for cocaine destined for the EU because other countries of Latin America, such as Argentina, Brazil, Venezuela, Peru, Chile and Ecuador, have turned into important countries of origin of the substance. The Caribbean countries are becoming significant points for the transit of cocaine, whereas the countries of West Africa, though still present as important transit points, face a reduction of the quantities trafficked through their territories.²⁹⁹ In addition, groups originating from Mexico and Nigeria induce volatility in the drug market by competing for domination. In Europe, the ports in the North-Western part of the continent, the Iberian Peninsula and on the Black Sea are the main entrance and distribution points for the cocaine trafficked from Central and South America.³⁰⁰

Greece is a “gateway to Europe for traffickers smuggling cannabis and heroin from the Middle East and Southwest Asia to the west and precursor chemicals to the east; some South American cocaine transits

²⁹⁸ EMCDDA, *European Drug Report 2014. Trends and Developments*, 38.

²⁹⁹ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*, 20; SODN-EMP, *Ετήσια Έκθεση για τα ναρκωτικά στην Ελλάδα έτους 2012 [Annual Report on Drugs in Greece 2012]* (Athens: SODN-EMP, n.d.), 46.

³⁰⁰ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*, 20.

or is consumed in Greece.”³⁰¹ Additionally, due to its geographical position Greece is ideal for cocaine trafficking by sea, either directly from the producing countries of South America or indirectly through the ports of Spain and Italy. Moreover, large quantities of cocaine are trafficked by sea in containers with legal cargo into Greece, which is one of the main gateways of the substance into the EU, as well as being itself a destination country.

Over the last few decades, drug issues have obtained great significance in Greek society and the effectiveness of the legal framework has been assessed many times in order to be updated and tackle contemporary challenges. For this reason, all laws related to drugs enacted in Greece after 2006 have focused not only on law enforcement but also on the treatment of drug users.

In 1970, for the first time in Greek legislation an important distinction between addicts and non-addicts was introduced: the former would not face the same amenability as the latter. But it was only in 1987 that a new law referred to the prevention, treatment, and reintegration of the addicts and, on the other hand, to the prosecution of the smugglers. Substantially, the 1987 had two balancing concepts – of repression policy and of social policy. In the following years, especially in 1993 and 1995, new amendments to this law were introduced reflecting the contemporary social problems of Greek society. In addition, in 2006 the first Code of Laws for Drugs came into force which was further amended in 2008 in order that the Greek legislation be harmonised with the Council Framework Decision 2004/757/JHA; a further amendment was introduced in 2013. In general, as in many other countries of Europe, Greece tends to focus on targeting drug supply and trafficking rather than use.

National drug policy is mainly based on the action plans on drugs which are updated every two or four years. The National Committee for the Coordination and Planning of Drugs Responses, convened under the chairmanship of the National Drug Coordinator drafted a new Action Plan on Drugs 2014-16, which is awaiting endorsement. The country overview by EMCDDA notes that the national strategy on drugs is based on a new drug coordination mechanism established by law in 2013, consisting of three levels: the Inter-ministerial Committee on the Drugs Action Plan, the National Committee for the Coordination and Planning of Drugs Responses and the National Drug Coordinator.

Market overview

According to EMCDDA,³⁰² up to 2012 the problem of drug use was defined as injecting drug use or prolonged/regular drug use of opiates, cocaine and/or amphetamines. In 2012, the broader definition of “high-risk drug use” was adopted. Especially, the latest available data on cocaine use derive from the University Mental Health Research Institute (2012) research, which involved a nationwide sample of high-school students aged 15-16. Results showed that 15.3% of the respondents have

³⁰¹ Central Intelligence Agency, “The World FactBook”, 2014.

³⁰² EMCDDA, *European Drug Report 2014. Trends and Developments*.

tried at least once one type of illegal substance and 2.3% indicated that they have used cocaine. Furthermore, a 2006 study conducted among the general population aged 15-64 in Athens, Thessaloniki and Heraklion showed that 19.4% of respondents had tried some illicit drug at least once, and that lifetime prevalence was higher among males (24.8%) than among females (14%). Most of the drug offences in Greece in 2012 were related to cannabis, followed by heroin and cocaine.³⁰³

According to the Hellenic Police, in 2005 – 2012 the annual number of drug cases ranged between 9,271 (lowest level) in 2007 and 12,335 cases (highest level) in 2009. The highest number of persons charged for drugs was 16,090 in 2009 and the lowest was 12,291 persons in 2011.

TABLE 28. OVERALL DATA ON DRUG ENFORCEMENT IN GREECE, 2005 – 2012

Year	2005	2006	2007	2008	2009	2010	2011	2012*
Drug-related cases	10,183	9,600	9,271	11,861	12,335	10,011	9,384	9,628
Persons charged for drug offences	14,558	13,622	12,895	15,825	16,090	13,018	12,291	12,817
Cocaine seizures by police (grams)	42,386	28,043	46,862	48,412	78,452	132,603	29,021	198,850
Cocaine (black) seizure (grams)						5,900		
Cocaine leaves seizure (grams)	5	898		5,901	583			251

* Data for 2012 is preliminary as the investigation of some cases and the identification of drug cases by the State General Chemical Laboratory has not been completed.

Source: Hellenic Police.

In 2012, the Hellenic Police seized 198.85 kilos of cocaine, Customs – 0.109 kilos and the Financial and Economic Fight Unit – 1.737 kilos.³⁰⁴ Moreover, the Greek Documentation and Monitoring Centre for Drugs notes that in 2011, the largest proportion of cocaine seizures in the country (89.8%) took place in the Prefecture of Thessaloniki, followed by the Prefecture of Attica with 5.4% and Western Greece with 3.1%.³⁰⁵

In 2012, law enforcement uncovered 426 cases and charged a total of 722 individuals, of whom 416 were Greek and 306 foreigners.³⁰⁶

³⁰³ EMCDDA, "Country Overview: Greece", *EMCDDA Country Overviews*, 2014.

³⁰⁴ SODN-EMP, *Ετήσια Έκθεση για τα ναρκωτικά στην Ελλάδα έτους 2012 [Annual Report on Drugs in Greece 2012]*, 24.

³⁰⁵ Greek Documentation and Monitoring Centre for Drugs [ΕΚΤΕΡΝ], *Η κατάσταση του προβλήματος των ναρκωτικών και των οιοπνευματωδών στην Ελλάδα. Ετήσια Έκθεση 2013 [The Situation of the Problem of the Drug and Alcoholic Products in Greece. Annual Report]* (Athens, 2013), 103.

³⁰⁶ SODN-EMP, *Ετήσια Έκθεση για τα ναρκωτικά στην Ελλάδα Έτους 2012 [Annual Report on Drugs in Greece 2012]*.

The Hellenic Police³⁰⁷ notes that the quantity of drugs seized is not intended entirely for the domestic market. On the contrary, Greece is predominantly a transit country and a stopover for criminal groups of cocaine trafficking. Spain, Italy and Portugal remain the main entrance points of cocaine in EU.

Table 29 shows the overall quantities of cocaine seized by all law enforcement authorities during the nine-year period (2004-2012). Cocaine seizures in 2011 doubled compared to 2010 and in 2012 they reached again the 2010 levels.

TABLE 29. TRENDS IN COCAINE SEIZURES IN GREECE (ALL LAW ENFORCEMENT AGENCIES), 2004 – 2012

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Cocaine (kg)	1,152	43	61	255	61	626	221	463	201

Source: Reitox National Focal Point-Greece, 2013 National Report (2012 Data) to the EMCDDA: Greece (UMHRI, 2013).

TABLE 30. SEIZURES OF COCAINE BY TRAFFICKING ROUTE IN GREECE, 2010

Trafficking route	Kg	%
By sea	171.943	76.1
By air	19.800	8.8
Overland	33.54	15.1

Source: SODN-EMP, Ετήσια Έκθεση για τα ναρκωτικά στην Ελλάδα έτους 2010 [Annual Report on Drugs in Greece 2010] (Athens: SODN-EMP, 2012).

According to SODN-EMP³⁰⁸ the price of cocaine was estimated to range from €32,000 to €60,000 per kilo with an average of €46,000 per kilo. The retail price was between €50 and €100 per gram with an average of €75. The average purity of cocaine samples in active ingredients was 59%, when in 2011 was 61.1% and in 2008 64.1%.³⁰⁹ A large drop in the minimum prices of cocaine took place in 2006 – 2007,

though cocaine maximum prices increased in 2012 after being stable for four years. The decreased prices, according to GR-E1 and GR-E2, have been attributed to the financial crisis in Greece. With regards all drug-related crime in Greece, there has been a downward trend between 2003 and 2008.

In general, according to the EMCDDA and Europol the consumer markets for cocaine Greece along with Lithuania, Poland, Czech Republic, Hungary, and Romania “report prevalence level of 0.5% or less, suggesting relatively small markets of cocaine”. Furthermore, Greece, for many

³⁰⁷ Hellenic Police, Ετήσια έκθεση για το οργανωμένο έγκλημα στην Ελλάδα για το έτος 2011 [Annual Report on Organized Crime in Greece for 2011].

³⁰⁸ SODN-EMP, Ετήσια Έκθεση για τα ναρκωτικά στην Ελλάδα έτους 2010 [Annual Report on Drugs in Greece 2010].

³⁰⁹ Reitox National Focal Point-Greece, 2013 National Report (2012 Data) to the EMCDDA: Greece.

years, has been the country recovering the largest quantities seized in the region.³¹⁰

TABLE 31. RETAIL AND WHOLESALE PRICES AND PURITY LEVELS IN GREECE (PRICES IN \$)

		Retail level								
Drug	Specifics	Typical	Range		Unit	Year	Typical	Range		
			Low	High				Low	High	Year
Cocaine salts		96.6	45.1	154.6	Gram	2012	6100	800	9160	2011
Coca paste/ cocaine base	Cocaine base	110.3	66.2	147.1	Gram	2008	54.8	1.8	100	2008

		Wholesale level								
Drug	Specifics	Typical	Range		Unit	Year	Typical	Range		
			Low	High				Low	High	Year
Cocaine salts		52,835.1	41,237.1	64,433	Kilogram	2012				
Coca paste/ cocaine base	Cocaine base	69,853	51,471	88,235	Kilogram	2008	50.2			2008

Source: UNODC, World Drug Report, Statistics.

TABLE 32. TOTAL DRUG-RELATED CRIMES IN GREECE, NUMBER OF POLICE-RECORDED OFFENCES*

Count						Rate per 100,000 population					
2003	2004	2005	2006	2007	2008	2003	2004	2005	2006	2007	2008
10,556	7,761	8,393	8,152	7,959	9,852	95.78	70.29	75.86	73.53	71.63	88.46

* Total Drug-Related Crimes means all intentional acts that involve the cultivation, production, manufacture, extraction, preparation, offering for sale, distribution, purchase, sale, delivery on any terms whatsoever, brokerage, dispatch, dispatch in transit, transport, importation, exportation, possession or trafficking of internationally controlled drugs (UN-CTS M5.2).

Source: United Nations Survey of Crime Trends and Operations of Criminal Justice Systems (UN-CTS).

Market structure and actors

The supply of cocaine to European countries from Latin America (especially Colombia, Venezuela and Ecuador) is carried out by criminal groups which have members from more than one nation, with specific roles, and they operate across more than one country (GR-E3). The most typical way of cocaine trafficking is by air whereby the shipment is imported from Latin America via Europe and then it comes to Greece. The second

³¹⁰ EMCDDA and Europol, *EU Drug Markets Report. A Strategic Analysis*, 42, 46.

way is overland by trucks that come from Europe, mostly Netherlands and Spain. Larger quantities (1-1.5 tonnes) are trafficked by sea.

Both GR-E3 and the interviewees from the Hellenic Police noted that OCGs which are involved in the importation of the cocaine consist of a small circle with few members structured hierarchically. It is estimated that the number of criminal groups which are involved in this business in Greece is six or seven. The members of the one group may know some members of the other, but in general these groups are accessed with difficulty and they do not know each other since they have different networks of clients. One client (wholesaler) of one criminal group can also buy from two different groups. The wholesaler sells by the kilo to groups specialised in retail sales. When criminal groups have ensured the cooperation of customs officers through bribery, they deliver the cocaine by legitimate cargo whereby a transport company receives it and delivers it to the members of the criminal organisation in the final destination country. They often choose the huge ports of Rotterdam and Antwerp, because it is easier to avoid checking of the cargo due to the high workload.

Criminal groups prefer sea shipment of cocaine followed by land transportation. They hide the cocaine in container-ships, which carry legal cargo and make sure that other members of the group will receive it in the transit port and take care of the transportation to the final destination. For that purpose, they create shipping companies, hire or buy container-ships and create or hire transportation companies. When a ship arrives at a crucial port, the criminal group may recommend the replacement of the captain and some members of the crew with trusted ones. Usually there is a coordinator responsible for the itinerary, the stops and the meetings with speedboats which will offload the cocaine. All these require high level of accuracy.

The transfer of shipments by high speed boats from the ship anchored near the coast to trucks waiting at the shore is a popular method. Thus, when the ship reaches port, there is nothing illegal in its compartments. Subsequently the traffickers ship the cocaine to the final destination in Greece or other Balkan countries. Another strategy is to unload the cocaine in Italy, Croatia or FYROM and transport it to Greece by trucks. Popular areas in Greece for unloading cocaine are West and East Peloponnese, Evia and many islands, like Kythera.

According to law enforcement interviewees, a new trend is to hide the cocaine in the container's columns; if it is done well, it is extremely difficult for the authorities to detect the hidden cargo which can be as much as 70 kilos.³¹¹

GR-E4 and GR-E5 stated that there are so many containers arriving in the ports of Piraeus, Thessaloniki, Patras, Volos and Heraklion that

³¹¹ Although even trafficking is not without its comical moments. On one occasion in 2004, in the port of Aigio (a town between Athens and Patra), "while the cargo of a ship from Latin America was being unloaded, a wooden box fell from a height, fell apart and bananas and cocaine spilled out. The whole area was covered with bananas and white powder – cocaine" (GR-E3).

the Customs Office is unable to check all of them, because they do not have the personnel and the technological equipment to deal with this number of containers. The interviewees noted that none of the Customs Offices has X-ray machines in order to examine the content of the containers properly and that Greece is the only EU country lacking such equipment. In their opinion, there was no corruption problem, law enforcement do their best and have successes despite these shortcomings.

The Economic and Financial Crime Unit of the Department of Drug Enforcement uses a risk analysis model which takes under consideration variables such as the cargo's country of origin, the shipping company, the cargo's receiver and the cargo's content. In this context, the Unit estimates the risk of smuggling of drugs or tobacco for a particular cargo. Examples of critical variables are the countries of Latin America (especially Venezuela, Ecuador, and Colombia), cargo that costs less than the transportation expenses (e.g. scrap metal), or a new shipping company that does business with Latin America. In these cases it is assumed that the risk of smuggling is high and further information is collected and/or the cargo is inspected with greater attention.

The Unit cooperates with the police, the prosecution and on occasion with the United States Drug Enforcement Administration (DEA, Athens Office). The interviewees emphasised the DEA's role as critical, because it has offices in Latin America, where it collects intelligence data on suspicious cargos and has the technical capacity to monitor via satellite the routes of suspicious ships. This allows the DEA to detect whether they change their initial routes and get close to the shore away from ports or change destination ports.

According to GR-E1 and GR-E2, there is strict division of labour and hierarchy in the criminal groups. Members specialise in finding clients, renting transportation or other tasks. Furthermore, these groups cooperate with other groups of organised crime, such as ones specialised in protection matters (e.g. contract killing), or in guns, explosives and robberies. The groups which deal in cocaine trafficking also deal in hashish and ecstasy, but not in heroine or opium. They are also involved in other illegal acts such as killings, contract killings and robberies.

In terms of the nationality of the members of these groups, Albanians, Serbs, Russians, Greeks and Bulgarians are high in the hierarchy. At the lower levels, those who distribute amounts around 30 kilos of cocaine are only Albanians. Every criminal group usually comprises predominantly members from one nationality, although there are Greeks in all groups. The bosses from each group know each other. They collaborate by borrowing some quantities or fight turf wars over territories, the quality of the drugs, or reckoning. The ones who definitely do not know the members of other groups are those who guard the drugs. There have been cases where one group tries to steal the drugs from the other, e.g. Albanian groups that trying to find the place where the good quality drugs are kept and steal them.

It is difficult to estimate the number of the groups which deal in trafficking because of the dark figure. In general, one group consists of 15-20 members but when there is an internal conflict, they can split into smaller groups. As a result the number of the groups can multiply, “today there are 30 groups, tomorrow 60” (GR-E1).

The number of members in each criminal group depends on their place in the supply chain. For example, groups dealing with the importation of cocaine are small, consisting of around five persons. However, groups which operate at the lower level supply chains usually consist of more members, up to twenty.

The hotspot regions are Glyfada, Kolonaki, Piraeus, where there are shopping districts or where the youth, media circles or film stars hang out. As in other countries, night-time economy establishments are also important consumption spots. According to GR-E3 there are several hotspots of cocaine dealing in Athens (Eksarcheia, Omonoia), Piraeus (streets near the Port and the Municipal’s Office), Thessaloniki and other big cities. But the interviewees all agreed that the places where large amounts of cocaine are distributed are difficult to find out.

Interviewees from the Hellenic Police stressed that the formation of criminal groups is usually based on old friendships among its members. Sometimes the members could have cooperated successfully in the past in an illegal activity with another person. This way they gain mutual trust which allows them to elaborate their cooperation in the future. On the other hand, if a high ranking member has a relative by marriage or by blood he can request the involvement of that person in the group. Friendships that are further exploited are also formed in prison. It has to be noted that traffickers are a very small and exclusive circle. New acquaintances are treated with high degree of caution. Membership in the circle does not change unless there are guarantees that a particular person can be trusted. If possible, however, additional risk is avoided.

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

According to Bruggeman³¹² a criminal organisation performs its activities in a manner similar to that of a legitimate business. Criminals are able to provide services and goods through the use of violence, intimidation and corruption. Corruption is an especially useful tool for criminal organisations and is used worldwide for penetrating into the legal systems of countries and increase opportunities for the acquisition of wealth and power. In addition, organised crime distorts competition when penetrating into the legal economy, since the proceeds from criminal activities are invested in legal entities.

³¹² W Bruggeman, “Η καταπολέμηση του οργανωμένου εγκλήματος: δυνατότητες, προβλήματα και ευκαιρίες, με ειδικότερη έμφαση στην Ευρωπαϊκή Ένωση [Fighting Organised Crime: Capabilities, Problems and Opportunities, with Emphasis on the European Union”, *Ποινική Δικαιοσύνη [Poiniki Dikaosini]* 3 (2000).

There is a significant re-investment of the profits derived from cocaine trafficking back into drug trafficking operations. Although the dark figure of such transnational crimes is considerable, crime groups can become extremely vulnerable because of the money trail. As a consequence, avoiding detection of the financial flows is a key concern for organised crime.

The source of money used to set up a cross-border smuggling operation is usually previous criminal activity (GR-E3). GR-E3 claims never to have come across a case where someone invested legitimate money in such an operation. When the revenue increases considerably, the smuggling operations move to a higher level in a cycle of expansion.

In addition, according to GR-E1 and GR-E2, money sources can be both the group's own revenue and loans from other criminal businessmen. Borrowers need to promise good interest, usually paid within a period of one month. Criminal entrepreneurs who are willing and capable of lending to criminal groups are usually owners of retail shops with high turnover, owners of nightclubs, or of big pawnshops. There have been cases where construction companies lent money to criminal groups which could not be invested in their own work due to the slump in the construction sector as a result of the financial crisis in Greece.

Also, money gained from providing "protection" to nightclub businesses is invested in cocaine, the profit then shared between both groups. This kind of protection originates from racketeering structures and is not linked to legitimate private security companies. Furthermore, a good crypt for drugs can be used to hide guns from other groups that pay a big amount of money for it.

Robberies and gambling are also common methods of securing financing for drug trafficking. Most of the income is then invested in other businesses such as tourism or petrol stations, either in Greece or in neighbouring countries.

Profits are also being transferred abroad to legitimate companies and through complex tax accounting laundered and reinvested in legitimate businesses. For example, criminal groups invest their money in the transportation sector by buying trucks and establishing a new company in order to import legal goods. After importing two or three times legitimate cargo, the fourth time cocaine is hidden among the legal goods the company transports.

There is a significant information gap as regards money laundering by organised criminal groups in the Balkans. The main laundering methods include:

- through legitimate companies that are listed on the stock exchange;
- through gambling – buying lottery tickets or bets from people who have already won, thus justifying their illegal money. For example, one of the most powerful Greek cocaine dealers, Alexandros Angelopoulos,

claimed that in a few years he won more than €8 million from bets in football games and lotteries;³¹³

- through professional football and basketball companies – by reporting higher profits than the actual ones or by understating their expenses.

The financial situation of traffickers is quite good, allowing them to own legal enterprises such as selling used cars. In addition to conspicuous consumption – expensive cars, residence in fashionable suburbs – they have good legal advice for the money laundering needed. Their property is often registered legally to other family members. Smugglers are either highly specialised and deal exclusively in cocaine or could deal in several drugs, and other commodities.³¹⁴ The vast majority of them are Greek who often collaborate in multi-ethnic networks. Some of the actors can be described as arbitrageurs who are involved in whatever commodity can provide the opportunity for profit. It should be noted that a division between upper-level actors and the stereotypical offenders, as mainly portrayed by media and popular culture, establishes a distorted image of the “true interplay between the different socio-economic layers of society.”³¹⁵

The social profile of the financiers is similar to the profile of the traffickers/distributors. They are usually in a good financial position as the traffickers, and they run legal businesses. Cocaine traffickers and financiers have good contacts with each other as they share a lifestyle, frequent the same clubs, and it is thus easy to arrange investment deals. It is not, however, a straightforward underwriting business, as the financiers cannot ensure that their share of the profit or loan repayment would be returned. Thus, they require collateral such as expensive cars, or an agreement that they would acquire a real estate at a low price. Still, there is generally trust among the two sides since they would usually have known each other for many years.

The profit margins for wholesalers are considerable and if the police confiscates an amount of cocaine the distributor will incur a loss; the damage, however, for the average wholesaler who has bought 15-30 kilos is smaller because of the sizeable difference between the wholesale and retail prices.

Retailers who sell to the end user usually are not involved in other illegal affairs. A dealer could be, for example, owner of a nightclub or an artist and he sells cocaine to 10-15 persons who are in close contact with him.

³¹³ Καθημερινή, “Συνελήφθη ο Αγγελόπουλος της κοκαΐνης [Angelopoulos Is Arrested for Cocaine]”, *Η Καθημερινή*, August 31, 2004.

³¹⁴ Kostakos and Antonopoulos, “The ‘Good’, the ‘Bad’ and the ‘Charlie’: The Business of Cocaine Smuggling in Greece”, 52.

³¹⁵ *Ibid.*, 55.

Settlement of payments

The typical method of settling payments is cash up-front. "The euro is popular with criminal networks for the purpose of physically transporting money across borders because it is available in high denomination notes and because it effectively disguises both the origin of the cash and the location of the criminal activity."³¹⁶ That criminal groups prefer euros to dollars is confirmed by GR-E1 and GR-E2. In terms of transfer method, criminal groups avoid using banks or other money transfer services such as Western Union. A preferred method is the "ant" tactics whereby many persons transfer small amounts of money; the amount is limited in order to make sure they would not be inspected by the authorities. The carriers are reliable persons who act as a link between the various organisations and they receive 5-10% of the value of the drugs involved or can be paid in kind with cocaine.

According to the Hellenic Police, placing the orders for cocaine is what sets the whole business in motion. Usually, some groups would order certain quantities of drugs and pay for them in advance. When the drugs are imported to the country where they are going to be sold, they are disseminated directly to the groups that have ordered them.

Payment for cocaine trafficking is often done in three stages: a) an advance is paid prior to the shipment of cocaine and its smuggling for any logistical or other organisational costs; b) the shipment of cocaine takes place; c) a payment is made after the completion of the operation and the delivery of the cargos. A typical case is described in Supreme Court Decision 2369/2007, in which the payment for the trafficking of between 1.5 and 3.250 tonnes amounted to \$4,100,000 and was completed in three stages: a) the amount of \$1,350,000 was paid in the first stage as an advance before the loading the cocaine (the money often paid partially and not entirely); b) the amount of \$1,350,000 was paid during the second stage of the transaction which is the typical entry of the substance into the transit business; c) \$1,400,000 was paid in the third stage after the delivery of the cargo as a bonus for the success of the whole enterprise.

Costs of doing business

The costs for cocaine trafficking can be inferred from a specific case discussed with GR-E1 and GR-E2. The case was in 2012 and the amount trafficked from Latin America was 120-150 kilos. Its transportation by sea had cost €300,000-€400,000. The interviewees reported that the cost of one kilo of cocaine in the country of production was about €1,000-1,500. When this amount is successfully transported to Europe, its wholesale price goes up to €40,000-50,000 per kilo, whereas the selling price to the end user is €100 per gram, which means €100,000 per kilo. For this reason, even if only half of the amount of cocaine sent to Europe passes undetected, the traffickers make a profit.

³¹⁶ Europol, *EU Organised Crime Threat Assessment*, 41.

In 2007, the Financial and Economic Crime Unit uncovered a factory for extracting cocaine in a house in the area of Anavisos (about 50 km far from Athens), as a result of which 16 members of the criminal group were arrested and later convicted for 25 kilos found in the factory. Organised crime groups very rarely set up factories in Europe, according to the interviewees, and the only other similar case was detected in Spain a few years ago. The criminals were from Colombia (a chemist specialised in cocaine production), Greece, Albania, England, Venezuela, etc., and were using raw material sent from Colombia by the leader of the criminal organisation.

Another serious case of cross border cocaine trafficking took place in October 2013 in the port of Thessaloniki, where the police in cooperation with the Economic and Financial Crime Unit managed to locate and confiscate a cargo containing 146 kilos of cocaine from Latin America hidden in a cargo of bananas. They also confiscated €352,000 in cash, €500,000 in bank accounts belonging to the members of the criminal group, 9 luxury cars, 1 motorcycle, fake passports and many technical devices. Those arrested and charged were members of five separate groups that used to cooperate in cocaine trafficking to Greece.

Relevant experience about financing schemes was gained in the so called “sverte” case which took place in 2000 in Venezuela, Spain and Greece (GR-E3). A big Latin American criminal group, which was trafficking cocaine, decided to transport to Europe about four tons of cocaine by sea. All the ships they owned or had used in the past for trafficking were known to the United States Defense Intelligence Agency, so they approached a Greek businessman, who was facing financial difficulties at the time, offering him \$1,500,000 to create a maritime company which would buy and repair an old ship to be used in the transportation of cocaine. The money was partially transferred from the criminal group to his offshore companies. Trusted partners of the Greek businessman then withdrew it and exchanged it to drachmas. In a few months, a ship was fitted for the operation and sailed from Venezuela but was under satellite surveillance by law enforcement. In an intermediate port in Nigeria, all the crew was substituted by men from the Philippines (the old crew were given severance pay). The new captain had been, however, involved in the past in similar criminal activities and the authorities knew him well. This allowed law enforcement to thwart the operation and prevent the trafficking.³¹⁷

According to GR-E1 and GR-E2, in most cases (but not always) the ship crews know nothing of the operation and the only one who is involved is the captain. It is common for the crew to be substituted in the last port before the delivery of the cocaine by experienced members who know what to do and how to act in order the cocaine to be delivered properly.

The Hellenic Police noted that in the most significant case of 2010 where the trafficking of cocaine took place via containers from Latin America

³¹⁷ Supreme Court, Decision 1018/2011.

to Europe, Greece was as an intermediate destination. The leader of the criminal group was from Montenegro, while some other significant members were Serbian entrepreneurs. Some members of the criminal group were arrested and it was established that their role was to legalise the profits by transporting large amount of money to offshore companies, buy luxury real estate or place cash in bank vaults which do not require a declaration of content.

As far as corruption is concerned, criminal groups bribe where it is necessary. Corruption of police officers can either protect a criminal group from prosecution or it can be used as a “weapon against competitors.”³¹⁸ According to GR-E1 and GR-E2, the corrupt civil servants – and more than one civil servant need to be involved – have to be very trusted persons to the criminal groups. The criminal groups use corruption methods to ascertain whether the authorities are monitoring the containers and appear only when they are sure that it is safe (GR-E4 and GR-E5). If they are not sure, the container loads are not released, unless a specific container relates to a legitimate business with another company which has nothing to do with the cocaine and the criminal groups are using it just to cover the rest of the containers in a possible checking. In this context, according to GR-E1 and GR-E2, it is difficult for one corrupt official to be in a position to guarantee that the transaction will be completed safely. This can increase the difficulties for the criminal groups but, on the other hand, it can be assumed that a small net of corrupt officials could be established around critical routes of cocaine control and inspection. However, the amount of bribery received by civil servants – although supposed to be high – cannot be estimated. The current social and economic conditions need to be taken into consideration when trying to make an estimate: the “economic crisis may also have resulted in increases susceptibility to corruption by individuals occupying key positions in the public sector, especially in countries where large salary cuts have taken place.”³¹⁹

The interviewees admit that more specific estimates of the costs, corruption fees or expenses that groups incur for doing business are difficult to make. GR-E1 and GR-E2 estimate that the costs of a criminal group for salaries and expenses like renting warehouses are not high compared to the large amounts it needs to spend for the creation of a new legal company which may not be profitable but is necessary for the establishment of a new cocaine route.

Profits and profit sharing

The profits from cocaine trafficking depend on a number of factors. According to the interviewees of the Hellenic Police, the profit from 100 kilos of cocaine is about two million euros. Profits are not equally distributed to all members, but the share each member receives depends on the position in the hierarchy of the criminal group.

³¹⁸ F. Rizava, *Οργανωμένο έγκλημα [Organised Crime]* (Athens, 2012), 171.

³¹⁹ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment.*

Some years ago, and especially before the financial crisis in Greece, the most typical way of spending the profits was the bouzoukia (live entertainment establishment with Greek pop and folklore music). In addition to a luxurious lifestyle, the Greeks involved in the criminal groups used to buy real estate and re-invest in drugs, while Albanian members of the group would invest their profit in legal businesses in their country.

As far as money laundering is concerned, efforts are made to have access to legal companies (usually offshore) by using legitimate entrepreneurs. Profits from cocaine trafficking are invested in establishing new legal shipping companies which manage the purchases of new ships. The creation of new offshore companies, the purchase of better ships and the expanding of the criminal network by hiring persons specialising in the complicated money transfers increase the power of the criminal boss. Having established strong positions, the leaders of the criminal group can then afford to visit personally the Colombian traders in order to gain their trust and ensure safer transits, but also to validate the structure and function of the new criminal group.

Access to capital in critical moments

Though there is no official data on recidivism,³²⁰ according to interviewees of the Hellenic Police, the majority of the convicted (almost 60%) are going back to business again. Being arrested and charged does not mean that one refrains from businesses: organised criminals usually continue operating even from prison, and can even learn new ways of running their business from there, including by making new contacts with other inmates.

Because of the significant profits, criminal groups have the liquidity cushion to face losses in critical moments of their business. Such costs are included in the total price, unless repetitive losses take place. Costs are also incurred when one or more of their members are arrested as the group needs to pay for lawyers, litigation expenses, bails, etc. In these cases costs could be said to be investments, as the leaders of criminal organisations strengthen their ties with their associates by providing full legal assistance to the members and cover the living expenses both of the arrested and their families. Because of the reputation of the criminal group, they can easily obtain the silence of witnesses and the possible exemption of the accused members of the courts.³²¹

³²⁰ Access to Hellenic prisons for doing social research is very limited and it is almost impossible to interview a member of a criminal group in prison. Following an incident in 2014 involving the murder of a correctional officer and the death of an inmate, the Ministry of Justice does not allow any guests in the correctional facilities for research or similar purposes. Research in the database of the Scientific Center for the Rehabilitation of Former Inmates of Correctional Institutions "Epanodos" (a body of the Ministry of Justice, Transparency and Human Rights) shows that not a single person convicted and imprisoned for cocaine trade and participation in organised criminal group has asked for the services of Epanodos (social workers, lawyers, psychologists, business consultants, etc.) in the period 2008 – 2014. As a result, concerning Epanodos, it was not possible to get in touch with ex-convicts to interview them.

³²¹ Rizava, *Οργανωμένο έγκλημα [Organised Crime]*, 46.

There are many cases in which criminal groups look to loan sharks for the financing of their business (GR-E1 and GR-E2). The Greek financial crisis has affected the availability of large credit lines but it is in such times that loan sharks thrive. GR-E1 and GR-E2 estimate that nowadays the amount of money given to criminal groups by loans sharks ranges between €200,000 and €300,000. This amount covers approximately one transit of cocaine, while the same criminal group may be financed three or four times per year. The repayment of the debt to loan sharks is done in instalments and it can take up to three months. The black market usurers often keep a collateral, usually an expensive car or a promissory note that real estate would be bought at a lower price in the case of default.

According to GR-E4 and GR-E5, the money criminal groups invest derives from other illegal activities, such as arms trafficking, and this applies to all kinds of drug trafficking, not only cocaine. Sometimes members of the criminal group do not resort to loan sharks, because they estimate that they would have sufficient revenue from selling the drugs to end users. In general, everyone in these circles is aware that members of the criminal organisation, who are experienced criminals, can play the role of the debt collectors without resorting to violence.

5. NATIONAL CRIMINAL MARKETS AND FINANCES: ILLICIT TOBACCO TRADE

This section contains the results of the studies of the illicit trade in tobacco products in seven European countries. Unlike drug trafficking – but similar to organised VAT fraud – this trade has a strong link to its legal counterpart, and the legal tobacco industry generates significant amounts of data about the illegal market. Because of the potential for damage to government budgets, the illegal tobacco market is of interest not only for law enforcement but is also watched by tax authorities.

Texts in this section use a couple of terms that would benefit from some explanation at the outset:

“Ant smuggling” uses the imagery of the numerous small efforts of ants bringing about a considerable end effect and refers to the frequent crossing of borders by a large number of individuals who buy and smuggle back into their country small quantities of cigarettes and tobacco.

“Illicit whites” (also known as cheap whites) is a term which refers to cigarettes legally manufactured in the free zones of Eastern Europe, the Middle East, the former Soviet republics, Southeast Asia, etc., only to be smuggled and sold in another country without excise tax being paid. The best known brand in Europe is Jin Ling, which is legally produced in the free zone of Kaliningrad (Russia) but destined for illegal markets in the EU. Their life cycle has three phases. In the first (legal) phase, cigarettes are manufactured in full compliance with the law, under a registered brand that can be sold in several countries. The cigarettes are produced at a very low cost and low quality. They are then sold legally and are transported to a duty-free zone. In the second (grey) phase, the cigarettes are sold and transported as legal goods, but the identity of companies and the origin of the funds involved are deliberately obscured. In this phase the cigarettes are moved around from warehouse to warehouse and from ship to ship, until their tracks are lost. In the third (black) phase, the cigarettes “disappear” somewhere along the way and are directed towards the network of wholesale and retail warehouses, and from there to the network of street vendors in the destination countries.

The texts in this section reference a number of sources as they draw on numerous in-depth interviews with government officials, independent experts and criminal entrepreneurs. The sources have been coded in order to preserve their anonymity. The first two letters of the code indicate the country (e.g. GR – Greece), “E” indicates an expert, while “C” means criminal entrepreneur. The description of the background of the individual sources referenced can be found in the “List of interviewees in the section on illicit tobacco trade” in the Annex.

5.1. BULGARIA: REBIRTH OF THE CRIMINAL TOBACCO INFRASTRUCTURE AFTER ACCESSION

Introduction

Bulgaria is one of the most affected EU member states by the illegal sale of tobacco products. While the average share of illegal sales compared to total tobacco sales is about 11% among all EU member states, the estimated share in Bulgaria for the period 2010-2014 was between 25% and 40%.³²² These data should be read in the context of two important characteristics: first, the revenue from excise tax and VAT on tobacco products has a significant weight in the national budget of Bulgaria, accounting for 11-12% of all revenue, while in west European member states the corresponding figures are 1-2%.³²³ The second factor is the developed infrastructure of the grey and criminal economy.

In terms of the prevalence of smoking, Bulgaria ranks second in the EU with 39% of the country's population being smokers.³²⁴ Given that a third of smokers consume illegal cigarettes,³²⁵ it can be estimated that the number of consumers of illegal tobacco products is between 300,000 and 400,000, and they are served by at least 15,000 members of various criminal networks:³²⁶ street vendors, peddlers, drivers, warehouse security personnel, importers from international criminal groups, owners of legal or illegal cigarette factories active on the domestic or international markets. The value of annual illegal sales is €150-300 million, or about 0.5% to 1% of Bulgaria's GDP.³²⁷

To understand the roots and causes of the illegal tobacco trade and its significance, an overview of the origins of the legal and illegal tobacco markets is required. Even before WWII, Bulgaria was one of the largest manufacturers of cigarettes and raw tobacco in Europe. During the Cold War, through the state-owned monopoly Bulgartabak, Bulgaria emerged as the number one supplier of raw tobacco and cigarettes in the Soviet bloc. In 1976-77, the Bulgarian efforts to penetrate markets beyond the Soviet economic sphere were actively supported by the State Security agency, the regime's secret service. The reason for its involvement was that for the countries of the Soviet bloc access to certain technologies was denied by the CoCoM.³²⁸ With the help from State Security, Bulgartabak gained access to cigarette recipes and technologies developed

³²² KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*; KPMG, *Project Star. 2011 Results*, 2012; KPMG, *Project Star. 2012 Results*, 2013.

³²³ National Revenue Agency; CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

³²⁴ TNS Opinion & Social, *Special Eurobarometer 332: Tobacco* (Brussels, European Commission, 2010).

³²⁵ CSD and Vitosha Research, *National Crime Survey for the years 2010, 2011, 2012* (<http://www.csd.bg/?id=1415>); AC Nielsen, *Empty Pack Survey Bulgaria, 2010 – 2012*, unpublished.

³²⁶ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*. Daily sales of 500,000 cigarette packs require between 5,000 and 10,000 retailers (with sales of 5 to 10 cartons per day). In addition, the market is served by middle and upper level wholesalers, ant smuggling agents, security guards, retail and warehouse personnel.

³²⁷ *Ibid.*

³²⁸ The Coordinating Committee for Multilateral Export Controls, an arms embargo mechanism established by the Western bloc countries during the Cold War.

by large multinational companies.³²⁹ Bulgartabak managed to enter the tobacco markets of Tunisia, Morocco, Iran, Iraq, and other Middle Eastern markets. The exports provided much needed dollar revenues to the communist government.³³⁰ As a result of this expansion, the tobacco industry became the third largest source of foreign currency after the arms industry and electronics. Another result with long lasting effect for the cigarette smuggling business after 1990 was the development of a close relationship with the Italian mafia, through the cooperatives in Southern Italy,³³¹ and with Greek tobacco companies and sea ports (BG-E3, BG-E21).³³² Many studies suggest that after 1990 officers of the State Security effectively privatised the infrastructure³³³ developed and exploited by the communist state for illegal import and export. Thus the excise goods – oil products, alcohol and cigarettes – became the most actively traded types of goods in the smuggling channels. For the Balkan criminal networks, tobacco smuggling comes second, after oil products.³³⁴ The deep involvement of State Security officers in the tobacco business in the 1980s is considered a decisive factor for the evolution of the tobacco smuggling networks after 1990.

The tobacco market presents an exceptional opportunity for precise and in-depth analysis. Unlike other traditional criminal markets (drugs, prostitution, racketeering, etc.), the illegal tobacco market has a strong link to its legal counterpart, and the legal tobacco industry generates an enormous amount of data about the illegal market. Due to the high taxes and excise rates for tobacco products, the illegal tobacco market is also closely monitored by the revenue agencies.

Market overview

The structure that emerged at the beginning of the 1990s around the criminal entrepreneurs known as the “cigarette men” (more on them below) is still basically unchanged. Tentatively, two independent groups can be distinguished: the “manufacturers” and the “merchants.”

The **illegal manufacturers** are probably the criminal group about which the least is known. The detection of workshops, warehouses or equipment for the manufacturing of illegal cigarettes has never led to the investigation of players in the upper levels of the network who finance and organise its overall operation. The manufacturers take advantage of the available resources of the tobacco industry in Bulgaria and in some of the East European countries. There is evidence that they had

³²⁹ At that time, the recipe for a Marlboro cigarette included 40 extracts of various plants and flavours.

³³⁰ Blitz.bg, “Полковникът от ДС и зам.-директор на НСС Чавдар Петров: ЦК прибра 60 млн. от италианската мафия [Interview with Former Deputy Director of the National Security Service]”, December 31, 2012, <http://www.blitz.bg/news/article/172205>

³³¹ The migration waves of the Turkish minority from Bulgaria to Turkey in the 1980s affected the supply of certain types of tobacco, as tobacco growers came mainly from the Turkish minority. This caused the search for alternative tobacco supplies, while Bulgartabak took advantage of the low prices (maintained thanks to subsidies from the EU) (Ibid.).

³³² Interview with BG-E21 who had been part of the smuggling channels in Greece until 2000.

³³³ CSD, *Corruption and Trafficking: Monitoring and Prevention* (Sofia, 2000); CSD, *Corruption, Trafficking and Institutional Reform* (Sofia, 2002); CSD, *Partners in Crime: The Risk of Symbiosis Between the Security Sector and Organized Crime in Southeast Europe* (Sofia, 2004).

³³⁴ By violating the Yugo-embargo the Milosevic regime was able to survive for a whole decade.

close ties with the executives of the state monopoly Bulgartabak during the 1990s (BG-E17, BG-E20). While at the beginning of the 1990s the illegal factories operated mostly in Bulgaria, by the end of the decade numerous illegal operations have emerged in other Balkan countries. In 2002, the Bulgarian government decided to establish joint ventures of Bulgartabak in the countries of the former Soviet Union, in order to avoid certain customs barriers. The decision enabled the export of an enormous quantity of old but highly productive, good quality cigarette manufacturing equipment.³³⁵ Later, some of this equipment was to be found in the Kaliningrad factory that manufactures the best-selling illicit brand, Jin Ling. Exported equipment of Bulgartabak, or parts of it, was distributed in all of South-Eastern and Eastern Europe, from Greece to Poland. At the beginning of the 21st century, due to the extremely high excise taxes on tobacco products, it became very profitable to set up illegal factories in the EU member states to meet the high demand for illicit cigarettes. Two models for such factories have been observed: a) China-made equipment was imported in Central Europe and assembled, mostly by Asians; and b) the illegal manufacturers who used old equipment from the tobacco industry in Eastern Europe, predominantly from Bulgaria, because of its specialisation within the former Soviet bloc (BG-E16, BG-E18).

Illegal manufacturing is aimed at securing the entire production cycle through the use of old equipment and the deployment of several networks which do not know each other. One network is linked with old equipment which is written off in legal factories and is reassembled by former engineers in the new illegal cigarette factories. The network employs people who find equipment and spare parts, others who assemble it, fine-tune it and launch it into production. There are also those who take care of the reverse process: disassembly, storage and export to another country. A second network consists of mid-level managers and engineers who maintain the equipment during the production cycle or hire employees of the Bulgarian tobacco factories and supervise them. At the low level, there are the drivers who transport the raw tobacco and other consumables, workers who print the packaging in printing workshops equipped with good quality machines. The secrecy of these enterprises has been growing: an illegal factory usually opens and closes within 2-3 months, workers are not aware who employs them.³³⁶ The most valuable resources in the chain, the highly qualified technicians and technology experts, set up and launch the equipment for 3-4 days, while the engineers tune the machines within 24 hours (BG-E10, BG-E12). Thus the period in which the system is most vulnerable is quite short.

The **illegal merchants** were able to become part of the Balkan smuggling infrastructure as early as the beginning of the 1990s, with Greece acting as both entry point and distribution centre (hub). In the mid-1990s, about 50% of the cigarette sales in Bulgaria were illegal.³³⁷ The cigarettes

³³⁵ Bulgartabak was the largest cigarette exporter in the world until 1990, and operated 13 factories.

³³⁶ The last portion of the route is carried out in darkened glass vehicles and at night time.

³³⁷ Data from a national representative survey conducted by the CSD in 1995 and commissioned by a large multinational company, unpublished.

were imported from Greece, where they were legally supplied by large multinational companies.³³⁸ The Balkan smugglers get their merchandise from the Greek duty-free warehouse operators³³⁹ and then transport it on to Europe at their own risk. A considerable share of the legally produced and legally imported into Greece cigarettes of known brands are smuggled through the Balkans into Central and Western Europe (BG-E3, BG-E20). In the smuggling infrastructure Greece is functioning as a **hub** where several networks of cigarette middlemen operate, linked to warehouse operators in the Middle East, Greece, Cyprus and the Turkish duty-free zones. The networks use various offshore companies which provide logistical support and financial services (bank guarantees, collaterals, etc.). The Greek hub is manned not only by Greeks and Bulgarians, but also by Russians, Georgians, Arabs, Serbs, Poles and others (BG-E20, BG-C1). The networks maintain good relations with the Greek political elites and magistrates. There are numerous cases where apprehended smugglers manage to avoid legal prosecution. In Bulgaria, the merchants – most often former State Security officers – work closely with the distribution channels of the state monopoly Bulgartabak and also maintain good relations with the representatives of large multinationals (BG-E20, BG-E21).³⁴⁰

The economic crisis of 1996 – 1997 in Bulgaria brought two significant changes: first, the popular foreign brands became too expensive for the Bulgarian market; and second, the political stabilisation that followed resulted in a better control of the Bulgarian borders. This led to the state monopoly's share of the market increasing to 80-85% (BG-E13, BG-E20).

At the end of the 1990s, the merchants took steps to adapt to the new situation. First, through the duty-free shops at the borders they continued to supply the high end of the market, mostly in the largest cities, with popular foreign brands. Second, they started exporting cigarettes to the highly profitable West European markets, in particular the UK, the Netherlands, Germany and others. Various smuggling techniques were used, like dumping of cigarettes from ships in waterproof packaging close to the coast, collecting them with boats and bringing them to the duty-free warehouses at the Greek borders. Other techniques included fake cargo flights and transporting of cigarettes in large trucks along with other goods used for cover (BG-E3, BG-E13). Some of the Bulgarian traffickers reside permanently in Italy or Poland. Despite the damages they suffered from foreign special law-enforcement bodies in 2002 – 2003, they kept working intensively until the supplies from multinational cigarette companies were discontinued (BG-E13, BG-E20).

After a period of adaptation of a couple of years, the illicit whites were introduced in the Greek hub. Until 2009, these cigarettes were of too poor quality and too expensive for the Bulgarian market, so the illegal

³³⁸ The market behaviour of multinational cigarette companies is driven by the tobacco monopoly which East European countries practically create by imposing heavy customs duty on cigarettes, thus rendering their imports prohibitively expensive.

³³⁹ These warehouses are usually owned by members of the Greek hub.

³⁴⁰ It is indicative that while these companies sell legally only a couple of master cases, they are among the top advertisers. These large advertising budgets are the basis for the extremely high influence that tobacco companies enjoy in the media, and as a consequence, among politicians and political parties.

merchants exported these types of cigarettes mostly to Central Europe (BG-E17, BG-E18). The illicit whites did not market well in Bulgaria prior to 2009 because of the competitive pricing of the Bulgarian low end brands and the wide availability of premium brands from duty-free shops.

BOX 1. THE “GREEK MODEL” OF SQUEEZING OUT THE ILLICIT WHITES

Given that Greece is an entry point for illicit whites, the “Greek model”^{*} refers to a “policy” which seeks to create incentives for the export of these cigarettes further on to other countries and thus to discourage their sale within the country. When a certain saturation level of illicit whites is reached, local legal producers reduce the prices of their merchandise as much as possible in order to make the sale of illegally imported cigarettes – given their much lower quality – unprofitable even at wholesale prices. As a result, the traffickers of illicit whites prefer to export them further to other countries.

According to expert estimates, after 2012 this policy started to be applied in Bulgaria (BG-E17, BG-E22). Immediately following the shock rise in the excise rate in the period 2009 – 2010, the illicit whites imported from Greece dominated the market. Gradually, legal Bulgarian producers started to expand their share in the illegal cigarettes market by manipulating – raising or reducing depending on the presence of illicit whites – their prices thus squeezing the latter out of the market. When imported illegal cigarettes are on the wane, the local legal producers allow the prices of their illegally sold merchandise to rise. This manipulation is made possible by two factors: a) legal manufacturers selling illegally have considerable room for manoeuvre in the prices of their untaxed merchandise; b) they have effective control over a network of illegal distributors from the wholesale to the retail, which parallels the legal one. There has been tacit political acquiescence of a small share of the merchandise of legal producers being sold untaxed. Support for this policy was warranted by the argument that the practice does not allow untaxed cigarettes to expand beyond a certain share of the market – a result that could not be achieved by enforcement methods only. Without the competition of legally produced but untaxed cigarettes, all the revenue from the illicit market would go to the illicit whites exporters and Bulgarian criminal importers.

* The term “Greek model” was used repeatedly by sources both from law enforcement institutions (BG-E3, BG-E17, BG-E18), as well as criminal entrepreneurs (BG-C1, BG-C2). Whether or not this policy is actually applied in Greece could not be established, although indirect evidence is found in the results of seizures and empty pack surveys by the Bulgarian Tobacco Industry Association which indicate that in 2009 – 2012 around 10% of untaxed cigarettes had been manufactured by a legal Greek producer.

Source: Authors’ elaboration based on the interviews.

Following the sharp increase of excise tax in 2009 – 2010 (in the wake of EU membership), Bulgaria and Romania became significant markets for illicit whites.³⁴¹ In Bulgaria, however, a new player linked to politicians accounted for 50% of all cigarette sales between 2012 and 2014, according to data from empty pack surveys.³⁴²

Bringing the tobacco excise rate up to the EU level after Bulgaria’s accession led to several peaks in the sales of illegal cigarettes and decline in the sales of legal cigarettes (Table 33).

³⁴¹ The affordability ratio (share of personal disposable income buying 1,000 cigarettes) in Bulgaria is 3.3%, and in Romania it is 2.2%. In most EU countries that introduced high excise taxes in order to discourage smoking the ratio is 0.8-1.3%.

³⁴² KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*; AC Nielsen, Empty Pack Survey Bulgaria, 2010 – 2012, unpublished.

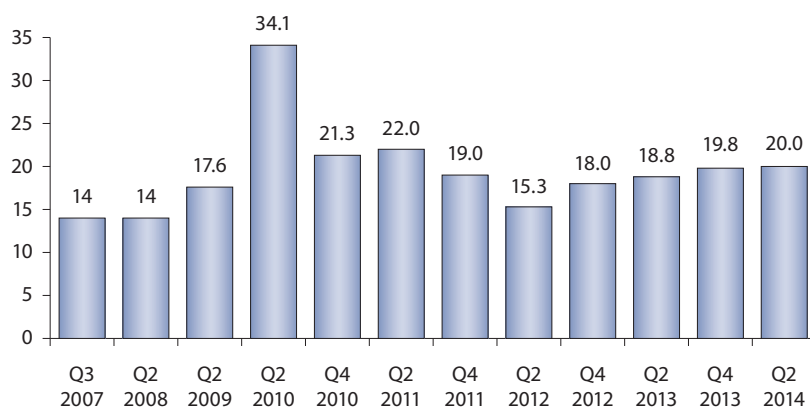
TABLE 33. CIGARETTE SALES AND DYNAMICS OF THE EXCISE RATE IN BULGARIA

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Legal sales (mln pcs)	24,979	20,656	23,085	20,142	20,575	14,823	18,424	19,107	16,400	10,520	10,875	11,600	11,500
Excise rate change (%)		73.3	0	50	-1.3	84.4	8.5	26.0	14.4	33.3	0	0	0

Source: Customs Agency.

The illicit trade in legal brands is no longer possible because of, inter alia, the lawsuits in the United States and the EU against the tobacco multinationals as a result of which a system for internal control was introduced. The multinationals are now watching out that their brands are not illegally traded as they would have to pay large fines, if intercepted. Bulgarian OCGs adapted to a changing environment by making more use of duty-free shops and, to a lesser extent, trading with neighbouring countries with lower excise rates such as Serbia, FYROM, and the former Soviet Republics. In 2006, a clear evidence of the linkage between duty-free shops and illegal sales emerged: after the rise of the excise rate by 84.4% legal sales decline from 20.5 to 14.8 billion pcs (Table 33), while sales in duty-free shops shot up from 1.7 to 6.7 billion pieces.

FIGURE 21. SHARE OF ILLICIT CIGARETTES SALES IN TOTAL CIGARETTE MARKET IN BULGARIA (%)



Source: Empty pack surveys by the Bulgarian Tobacco Industry Association.

Rising prices of legal cigarettes and rising sales of illegal ones, furthermore, coincided with the end of the model of supply of established brands through the duty-free shops to other Balkan countries and further on to Europe. Duty-free shops in Bulgaria and Romania were closed and so were the Greek ones at the Bulgarian border.³⁴³

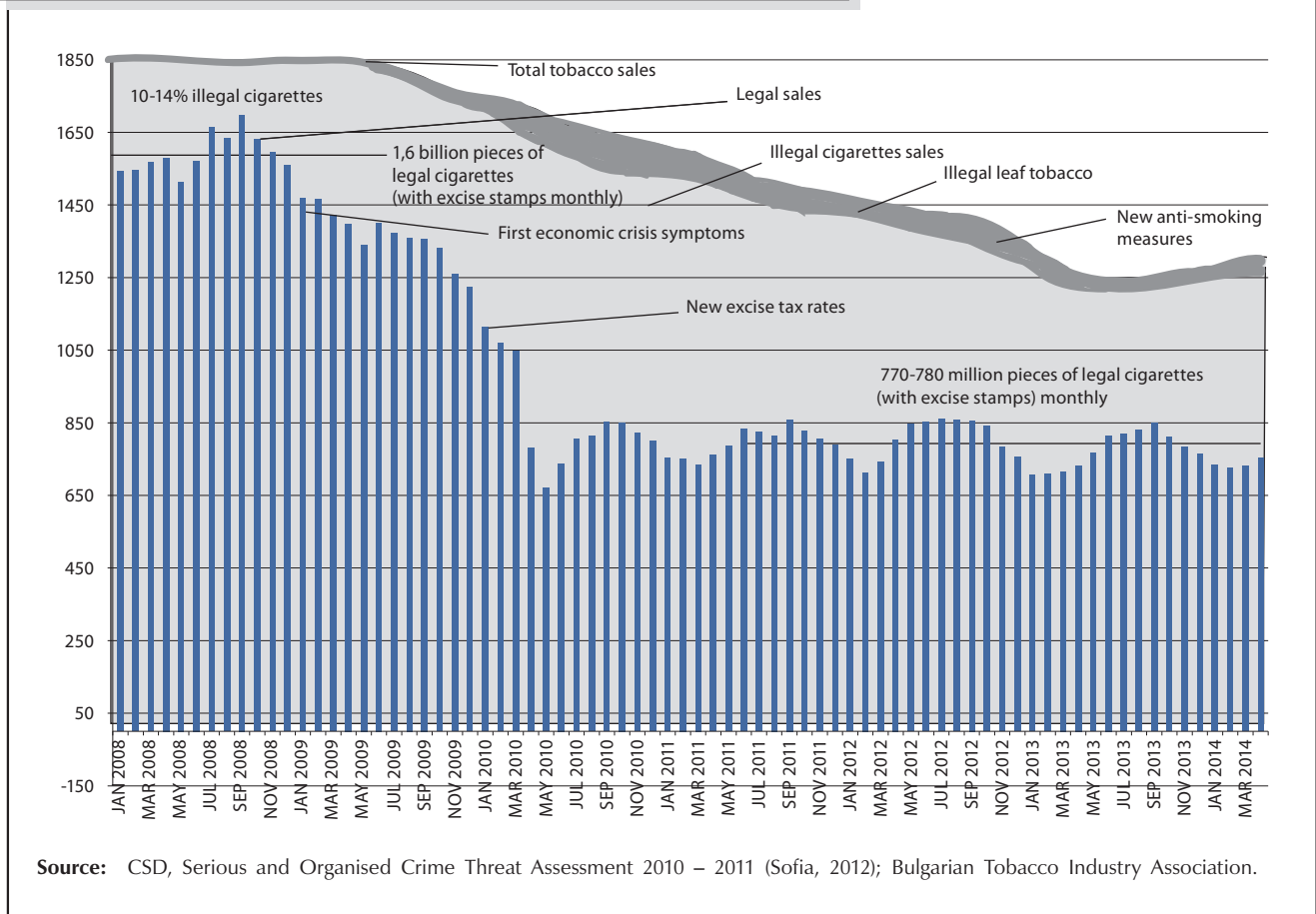
Estimating the volume of illegal sales needs to rely on a number of methods in order to offset the limitations that each one has. In Bulgaria, for example, empty pack surveys do not work well in small towns where

there is no proper waste management but it is exactly in these towns (because of low disposable income) where most illegal cigarettes are consumed. Similar considerations apply to hand-rolling tobacco (HRT) popular among low income groups, which is believed to account for

³⁴³ Serbia and FYROM closed them after the fall of Milosevic.

20-25% of all illegal consumption. Triangulating the outcomes of all research methods, including the drop in legal sales due to rises in prices and the ban on smoking in public spaces, allowed CSD³⁴⁴ to estimate illegal consumption at 25-27% of overall consumption³⁴⁵ (Figure 22).

FIGURE 22. DYNAMICS OF LEGAL AND ILLEGAL SALES OF CIGARETTES IN BULGARIA (2008 – 2013)



Overall, the Bulgarian illicit tobacco market is highly dynamic and has undergone a number of contractions and expansions – even “restarts” – which frustrates the efforts of both law enforcement officials and researchers. Each contraction and expansion of the market creates conditions for the entry of new players and the return of old ones. Each new cycle also creates the need for start-up funding of new entrants.

Both data (Table 34) and interviews with customs and police officers indicate that there has been a linkage between the growth in the illegal market and the number of seizures (BG-E7, BG-E13, BG-E14): while in 2008 the seizures of illegal cigarettes are 0.5% of their estimated volume, in 2011 they were as high as 15%. Political instability after 2012 has brought down both seizures and illegal sales.

³⁴⁴ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

³⁴⁵ CSD estimates in 2012 – 2014 are almost identical to the estimates of the Bulgarian Tobacco Industry Association.

TABLE 34. CIGARETTE SALES AND SEIZURES OF ILLEGAL CIGARETTES IN BULGARIA

	2008	2009	2010	2011	2012	2013
Legal domestic sales (billion pcs)	18.77	16.8	10.91	10.8	11.57	11.5
Total illegal cigarette sales (billion pcs)	2.97	3.5	4.93	2.84	2.23	2.66
Share of illegal products	15.8%	17.7%	32.1%	26.3%	24.5%	19.4%
Seized illegal cigarettes (million pcs)	15	91	386	409	181	101
Share of seized cigarettes in all illegal cigarette sales	0.51%	2.6%	7.83%	14.4%	8.12%	3.8%

Source: Customs Agency, Ministry of Interior and KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results.*

Market structure and actors

Bulgarian OCGs active on the domestic and international market for illegal tobacco products can be described as a multi-layered cascade system without hierarchical subordination. Even the criminal networks that manufacture and sell – or buy and re-sell – dozens of containers, do not fit into the model of centralised and subordinated criminal organisations. Availability of financial resources and the social capital of criminal entrepreneurs have become critical factors, rather than a formal hierarchy.

The architecture of the illicit tobacco business can be likened to a system of cascading reservoirs that flow into each other. The largest (highest) reservoirs are filled in first and they overflow into the tanks at the lower levels. The highest level needs to maintain full capacity constantly – a kind of uninterrupted supply – in order to keep the cascade running. For a market the size of Bulgaria this requires the purchasing of several shipping containers a week (5-8 in the period 2011 – 2014).³⁴⁶ The modus operandi in this business is also shaped by the fact that cigarettes are much bulkier than narcotics and thus require an organisation for the movement of large volumes of merchandise, with the corresponding transport infrastructure, ownership modalities, etc. In many ways, the illegal trade needs to be organised like the legal trade of a complex industrial product.

Based on the financial resources they control, several levels of the system can be loosely identified. This is a generalised model as each level has a number of sub-strata (segments) which collaborate not only vertically but also horizontally. There are, for example, a number of small-time criminal entrepreneurs who co-exist with the larger networks and supply the middle and lower level reservoirs. These entrepreneurs and the more established networks can compete, cooperate or function independently of each other.

³⁴⁶ These calculations are based on estimates of the illegal market and are confirmed by key sources (BG-E13, BG-E17, BG-E20).

TABLE 35. THE ARCHITECTURE OF PLAYERS IN THE ILLICIT TOBACCO TRADE IN BULGARIA

High level		
	Importers	These are several large-scale national and international importers who traffic cigarettes to warehouses in Bulgaria.
	Illegal manufacturers	These manufacturers own mobile production facilities which are installed for brief periods of time in Bulgaria or elsewhere in Europe.
	Legal manufacturers	Bulgarian producers selling part of their merchandise to criminal networks avoiding excise and VAT taxes.
Upper middle level		
	Regional level merchants/importers	They buy legally produced cigarettes without paying excise and VAT taxes, as well as cigarettes from illegal manufacturers and large-scale importers. If these merchants can arrange prices lower than offered by the large-scale importers, the latter are bypassed.
	Sub-regional merchants	These sub-regional players buy merchandise from the regional merchants and are part their distribution network. They can also bypass the regional merchants if lower prices can be ensured, even outside of the country.
Lower middle level		
	Suppliers and couriers	These players supply the retail networks and act as intermediaries between the larger scale merchants and retailers. Can have their own small warehouses.
	Independent importers and rogue merchants supplying retailers	An example of the fairly open nature of the illicit tobacco business. They have their own network of ant smugglers and can even traffic larger quantities across the land borders. Can import legally produced cigarettes from neighbouring countries but without paying excise and VAT.
	Owners of ant distribution networks	These players buy merchandise at their own expense and own a network of individual smugglers or small retailers, the latter working for a wage.
Low level		
	Retailers (vendors)	Individuals from disadvantaged social groups (unemployed, pensioners, etc.), including phone sales people and all kind of employees – from cleaning personnel in offices to taxi drivers – who sell cigarettes at their place of work. This group also includes people involved in the transport and security of cigarettes, as well as owners of small warehouses.
	Street peddlers	Recruited mostly among the ethnic minorities and working at open air bazaars.
	Ant smugglers	They carry out smuggling of small amounts of illegal tobacco products. Residing in the regions close to the borders with Serbia and FYROM, these individuals take advantage of the lower price of cigarettes across the border (thanks to the lower excise taxes in Serbia and FYROM). They cross the border daily, supplying cigarettes to certain resale points in Bulgaria and profiting from the price differential. A similar model is applied at the Turkish border with the duty-free shops.
	Tobacco growers and vendors of HRT	The people producing and selling HRT are in the same group. The consumers of the fine-cut tobacco are people with low income, in rural areas, pensioners and marginalised urban populations.
	Factory workers	These are the people willing to live and work for several months in isolation and toil for 10-14 hours a day with few days off.

Source: Authors' elaboration based on the interviews.

The high level

The “cigarette men”³⁴⁷ – players at the highest level of the illicit tobacco market, also referred to as “the heads” – are a good starting point for understating this environment as they have both been the decisive factors shaping the market and provide a link to the origins of this illegal business. As described in the introduction, these players have roots in the tobacco industry before 1990, and in the early 1990s became an institution of their own. In the period 2001 – 2007 – the time preceding Bulgaria’s EU accession – the players at this level were the large-scale merchants linked to the duty-free shops. Around the time of accession (2007 – 2008), most big players were not particularly interested in the Bulgarian market and were either exporting cigarettes from Greece through Bulgaria to Western Europe or had illegal production facilities there. Some, however, had been preparing for the opportunities provided by the sharp rise in the rate of excise tax (BG-E3, BG-E17, BG-C1).

In that period, players at the highest level supplied tobacco products using two basic mechanisms: a) import of illicit whites to the Greek hub and subsequent transfer to the EU member states (including Bulgaria); b) local production through legal cigarette manufacturers with significant market share in the legal cigarette markets in Bulgaria and Greece.³⁴⁸ It is estimated that 5 to 7 merchants, and 2 to 3 legal manufacturers operated under this mechanism in Bulgaria. The illegal manufacturers with 2-3 factories in Bulgaria and 5-6 in the other EU countries are also in this group. This model has price and flexibility advantages over the illicit cigarettes coming from the Middle East and China.

The **first group at this level** – the importers of illicit whites – itself needs to be broken down into two additional categories. The first group are the “old-timers” who were trafficking to Western Europe but were flexible enough to start supplying the Bulgarian and Romanian markets after 2009-2010. They have a well established reputation at the stage of purchasing of shipping containers and can easily expand their orders. The size of the order depends on the type of ship involved but on average includes between 6 and 20 containers. In terms of the number of players, between 3 and 8 members of the core at the Greek hub were mentioned by interviewees. Usually, there is collaboration both in the financing of operations and in buying protection in law enforcement and at the political level. The network of “purchased” law enforcement officers and magistrates is shared. This collaboration is mostly imposed by the need to evenly share the risk and avoid rivalry from the competition. “Play it alone, and you cry” (BG-C1).

The second sub-group includes the new players – “extreme risk” entrepreneurs,³⁴⁹ who have neither the sufficient capital nor the adequate

³⁴⁷ Cf. the “tsigarades” in the chapter on the illicit tobacco trade in Greece in this report.

³⁴⁸ It should be noted that these two mechanisms often overlap at the middle and the lower levels of the distribution network, while the upper levels involve completely separate players.

³⁴⁹ CSD, *Organised Crime in Bulgaria: Markets and Trends*, 27.

experience in the illegal cigarettes business. They had been anticipating³⁵⁰ the black market boom after 2009 and were actively seeking funding to get into the illegal trade. Using political protection, in 2009 some of them managed to make a single purchase of untaxed cigarettes from the then Bulgarian monopoly producer, fictitiously export them to FYROM and return them to Bulgaria. The proceeds of this operation funded subsequent regular imports from Greece (BG-E17). A slump in the demand for illegal tobacco products, stricter customs control (both at the border and inland) and several successful police operations have decimated this group. As a result some became part of the criminal wholesale networks which illegally distribute the brands of legal Bulgarian manufacturers.

The second group at the highest level are the illegal manufacturers. Their merchandise imitates popular brands so well that it took time and luck for the legal manufacturers to discover that their products are being faked. Mobility is the main characteristic of their production facilities, which requires the availability of several locations to choose from. The other key factor is a short life-span – as mentioned, these illegal factories operate for 2-3 months at most, after which they are dismantled and moved to a different location. This is required not only by conspiracy considerations but also by the fact that factory workers cannot work and live for long periods of time in total isolation.

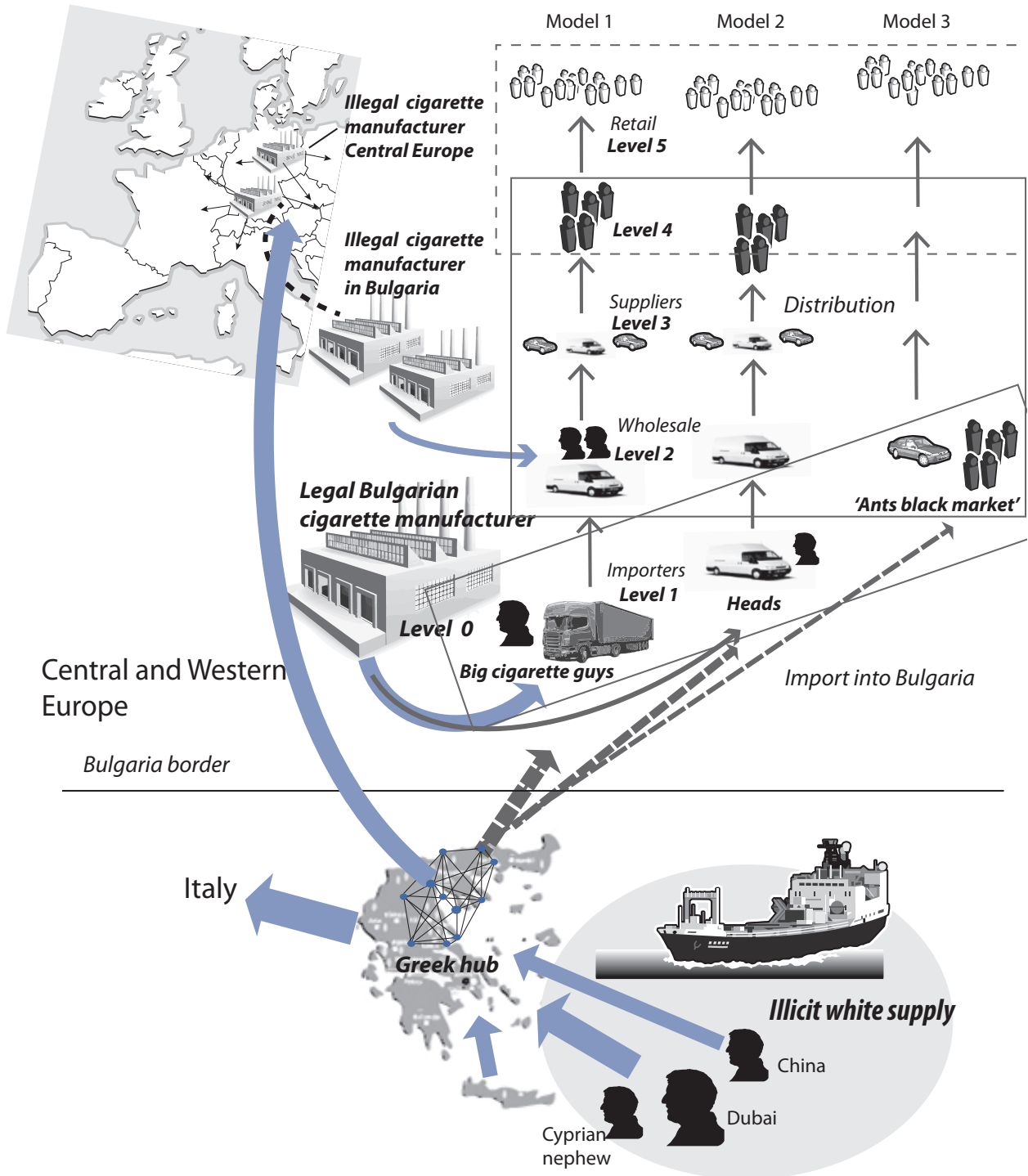
These illegal facilities require several types of participants. The first are the **highly qualified experts**: the tobacco technologist who supervises the tobacco recipe, the industrial engineer who designs and oversees the assembly of the machines, and the production supervisor. Next there are the technicians – usually with experience as workers in industrial plants – who operate the machinery. Drivers are the next category, and not an insignificant one because they have to be trusted and loyal as they are the ones transporting the merchandise and need to observe a number of conspiracy rules. There are also the workers from the already closed state-owned cigarette factories who are hired by the production supervisor and, just as the technicians, do not know the exact location of the mobile factory as they live and work only inside it.

The third group at the highest level are the legal manufacturers who sell their products on the illegal market. This is considered to be the most successful investment scheme. According to interviewees, some are local legal producers of alcohol with long experience in excise tax avoidance through a well-established distribution network. The model tested for a decade with alcohol bootlegging is applied to cigarettes as well: a symbiosis of legal and illegal production. It is believed that this model copies the so called Greek model described in Box 1. The Bulgarian specifics are that initially the legal manufacturer has no established cigarette brands. Its strategy (similar to the strategy on the alcohol market) is to create recognizable brands on the legal market, and then to sell them on the illegal cigarette market (BG-E17, BG-E22).

³⁵⁰ The anticipation is based on their experience in Eastern Europe where they know the potential of the illegal market to react to a sharp price rise (because of excise rise).

The players at the highest level are not involved in the management of the lower levels of distribution (BG-E8, BG-E10, BG-E15).

FIGURE 23. THREE LEVELS AND THREE MODELS OF ILLICIT TOBACCO IN BULGARIA



Source: Authors' elaboration based on the interviews.

The middle level

The **next level** of the system is occupied by the regional Bulgarian criminal entrepreneurs who buy wholesale from the cigarette men. This level provides the link between the upper and the lower levels and their operations are market driven. They move the supplies, taking the risk for the operation. Their capacity is at truck/van level, i.e. they handle about 150-250 master cases (BG-E1, BG-E3, BG-E17). This group of 20-30 players is the backbone of this kind of criminal infrastructure, which large criminal entrepreneurs depend on.

Entrepreneurs at this level are ready to expand their operations when there is a booming market and never completely abandon this kind of business when sales are slow. A cigarette man needs 2-3 players at the middle level who can activate the distribution at the lower levels. Without prior coordination with these players, the investment of large-scale criminal entrepreneurs can easily flop.

Middle level merchants are usually local businessmen with a sizeable business of their own, typically some kind of commerce – including alcohol and tobacco – and having their own transport companies. They employ a manager for the illicit tobacco trade – a person who is in charge of the organisation – but also bears the risk – of dealing with storers and suppliers (BG-E8, BG-E13, BG-E17).

These entrepreneurs are at varying degrees of collaboration with the highest level, some are even independent and compete with players at their level or higher. For example, to maximise their profits they can import directly from the Greek hub but then the risk is doubled.³⁵¹ Expanding the operations to the level of cigarette men is possible but quite expensive and requires protection from magistrates and at political level; thus, it is not very common.³⁵² Nevertheless, in 2013 and 2014 there have been cases of regional merchants progressing to the highest level.³⁵³ There are also **sub-regional** merchants who typically handle 30-50 master cases; they can go up to 100 master cases in larger regions or become regional distributors in smaller regions (BG-E1, BG-E3, BG-E9, BG-E10, BG-E17).

Next in the illicit trade network are **storers, suppliers and couriers**. In border areas they can ally themselves with small importers and bypass the regional level, although they are typically in fairly clear subordination to the sub-regional merchants. The reason for this kind of relation is that the geographical location limits mobility and the transaction costs increase

³⁵¹ In turn, the distributors buying from them can decrease the quantities they order or stop buying altogether.

³⁵² A less risky option – although one that cannot be controlled by the truck/van level merchant – is to be offered to distribute the product of an illegal cigarette factory.

³⁵³ This kind of upward mobility is not without its risks as evidenced by a criminal entrepreneur with experience in VAT fraud who decided to enter the illegal cigarettes market. Because of late entry, he had to pay 30% more for the merchandise and had to work for without profit for a while. After having large quantities seized on couple of occasions by law enforcement, he was killed, the explanation being that he was an outsider wanting to climb too quickly to the highest level (BG-E1, BG-E14).

sharply. In general, the lower the level of a player in the illicit tobacco trade, the likelier it is that he would be in an employer-employee type of relations with the higher level. This group may include both trusted and long-time employees of the large regional or sub-regional traders and professional criminals. At this lower middle level the number of people with criminal experience is the highest. This is also the level where participants usually run the highest risk: they are in touch with the retailers who may betray them, and they carry risky amounts of illicit cigarettes.

Low level

The third general level of the criminal system that takes care of logistics and supplies are the retailers. At this level, there are also certain mixed models, including an “ants” black market in border regions, distribution networks operated by members of the Roma ethnic group, etc.

The boom in demand for illicit cigarettes – the prevalence of consumption of illegal cigarettes was around 40-45% in 2010, reaching even 90% in some areas – resulting from the shock increase in the excise rate and general economic slump, brought a large number of people with no criminal experience into the illegal market.³⁵⁴ This in turn required a large distribution network ensuring a regular supply of the merchandise. The entry of 5,000-7,000 persons in the illegal distribution within a period a 2-3 months in 2010 was of epidemic proportions. These people had no experience with dealing in the black market – how to find a supplier, storage, etc. (BG-E7). Many retailers – kiosks, small corner shops, etc. – would concede to start selling illegal cigarettes only after being approached daily by a black market supplier (BG-E15).

Following the peak in illegal sales at the end of 2010, in the next 3-4 years the market gradually stabilised, pushing out the large numbers of individuals that got involved at the lowest distribution level. Interviewees indicate that supplies had become erratic, and suppliers come and go (BG-C2, BG-C3). The low quality of illegal cigarettes has also contributed to consumers switching to legal brands. As a result the retailer/street peddler level has become more secretive and closed, and sales have become more cautious. Further, unlike before 2010 – when many legal outlets would sell illegal cigarettes – distributors would now have to seek alternative sales methods since harsh fines and stricter enforcement are discouraging the involvement of legal retailers.

Key to understanding the involvement of many people at this level of distribution – cleaners, drivers, security guards, etc. – is that because of their low income selling illegal cigarettes involves no opportunity cost for them. Larger merchants and suppliers actively seek out individuals from disadvantaged groups who – again, because of their low income and lack of any assets to be forfeited – can count on getting away with administrative penalties only, if caught with small amounts of illegal cigarettes.³⁵⁵

³⁵⁴ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

³⁵⁵ Even if they accumulate many fines, there is a threshold beyond which their property cannot be forfeited.

Financing and financial management

Notable at this level are the ant structures, mostly involving members of the Roma ethnic group. These include ant retail – peddling at places with considerable footfall – and ant smuggling – transporting small amounts from Turkish duty-free shops or legally bought cigarettes from FYROM and Serbia. Entry in both types of activities is reserved for members of particular clans/extended families who work for a wage.

Sources of capital for criminal operations

Legal producers who sell their merchandise at the illegal market

The model is applied by a large oligarchic group which uses political and judicial influence to secure its investments. The same approach has been tested for a decade in the investment in the liquor and wine market. It is a symbiosis of legal and illegal investment. To enter the illicit tobacco industry, a privatised factory of the state tobacco monopoly is bought with a credit of €15 million. The purchase is carried out through the stock exchange, supported by a loan from a large Bulgarian bank. The actual ownership structure is hidden through the use of an attorney partnership and offshore companies. A competing Bulgarian oligarchic group actually wins the bidding for the deal and tries unsuccessfully to challenge the privatisation transaction. This may be the reason why the initial entry in the illicit cigarettes market is very cautious, and the new brands are being tested mostly on the legal market, supported heavily by advertising and development of the distribution network. It is believed that at the period of building the brands, cigarettes have been sold at a loss. The cost of the whole brand building operation, including the subsidies, is estimated at about €20 million.

The large importers (who can be seen as a periphery of the Greek hub) have made their initial investment back at the beginning of the 1990s. The social capital of this group is joint participation with their Greek partners in various legal and grey business ventures. These include trade and real estate legal companies, grey import from China (the so called Chinese cargo) through the ports of Thessaloniki and Piraeus, joint ventures in transportation companies and shady investments in real estate (BG-E17, BG-C1, BG-C1). After the accession of Bulgaria to EU and lifting the customs control between Bulgaria and Greece, the old Bulgarian cigarette men increased their share with capital and management of the container transport to Central and Western Europe (BG-E3, BG-E17, BG-C1, BG-C2). As it became possible for illicit whites to enter the Bulgarian market, the investments were expanded by ordering more containers through the Greek hub. By the mid-2010, 1 out of 4 containers bought by Bulgarian traders was destined for the Bulgarian market (BG-E22). If the cost of a container is between €200,000 and €275,000, the expansion is roughly in this amount. In addition, corruption fees and logistics cost €50,000 to €100,000. Putting these two sums together shows that the entry capital at this level is €250,000 to €375,000 (BG-E3, BG-E17, BG-E20). Expansion relied on various sources. In some cases, the Greek partners simply provided in-kind credit.

“Most players moved funds from other businesses, just at the beginning of the crisis. Others started to order less ‘Chinese cargo’, fewer shoes, fewer toys. Others froze their construction projects. [...] People who had exited completely the cigarette business (and gone to construction, trade), now made a second entry. However, despite being trusted, they had to wait longer, to invest twice as much as the old players” (BG-C1).

Greek importers used to provide in-kind credit to Bulgarian partners when they saw that they are reliable and business is growing. This continued even after the number of seizures grew due to the introduction of X-raying at the border, as long as the Bulgarian counterpart was not known to have problems with the law (BG-C1).

Political protection of the investment

There is evidence showing how a group of new players – extreme risk entrepreneurs – got an opportunity at the beginning of 2009 to purchase from the then still state-owned tobacco company³⁵⁶ cigarettes at around 22.5 euro cents per pack. The initial investment required was €60,000 per container. These containers were exported from Bulgaria to FYROM and then returned back to Bulgaria. An additional €50-60 thousand was needed for logistics, border crossing and security. These initial €110-120 thousand got them around €650 thousand in retail sales, which was then reinvested into further cigarette purchases from the Greek hub. At that moment, there were at least 2-3 groups exploiting this scheme (BG-E17).

Criminal entrepreneurs at the middle level (150-250 master cases)

The most typical type of financing – respectively financier – comes from a legal cigarettes or other excise goods business. These are people who already understand this kind of market but their legal profit margins are very thin because of the high excise rate. There is reason to believe that the expansion of the business following the 2009 – 2010 boom had been done with operational capital loans. Given that it was the height of the financial crisis, the banks must have seen these as low risk credits. It should be noted that the operational credit needed to buy legal cigarettes is higher than the one needed for illegal cigarettes. Thus, there is reason to believe that the bank branches have been aware of the black market business of their customers (BG-E15, BG-E16). With the new cigarette wave, the initial investment has been about €100,000 to €150,000. Its size depends on how affluent the area is. If a supplier is changed (because another offers lower prices), the amount can go up to €250 thousand (BG-E2, BG-E3, BG-E12). When a larger scale illegal merchant works with a legal manufacturer, the former undertakes not to export the merchandise outside Bulgaria for fear of seizures (BG-E1, BG-E8).³⁵⁷

³⁵⁶ The state-owned company would only use tested and approved distributors. In this case, despite objections the company was forced to sell to these new players.

³⁵⁷ According to interviews with OLAF officials, there have been very few seizures in the EU of cigarettes of legal Bulgarian origin.

As in the drugs market, here also a prospective criminal entrepreneur can get trade credit. An interviewee (BG-E20) relates the story of a law enforcement informer who had to help uncover an illegal warehouse. During the first attempt his van could not be tracked so he called the supplier to say that he failed to sell the merchandise; “no matter”, he is told, “you can come for more”, effectively providing him with trade credit.

Small retailers who work at their own expense usually start with €1,000-€2,000. “A Turkish guy gave me €1,000 and I paid him back in 3 months €1,225” (BG-C3). The entrepreneur is both financier and organiser, typically has a legal business (a hotel or a small production enterprise) and himself delivers the merchandise to sales points (hair salons, cafés, etc.) (BG-C3).

At the lowest level, retailers start with 2-3 cartons at €9-€12 each or a kilo of tobacco. They can also get these on credit, to be paid after receiving them 2-3 times. Their regular income is quite low – €70-€80 a month³⁵⁸ – while they can get double that by selling illegal cigarettes (BG-E9, BG-C4).

Retailers that make €100-€150 a month require small amounts to enter the illicit trade – €20-€30 (when they traded legally, cigarettes would make around 10% of their revenue) (BG-C4). Larger traders with a turnover of €4,000-€5,000 do not require bigger entry amounts, either. Supply is increased only gradually until the limits of the demand are established, thus minimising the risk (BG-E17).

Settlement of payments

The legality of the payment methods varies at the different levels of criminal operation.

High level

Payments for the illicit whites entering through Greece are done through the legitimate banking system as these are made by a range of entrepreneurs who have long had contacts with the manufacturers. At the period of high demand for these cigarettes in Europe the illicit whites factories were working at full capacity and there were waiting periods, so there was a large volume of transactions. Although a buyer outside a closed circle of players has no chance of getting a deal (BG-E15, BG-E16, BG-E18), tracing the payments is of little use to law enforcement as there is nothing illegal at this stage – no offshore accounts, no suspicious transactions, etc. Traditionally, the players in the Balkan cigarette smuggling market who buy large quantities from large legal manufacturers or distributors use legal payment channels, utilising bank warranties and other bank instruments. This way, the large players in the illegal tobacco industry are able to keep out the smaller players (the outsiders), who operate with cash payments. One of the examples

³⁵⁸ *Analysis of the Situation in Relation to Minimum Income Schemes in Bulgaria: A Study of National Policies*, George Bogdanov, Boyan Zahariev, Peer Reviews in Social protection and Social Inclusion, 2009.

of an organisation designed to control the lower levels of the market was the group of Ivan “the Doctor” Todorov, who was shot in 2006.³⁵⁹ The group made players at the lower levels of the market pay for bank warranties that it provided to them (BG-E3).

The logistics companies are perfectly legal but their warehouses are in countries such as Egypt, Libya, Tunisia and after a series of documentary transfers the tracks of the merchandise get lost. These transfers are done between companies registered in Asian countries as it takes a long time to receive a response to an inquiry. Legal payment methods are also used between Bulgarian legal producers and wholesale illegal merchants: “They pay through their own bank. It is probably concealed within their legal purchases for cigarettes and alcohol. However, no one has sought indications of problems between invoices and bank transfers” (BG-E8).

Middle level

Cash payments are typical at this level. “In June 2012, a Varna-based businessman financed the purchase of smuggled cigarettes from Greece to be sold later in Bulgaria. He handed in the money personally at a meeting in one of his restaurants. He brought €250,000 to pay for the import from Athens. The financing was provided in exchange for a share in the distribution and payment after sale (BG-E1). When criminal entrepreneurs who do not know each other need to do business, various methods are applied to ensure against a possible swindle. One method is explained by an interviewee:

“The transaction scheme is similar to the one used for returning stolen cars for ransom (known as ‘the Indian’ or the ‘one hander’) – one hand (the hand that takes the money) does not know where the truck-load of cigarettes is. The truck is parked the previous day at a remote location – in this case a town in Northern Bulgaria whereas the money is expected at the petrol station in Sofia. When the money is exchanged, the buyer sends a trusted helper who finds the keys hidden in the vehicle. In this case, it was about 140 master cases of the brand *Kapital* which looks like *Davidoff* for the amount of €60,000. The price is agreed to be lower because during the negotiations it became clear that there will be a shipment a week” (BG-E1).

Cash upfront became the most common payment method following the stabilisation of the illegal market after 2011. In order to collect the payment, smaller orders are placed at more frequent intervals. “In other words, instead of one, three supplies are made. If payment is not advanced, placing an order gets more difficult and only 1-2 are allowed” (BG-E6, BG-E10). In this way, the movement of payments upstream precedes the movement of the merchandise downstream by about a week.

³⁵⁹ Millenium, *Колекция: Убитите Босове 6 – Иван Тодоров Доктора [Murdered Bosses Collection, Book 6: Ivan “the Doctor” Todorov]* (Sofia: Millenium, 2008).

Costs of doing business

The costs for operating at a given level are also indicative of the start-up capital needed to enter the market. As the understanding of the illegal market for cigarettes requires an analysis of both production and trading, the respective costs need to be considered separately.

Production

Legal manufacturers who sell illegally

Direct costs involved in this kind of operation include:

- The premises and machines in this case are shared. Data for the quantities produced by the main Bulgarian manufacturer indicate that between 8 and 11 million packs of both legally and illegally sold cigarettes are produced monthly,³⁶⁰ meaning that half of the depreciation of machines should be attributed to the illegal merchandise (BG-E16, BG-E18).
- The same division ratio applies to materials – tobacco, paper, cigarette filters, etc. (BG-E16, BG-E18).
- With respect to the remuneration of workers, costs related to the illegal merchandise are referred to as the “third shift” (BG-E15, BG-E17).

Indirect costs involve the marketing – including research, advertising, and retail support of brands which do not have a long tradition in Bulgaria. Illegal sales capitalise on the effect of this marketing. The manufacturer has transferred all the costs involved in the distribution of the illegal merchandise – transport, bribery, peddler wages, etc. – to the illegal merchants. Many costs associated with the legal side of business, however, would not have been made had it not been for the revenue from illegal sales (BG-E16, BG-E17, BG-E18).

At the manufacturing level additional costs include political protection, the estimates of which vary between €2-3 million to €10 million per year (BG-E17, BG-E20, BG-C1); given that the latter number would make such a production unprofitable, the former seems more realistic. Corruption expenses with respect to law enforcement officers and tax officials are considered to be around 10% compared to the amount for political protection. Expenses for media advertising (sponsorship), although shared with the legal production, are estimated at an additional €2-3 million per year, with the same amount needed for product development and loan repayment. There are also the reserves that need to be maintained which are around 10% of the annual profit (BG-E3, BG-E11, BG-E17, BG-C1, BG-C2).

Illegal manufacturers

Illegal factories that deliver good quality products require several types of investment:

³⁶⁰ The roughly equal division between the legal and illegal merchandise occurred for the first time in 2011. In 2014, data from retail and empty pack surveys and consumer polling indicate that the illegal exceeds the legal by 30-40%.

- Costs associated with the factory site, usually in inconspicuous locations.
- Equipment costs are related to the acquisition of old cigarette production machines which are still abundantly available in Bulgaria because of its communist-era specialisation. Maintenance expenses in this case are important because spare parts are difficult to obtain and can even be imported from China. There were Bulgarian companies which used to manufacture machines for the tobacco industry; after 1990s they specialised in the maintenance of the old equipment.³⁶¹
- Costs for additional equipment which conceals the work of the factory – said to be on occasion more expensive than the production machines – including specially designed air conditioners and insulation preventing the smell from giving away the factory, own power generators in order to conceal the high consumption of electricity, etc. (BG-E8, BG-E12).
- Expenses for raw materials and consumables. The cost of tobacco is a particular consideration as fair quality cigarettes require 20-40 varieties of tobacco. The importation of leaves from Brazil, Zimbabwe, the United States, Malawi, Argentina, India and other countries need to be clandestine – which adds further expense – in order to prevent being traced to the factory (BG-E8, BG-E17).

It is difficult to make an estimate of the assets of the manufacturers as the equipment has been accumulated over time with the first investments going as far back as the early 1990s (BG-E 17). The social capital of the owners is also difficult to measure as most of them are entrepreneurs with considerable expert and managerial experience.

There are several sub-groups in this manufacturing category which differ in the quality of their product, and the respective cost.

- The production of illicit whites requires minimal investment as equipment, materials and labour are cheap. They can not afford much counter-surveillance investment, and so are frequently uncovered by law enforcement.
- Then there are those who imitate low end brands where most of the quality effort and expense goes into the packaging. They cannot produce large quantities as otherwise the legal producers would detect it in their sales. Seized production facilities have been estimated at around €400,000 per factory.
- The third sub-group are the producers of mainstream brands. The Greek *Karelia* is popular among these manufacturers as it has a large market share and is often smuggled untaxed from Greece. Seized production facilities have been estimated at around €600,000 per factory.

It should be noted that this model works because cigarette factory owners are able to move freely abroad. There have been several investigations in the EU and in Balkan countries where Bulgarians have been involved

³⁶¹ In the last decade, a number of workers and illegal factory equipment originating from Bulgaria have been detected in Greece, Poland, Germany, Austria and the former Soviet republics (BG-E11).

(BG-E3, BG-E12). People related to a factory in Greece have been later caught in a factory in South-western Bulgaria, or machines from an illegal factory in Austria or Germany have later been discovered in an illegal factory in Bulgaria close to the Turkish border (BG-E11). Unfortunately, too little is known of the cooperation of distribution networks in EU countries with Bulgarian manufacturers: how expenses are shared, how margins are determined, etc. The cost of various forms of mobility (transfer of people, machines, management of raw material and consumables) is also unknown.

Trading

High level

The cost of illicit whites in the Dubai factories has been changing, but before the 2008 crisis a pack cost between 15 and 30 US cents or between €55,000 and €110,000 for a container. Having gone through various warehouses and ships, these arrive in Greece at around €200,000 and €290,000 for a container. Established traffickers paid on average €180-€200 thousand, but to get that price they needed to purchase at least 2-3 containers. At that time, out of 4 containers only 1 stayed in Bulgaria. After 2009, additional investments were required in sustainable logistics (transportation and warehousing) and for ensuring the security of the supplies (bribing customs and police).

Middle level – regional merchants

At the time of the mass imports of illicit whites from the Greek hub, merchants used to buy the pack at 75 euro cents or around €75-€100 thousand per shipment. Prices have gone down since to 51-56 euro cents or €50-€55 thousand per cross border shipment and 44-50 euro cents (€44-€51 per shipment) per pack from a legal Bulgarian manufacturer.

These merchants can arrange a shipment directly from a Greek supplier thus bringing the price of a master case down by about €50, or around 20% per ¼ of a shipping container (250 master cases). To get into this category, however, these entrepreneurs need to ensure safe passage of the border and transportation within the country. During the boom of the illegal cigarettes trade there were cases of cooperation among several merchants for the establishment of a sustainable smuggling route, as the required additional investment is around €20,000.

Middle level – sub-regional merchants

Initially these players bought at between 72 and 82 euro cents per pack investing €18-€20 thousand per shipment of 50 master cases, but if a smuggling operation is in its early stages it can cost them up to €50 thousand. There have been instances when a regional merchant would suggest a cooperation, whereby he would provide half of a €200-€250 thousand investment, and another 2-3 smaller partners would come up with the other half (BG-E9, BG-E10, BG-E17). Later, the prices for a master case at this level also came down, meaning that an entrant

would now need an initial amount of around €30 thousand (in addition, of course, to being *allowed* to enter by the established players) (BG-E9, BG-E16). There are also smaller traders who need a start-up investment of €15-€20 thousand, depending on the region (BG-E10, BG-E17). Local level suppliers, when independent entrepreneurs, buy at 77-92 euro cents per pack, which requires between €6,000 and €13,000 for 8 to 15 master cases.

Low level

Street peddlers work for a wage which depends on the location – for example, at a popular open air market in the capital Sofia the daily wage is €35-40 while in the suburbs it is €10-15.

At peak moments, when there could be up to 300 people working at the markets, the peddlers would be guarded thus increasing the price of cigarettes due to the expense for security guards. As most of these workers come from poor backgrounds, there are additional forms of compensation, such as provision of housing for them in apartments owned by the local boss or in municipal housing ensured through bribery of the local municipal administration.

The average salary the workers at the illegal factories receive abroad (usually somewhere in Greece or Central Europe) is € 1000-1200, and in Bulgaria is € 500-600 per month (BG-E6, BG-E12).

Profits and profit sharing

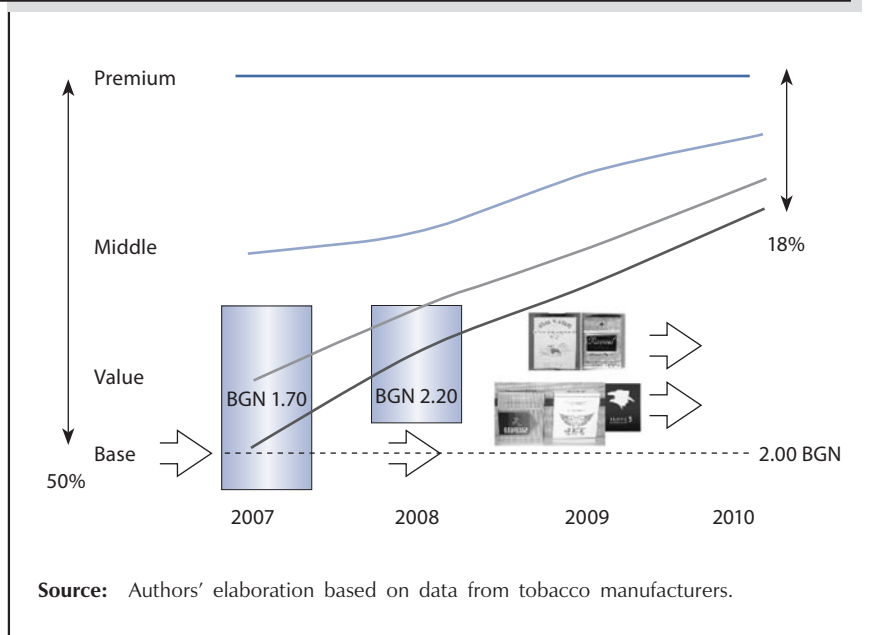
As could be expected, the profit margin in the illegal cigarettes business depends on the mark-ups of the players at the various levels of trade. With a production cost of 20-25 euro cents per pack, plus the excise and VAT, at least 2.10 euro cents mark-up is needed for a profit. For comparison the average retail price per pack of licit cigarettes in 2001 is just 40 euro cents. An additional factor influencing both sales and profits is a kind of “compression” – the diminishing price differential between the premium and “value” brands. Because of the rise in the excise tax rate, the difference has come down from 50% in 2007 to 18% after 2010.

In the past 5-6 years, the profit margins have been changing dynamically, influenced by the competition among varying sources of cigarettes and tobacco³⁶² at the stage of entering the country, further reflecting on the prices for end consumers. An additional factor in Bulgaria are differences in regional pricing: while in large cities such as the capital city Sofia illegally sold premium brands are priced at around BGN 3.50 (€1.75), in poorer regions such as the border areas with Greece they can cost BGN 2.20 (€1.10) or even less (BG-E8, BG-E11).

Margin not only fluctuates, but is also dependent on the length of the supply chain. There are typically 5-6 levels, although in border areas there can be as few as 3 because the easy access to smuggled cigarettes

³⁶² The market of HRT is quite different so it will not be considered here.

FIGURE 24. CHANGES IN THE PRICE DIFFERENCE BETWEEN PREMIUM AND VALUE BRANDS IN BULGARIA



Source: Authors' elaboration based on data from tobacco manufacturers.

allows few distribution levels to ensure sufficient profit at low risk for the players (BG-E13, BG-E18). A key factor is, of course, the volume of the orders: the differences between an order of 250 and of 100 master cases are tangible (BG-E8, BG-E9, BG-C1, BG-C2). Thus, if the margin is, say, 23 euro cents per pack, or 32% at 200 master cases, for larger volumes the trader could give a discount and bring his margin down to 29-30% but receive a larger gross amount (BG-C2).

In 2011, the illegal market stabilised at levels that would be maintained for the next 3 years; the sales are at 2.8 billion pieces or 11.6 million packs per

month (Table 34, above). In that period, the structure of the black cigarette market is approximately as follows: Bulgarian legal manufacturers had 35-40% of the illegal market, with another 35-40% being illicit whites from Greece and the remaining 20% of small scale smuggling and counterfeit brands produced in Bulgaria and the neighbouring countries.

The proposed models are based on the combined knowledge of different sources and allow for the enormous (and still growing) margin to be traced systematically across the supply chain. On each level there are fixed costs such as salaries, depreciation, raw materials, transport and infrastructure; however, they are usually shared with legal business expenses for both conspiracy and financial reasons. As previously shown at the higher levels there are key expenses such as bribery which are again shared by the illegal and legitimate side of the business.

The tables below show indicative assessments of the monthly margins at the different levels in three of the main schemes. In scheme 1 the main illicit cigarette source is a legal Bulgarian tobacco company; scheme 2 uses cigarettes supplied by the Greek hub while scheme 3 deals with small scale smuggling. At each level the margin is calculated by deducting all previous expenses per piece along the chain and multiplying it by the volume sold monthly.

In scheme 1, the mark-up and margin of the various trading levels for the cigarettes of a Bulgarian manufacturer are presented in Table 36.

Scheme 1 (where production cost is €0.20-€0.23 per pack with a retail price at €1.50) is applicable only for the big cities. At the smaller and poorer local markets the retail price will be in the range €1.10-€1.25 which means lower margins on every supply level. It is worth noting

TABLE 36. ILLEGAL SALES IN LARGE CITIES OF THE MERCHANDISE OF A LEGAL BULGARIAN MANUFACTURER

Level at which entrepreneur operates	Buys/Cost (€/pack)	Sells (€/pack)	Monthly margin excluding expenditure and corruption fees (€)
Level 0, manufacturer (cost)	0.20-0.23	0.44-0.49	~1,100,000
Level 1, buys 200-250 master cases	0.44-0.50	0.60-0.65	80,000-100,000
Level 2, buys 30-50 master cases	0.60-0.65	0.77-0.82	15,000-20,000
Level 3, buys 8-15 master cases	0.77-0.82	0.92-1.03	2,500-7,700
Level 4, buys 1-2 master cases	0.92-1.03	1.28	1,000-2,000
Level 5, buys 2-14 cartons	1.28	1.54	150-1,200

Source: Authors' elaboration based on the interviews.

that for the Greek model to work prices and consequently margins must fluctuate constantly (BG-E3, BG-E17, BG-C2) and so within a month the retail price can vary from €1.50 to €1.35 and back to €1.50 (BG-E6, BG-E9). Because of this, any margin assessments can be highly speculative.

“When all corruption fees (political protection, media support, bribing law enforcement officers, tax officials and magistrates) are taken into account, out of a revenue of €12-13 million at that time, the net profit would have been around €2-3 million. Now [after 2012], however, that [the manufacturer] is virtually a monopolist, the net profit could be as high as €10 million“ (BG-E20, BG-C1).

When the expenses and the corruption fees³⁶³ of the trade are deducted, out of an annual gross profit of €300 thousand to €1 million the middle level merchants retain around €500 thousand, provided there are no damages not covered by the reserve fund. If an incident should happen, the profit could be halved; the same applies to second and third levels (BG-C2). The issue which remains open is whether the various levels can come to an agreement on the sharing of incidental costs, or respectively sharing higher profits when they occur.

As regards illicit whites imported from Greece (initially also from Turkey), the profit distribution is similar to the one for the legal manufacturer, the difference being that level 0 is the Greek hub, while large-scale importers share the profit with intermediaries in Greece (Table 37). Here also, from a revenue of between €1.2 million and €3.6 million, approximately two-thirds goes to cover expenses and corruption fees, with the largest additional expense being a “border crossing toll” of around 30% (BG-E3, BG-E13, BG-E17, BG-C1, BG-C2).

³⁶³ Criminal entrepreneurs refer to them as “participation tax” (BG-C1, BG-C2).

TABLE 37. PRICES PER PACK OF ILLICIT WHITES AND MONTHLY PROFIT IN BULGARIA

Level at which entrepreneur operates	Buys (€/pack)	Sells (€/pack)	Monthly margin excluding expenditure and corruption fees (€)
Level 1, importer from a Greek warehouse	0.50-0.55	0.60-0.65	100,000-300,000
Level 2, buys 200-250 master cases	0.60-0.65	0.77-0.82	40,000-100,000
Level 3, buys 30-50 master cases	0.77-0.82	0.92-0.97	6,000-20,000
Level 4, buys 8-15 master cases	0.92-0.97	0.92-1.08	1,500-13,000
Level 5, buys 1-2 master cases	0.92-1.03	1.28	1,000-2,000
Level 6, buys 2-14 cartons	1.28	1.54	150-1,200

Source: Authors' elaboration drawing on the interviews.

Levels 3 and 4 pushing for larger profit margins has been – together with stricter law enforcement and the superior quality of the domestic legal producer – an important factor in the shrinking share of illicit whites from Greece. They are also involved in dealing in cigarettes illegally produced in the country and imported from Greece. If they find a contact in Greece, these middle level criminal entrepreneurs enter at the price level of the large merchants but pay a premium for buying smaller quantities, and also have to pay the border crossing “toll” (corruption fee). Further down, the merchants buying from them need also a larger profit margin in order to make commercial sense to buy the more expensive merchandise. With respect to illegal manufacturing the scheme is similar: illegal manufacturers usually work with merchants handling 200-250 master cases by giving them a good margin and overall earn higher profit thanks to lower cost (no border crossing tolls to pay).

The case of entrepreneurs operating networks of ant smugglers in border regions is somewhat different. Their operation can be compared to an hourglass: in the upper bulb, the entrepreneur hires dozens of individuals (usually from socially disadvantaged backgrounds) to make a number of “runs” smuggling small quantities from a neighbouring country or the duty-free shops. In the bottleneck of the scheme, he then buys up all the stock from the ants, pools it together and, in the lower bulb, he deals as a wholesaler (Table 38).

At the lowest levels, the income is in the form of a daily or monthly wage. Wages depend on the turnover a retailer/peddler can muster, which is dependent on the location. The most effective ones can earn €1,250-€1,500,³⁶⁴ in most cases this being an additional income. Typically, these are individuals in night clubs, grocery shops in large cities with a good

³⁶⁴ The average monthly wage in Bulgaria in 2014 was €400.

TABLE 38. PROFITS IN AN “HOURGLASS” SMUGGLING SCHEME IN BULGARIA

	Buys (€/pack)	Sells (€/pack)	Monthly margin excluding expenditure and corruption fees (€)
Level 1, buys 3- 10 cartons	0.77-0.82	0.92-1.03	150-1,200
Level 2, buys up and pools 8-15 master cases	0.92-1.03	1.28	2,500-7,700
Level 3, buys 2-14 cartons	1.28	1.54	150-1,200

Source: Authors' elaboration based on the interviews.

footfall, the so called “exclusive suppliers”,³⁶⁵ popular mobile vendors,³⁶⁶ etc. (BG-C4, BG-C9, BG-C2). Then there are vendors in grocery shops in smaller towns, other mobile salespersons such as taxi drivers, who can make €500-€750 per month. At the bottom of this distribution network is the poorest segment of the population – unemployed, pensioners, individuals in remote villages. In addition to cigarettes they also sell HRT in packages of between 100 grams and a kilo; they earn €100-150 per month (BG-E9,BG-E17).

Access to capital in critical moments

The financial aspects of the Bulgarian illicit tobacco market are cyclical and each new cycle places different demands on criminal capital. Additional investment by criminal entrepreneurs in the illicit cigarettes business is particularly needed in times of sharp increases of the excise tax or of political instability. Conversely, when consumers have adapted to the new prices and multinationals demand more sales from their distribution networks, this puts additional pressure on customs for more revenue and law enforcement becomes more active in seeking seizures; in such times criminal entrepreneurs may choose to suspend operations (BG-E3, BG-E17). “All criminal markets are cyclical but this is an industry. There are industrial processes involved in the cigarettes market and there is a considerable momentum created by the production of millions packs a day and hundreds of thousands of smokers seeking to buy” (BG-E3).

Most criminal entrepreneurs maintain reserves – a number of master cases of each shipment are set aside and revenue from them is placed in a reserve fund. This fund has two functions (BG-E3). The first is insurance against unexpected losses – such as those made by inexperienced new entrants – and additional expenses at turning points of the operation. The latter usually arise at times when the network is being restored after a critical moment – before its various parts fall into place and start operating smoothly the system is vulnerable to various hitches, such as

³⁶⁵ Owners of industrial enterprises allowing only one illegal cigarettes vendor to enter the premises and sell to the workers.

³⁶⁶ Orders are placed over the phone or online and delivered only if the vendor knows the client personally. New clients are admitted only after a recommendation.

law enforcement seizures, merchandise being lost or stolen, deceit by a trading partner, etc. Seizures in particular can go up by 15-20% at such times thus necessitating additional bribery expense for law enforcement officers,³⁶⁷ magistrates, lawyers, etc. At the end of the criminal career there is also the “exiting” expense – if a criminal entrepreneur wants to retire uneventfully he needs to insure himself against prosecution or media inquiries (BG-E17, BG-C1, BG-C2).

Although there have been fewer seizures, the damages suffered by criminals have grown (BG-E17, BG-C1). “If you’ve lost twice in a row and you are short on cash, you need to borrow. If you can’t borrow from friends, then you will have to pay high interest or give the creditors a stake in the business. In any case, they will require a collateral – they would have researched you and know what you own. Another blunder, and you are out for good” (BG-C2).

The second function of the reserve is related to the need of maintaining liquidity of the criminal capital. Money cannot be invested in something with limited liquidity such as real estate. “You can’t buy a car or a seaside villa, you can’t keep it in the bank. It needs to be in cash in high denomination notes, best of all euro” (BG-C1).

At the level of the Greek hub there is a specific form of capital raising – network financing. At critical times – such as the second half of 2011 when it seemed that action would be taken against the hub – players at that level mobilised resources within the network. „There were at least 4 or 5 ships loaded with varying numbers of containers that are just cruising around unable to dock as they will be nailed. The merchandise, however, has been paid for. Couple of guys went to check what are the chances of going through Georgia. [...] If they would let us work, enough money can be put together, and then they can seize all they want; only if we could be allowed to work for a while” (BG-C1). The loss of containers is a calculated damage, and in these cases the other players can help, even “the person can be allowed not to pay back” (BG-C1). The only irreparable damage to the hub can be inflicted at the political level, in which case even networked financing cannot help and other means need to be sought (BG-E17).

In the period 2009 – 2011, the seizure of one container required the sale of 3-4 containers to cover the losses. It depends, however, how the cigarettes have been seized. If uncovered at the warehouse, then the costs are not significant – lawyers, fines, etc. If captured during inland transportation, however, the damage could equal the value of a whole container. As a result, in recent years cigarettes would not be typically stored in warehouses but a kind of mobile warehousing would be used – trucks and vans load and offload without going through storage facilities, the locations for transfer being arranged at the last minute.

³⁶⁷ An example is the case of an informer who had to leave his van to be loaded by a large importer (the conspiracy requirement is to leave the van open with keys hidden somewhere in the vehicle). When law enforcement tracked the empty van, a special police unit was called in but found nothing in the warehouses. Later, the importer demanded the informer recoup the €40,000 he had to pay the police to remove the cigarettes container. The subsequent investigation uncovered two police officers who took the money, and had also previously prevented several law enforcement operations (BG-E2, BG-E20).

Another model applies to players down the chain of distribution. The creditor is also the head of the distribution network. “If I borrow €1,000, in 10 days I need to pay back €1,250. I need to pay back after 20 days, the latest. If you are late, he has a group that collects debts. If there is a surety, he is also held responsible” (BG-C3). These creditors can, however, help when there are problems with the sales, in which cases the interest is smaller or the repayment period is longer. “There was no interest – just a deadline, depending on the amount borrowed. Of course, there had to be a collateral” (BG-C4).

Overall, raising criminal capital at critical moments presents the entrepreneurs with a choice between two options. The first option is to figure out whether it is cheaper and less risky to transfer funds from another illegal business – e.g. VAT fraud or illegal logging – than to borrow against high interest – or to seek a co-investor with whom to share the profit. The second option is to use money from a legal business in which case the downside is the cost for the legalisation of the funds. Given that, according to BG-E3, in Bulgaria this cost is not high, the demand for expensive external funding would be lower than in countries with stricter enforcement of money laundering regulations.

5.2. GREECE: THE RISING SHARE OF ILLICIT CONSUMPTION IN A TIME OF CRISIS

Introduction

Tobacco smuggling is a common criminal activity in Greece, due to its important geographical position situated in the route of the tobacco smuggling from Asia or North Africa to Europe. As a result, Greece has become a source, transit and destination country. The extent of the Greek land and sea borders, the large number of Greek islands and long coastline are factors facilitating tobacco smuggling. This cross-border criminal activity is operated almost exclusively by organised criminal groups consisting of members from more than one nation, with specific roles, duties and responsibilities.

Tobacco smuggling and illicit tobacco trafficking are investigated and prosecuted by the Hellenic Police, Financial and Economic Crime Unit, Customs Office, Coast Guard and the Public Prosecutors. They cooperate with each other and with other European agencies, such as Europol, Eurojust, OLAF, to synchronise their actions and be more effective. This type of smuggling has serious consequences for the economy of the member states of the European Union because of lost revenue and ill effects on public health (because of the questionable quality of contraband tobacco), and in the funding of organised crime.

In the Greek criminal justice system tobacco smuggling was not considered organised crime until 2012 and, as a result, members of such groups when arrested were not convicted for participating in a criminal organisation and given mild convictions. This has been a crucial factor in relation to the spread of tobacco smuggling in Greece during the last

decade. Another key factor is that since 2008 the cigarettes excise tax has been increased, so the retail price per packet also increased from €2.10 in 2007³⁶⁸ to €3.90 in 2014. This tax policy in combination with the widely shared attitude that avoiding tax payment is not a serious crime created a considerable interest in illicit whites and caused the spread of smuggling. As a result of changing criminal policy, the police report on organised crime identified 19 OCGs in 2011,³⁶⁹ while the same report for 2005 had only 5.³⁷⁰

Organised crime groups involved in tobacco smuggling are divided into those that deal with the illegal importation and transfer of the tobacco from abroad to Greece or to Northern and Western European markets, and those that deal exclusively with the selling of tobacco products in Greek markets.

“There seems to be a range of ‘entities’ involved in cigarette smuggling that can be placed on a continuum. [...] In addition, there are specific ‘actors’ in the cigarette smuggling business in Greece including the corrupt public officials, and the legal sector.”³⁷¹

In general, in Southern Europe, a sector of the Italian mafia is one of the main dealers in tobacco smuggling and they transport huge quantities of illegal tobacco products from Albania, FYROM and Croatia to Sardinia and Naples by high speed boats.

Market overview

Criminal organisations are generally not confined by national borders. They often create partnerships within and outside the EU either with individuals or with other networks to commit individual or multiple crimes. These groups appear to be increasingly involved in the legal and illegal market, using experts who are not criminals and also non-criminal structures, assisting them in their criminal activities. In addition, they enjoy the freedom of movement of capital, goods, people and services in the EU. Some criminal organisations, especially indigenous groups, move towards low risk – high reward (cigarettes, alcohol, outdoor crime) than to high risk crime (drugs).³⁷²

This happens for a number of reasons:

- the penal consequences for those who sell illicit cigarettes are lower than for drug dealers while the rewards are high in both crimes;

³⁶⁸ G. A. Antonopoulos, “Μετανάστευση, συνωμοσία του άλλου και οργανωμένο έγκλημα στην Ελλάδα [Alien Conspiracy and Organised Crime in Greece]”, *Egklimatologia, Nomiki Vivliothiki* 2, no. 11 (2011): 38.

³⁶⁹ Hellenic Police, *Ετήσια Έκθεση για το οργανωμένο έγκλημα στην Ελλάδα για το έτος 2011 [Annual Report on Organized Crime in Greece for 2011]*, 37.

³⁷⁰ Hellenic Police, *Ετήσια Έκθεση για το οργανωμένο έγκλημα στην Ελλάδα για το έτος 2005 [Annual Report on Organized Crime in Greece for 2005]*, 2005, 14.

³⁷¹ G. A. Antonopoulos, “The Greek Connection(s): The Social Organisation of the Cigarette-Smuggling Business in Greece”, *European Journal of Criminology* 5, no. 3 (2008): 6, 28.

³⁷² Bruggeman, “Η καταπολέμηση του οργανωμένου εγκλήματος: δυνατότητες, προβλήματα και ευκαιρίες, με ειδικότερη έμφαση Στην Ευρωπαϊκή Ένωση [Fighting Organised Crime: Capabilities, Problems and Opportunities, with Emphasis on the European Union]”, 316.

- law enforcement agencies focus on drugs trafficking due to their serious consequences in social, economic and political terms;
- the capital needed for doing business is smaller in tobacco smuggling than in drugs.

Most OCGs have many members – from 15-20 to much more than that – both Greeks and foreigners. Greeks usually are the leaders, as far as the selling of tobacco in Greece is concerned or taking care of the transportation by trucks to another European country, while foreigners are responsible for the import. “Roles of the persons involved in tobacco smuggling are several and quite different: the wholesaler, the procurers, the street vendors, the scouters, the warehouse guards, the legitimate shop owners, the thieves – burglars, the drivers, the protectors, the deputies, the cashiers and the corrupted officials.”³⁷³

Those groups used to change often the lower hierarchy members, who are usually foreigners, in order to protect the leaders of the criminal groups from being identified by the authorities. It is interesting to note that in cases where ships were confiscated, most of the persons arrested were from East European countries (Romania, Ukraine, etc.).

Organised criminal groups often use legitimate companies in tobacco smuggling. They buy established companies or start new ones which are active in legitimate import/export (e.g. frozen foods in a notorious case in Athens³⁷⁴) and they add tobacco when transporting the products by ship or lorry. In a recent case, the leaders of a criminal group had established several companies in Greece and Bulgaria and they used them to send products along with illicit tobacco. Furthermore, it is known that OCGs are linked with legal businesses such as transport companies which occasionally play an important role in smuggling the tobacco from the country/place of origin to the destination country/place.

A new trend is for criminals to hide the tobacco or cigarettes in refrigerated containers (under the floor for example) that contain legitimate products for legitimate companies which have no involvement in the tobacco smuggling and their owners or their employees know nothing about it. After the delivery of the products to the legitimate companies, the criminals who had tracked the route of the containers take the “empty” containers under their possession by buying or hiring them, thus managing to receive the hidden tobacco or cigarettes.

According to the General Secretariat of Inland Revenue, the seizures of contraband tobacco products made by all the state authorities during the first half of 2013 rose 116% in comparison to the first half of 2012. Ninety-two per cent of the 820 confiscations made were related to amounts of cigarettes up to 50,000 pieces – a rise of 129%, which is more than double in comparison to the first half of 2012. Between

³⁷³ Antonopoulos, “The Greek Connection(s): The Social Organisation of the Cigarette-Smuggling Business in Greece”.

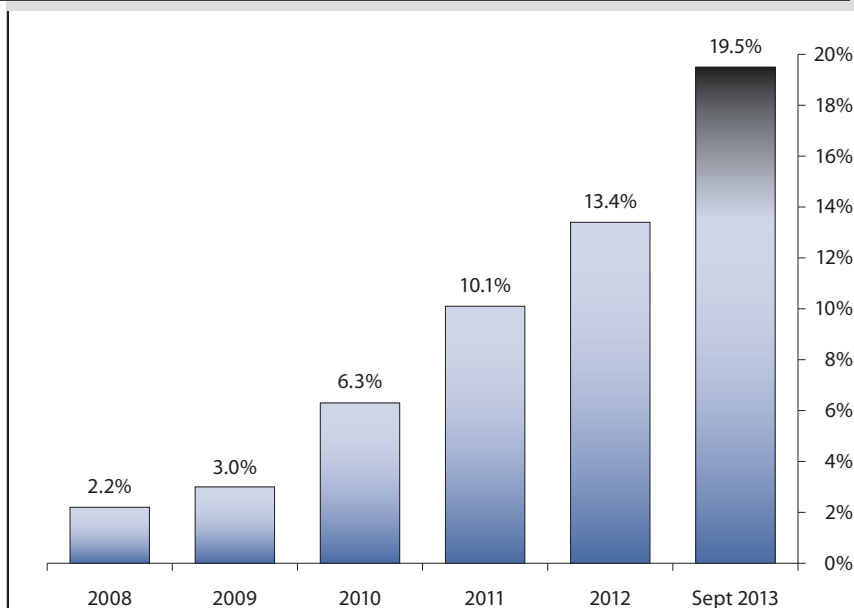
³⁷⁴ Lambropoulos, V. “Εταιρείες τροφίμων σε ευρύ κύκλωμα διακίνησης λαθραίων τσιγάρων [Food Companies in a Wide Circuit Trafficking Contraband Cigarettes]”, *To Vima*, October 09, 2012.

January and August 2013 129,404,100 cigarettes were seized.³⁷⁵ According to GR-E5, four billion illegal cigarettes are sold every year in Greece, which is about 20% of the total consumption, causing about €600 million of revenue loss annually.

According to one of the experts interviewed, the Papastratos Company loses about €25 million every year (GR-E5). The results of a Phillip Morris commissioned study by AC Nielsen of the illicit tobacco market in September 2013 (which involved collecting 6,000 empty packs of cigarettes in 20 cities in Greece and identifying them as original/legal or counterfeit/illegal products) show that:

- 19.5% of the cigarettes sold are illegal and this number is 6.1% higher than the previous year (2012);
- three quarters of illegal cigarettes have no information about their destination country (e.g. signs referred to the domestic market, as counterfeited domestic tax stamps or security marks, pictorial health warnings);
- estimates show that the share of illicit tobacco consumption increased from 2.2% in 2008 to 19.5% in 2013 (Figure 25).

FIGURE 25. ESTIMATE OF THE SHARE OF ILLICIT TOBACCO CONSUMPTION IN GREECE (2008 – 2013)



Source: N. Theofilopoulos, "Presentation at the Foundation for Economic and Industrial Research Conference on Illicit Tobacco Trafficking" (Athens: Unpublished, 25 November, 2013).

According to the Financial and Economic Crime Unit,³⁷⁶ 417 shipments containing 744 million cigarettes were seized in 2011; in 2012, 1,151 shipments with 456 million cigarettes were seized. The latest data from the Unit show that in the first half of 2013 there were 162 investigations in relation to tobacco smuggling, 64 people were charged, 104 cases of smuggling were monitored and 129,404,100 cigarettes were confiscated.

In 2011, the Hellenic Police³⁷⁷ dealt with 417 cases of tobacco smuggling, where 19 criminal

³⁷⁵ Statistics provided by Mavraganis, "Presentation at the Foundation for Economic and Industrial Research Conference about the Illicit Tobacco Trafficking", 50.

³⁷⁶ The Financial and Economic Crime Unit is a body of the Ministry of Finance, specialised in financial fraud/embezzlement, money laundering, VAT fraud, etc. It has a subdivision responsible for drug trafficking that also deals with tobacco smuggling, because of the serious economic consequences of this crime.

³⁷⁷ The Department of Protection of Property Rights of the Hellenic Police deals with the investigation of economic crime against individuals, companies or the state. As regards tobacco smuggling, the Department mainly deals with sharing information, and after accessing the information the Service goes ahead with investigations of certain places or/and vehicles in the area. Because the phenomenon has international dimensions, the police investigation extends to the level of exploitation channels of international police cooperation.

TABLE 39. NUMBER OF OCGs AND LOST REVENUE IN TOBACCO SMUGGLING IN GREECE (2011)

Cases	Number of OCGs	Members	Revenue leakage
417	19	169	€125,000,000

Source: Hellenic Police, *Ετήσια έκθεση για το οργανωμένο έγκλημα στην Ελλάδα για το έτος 2011 [Annual Report on Organized Crime in Greece for 2011]* (Athens: Ministry of Public Order and Citizen Protection, 2013), 36.

organisations and 169 members were involved. In addition, it is estimated that taxes of €125 million were lost from tobacco smuggling for that year only.³⁷⁸ The Deputy Chief of Hellenic Police claimed that the seizures of contraband cigarettes conducted by the authorities in 2012 were 176% more than in 2011 and the lost taxes are estimated to be about €70 million.³⁷⁹

According to the Centre of Planning and Economic Research (KEPE) – the largest economics research institute in Greece – the consumption of illicit cigarettes reached 18.8% in 2012 compared to 15.9% in 2011 and 12.6% in 2010.³⁸⁰ Insofar as illicit cigarettes are cheaper, this is not a surprising reaction to the economic crisis.

Market structure and actors

The market is structured hierarchically but, according to the Hellenic Police, few details are known because arrested offenders are usually low in the hierarchy – e.g. the driver or the person who is responsible for the warehouse – and so little information can be obtained from interrogating them.

“In respect to the distribution of contraband cigarettes, there is an open and a closed market. The open market exists in the centre of Athens, Thessaloniki and Piraeus or at public markets in specific areas throughout the whole city on specific days of the week. According to media references there used to be an open market in contraband cigarettes in Patras, Heraklion and Larissa in the mid-1990s. The ‘closed’ market, on the other hand, is not geographically limited. Finally, violence is not an integral part of the cigarette smuggling business in Greece. A discount may be given to closed market customers buying medium to large quantities of cigarettes.”³⁸¹

³⁷⁸ Hellenic Police, *Ετήσια Έκθεση για το οργανωμένο έγκλημα στην Ελλάδα για το έτος 2011 [Annual Report on Organized Crime in Greece for 2011]*, 36.

³⁷⁹ Statistics provided by A. Stamatakis, “Presentation at the Foundation for Economic and Industrial Research Conference on Illicit Tobacco Trafficking” (Athens: Unpublished, November 25, 2013). The figure refers to revenue leakage from the quantities of the confiscated cigarettes, not from the total amount of illegal cigarettes sold in the domestic market for this period of time.

³⁸⁰ Centre of Planning and Economic Research, <http://www.kepe.gr/images/pdf/Press%20Office/Press78gr.pdf>

³⁸¹ Antonopoulos, “The Greek Connection(s): The Social Organisation of the Cigarette-Smuggling Business in Greece”.

Organised crime groups who deal in tobacco usually cooperate with each other in transporting the tobacco across more than two countries (especially when they have to transport a large amounts) as well as in selling it to several markets in Greece or abroad (mainly).

Organised crime groups have tobacco smuggling as their main and sometimes sole illegal activity and they have members from many countries, especially from countries of origin, transportation or final destination of the tobacco, such as Northern Cyprus, Turkey, North Africa, Middle East, Balkan countries (including Greece) and Eastern Europe. Tobacco usually comes from China, Northern Cyprus, Egypt and other countries in North Africa, the Middle East, Qatar, Pakistan, Vietnam and the United Arab Emirates via sea shipments and is then transported by lorry to other countries or Greek cities. Destination countries are mainly the United Kingdom, some of the Scandinavian countries (Finland, Sweden), and also France, Germany, Poland, Belgium and any other European country in which the retail price of cigarettes is high. In Greece, the main routes of tobacco smuggling are from the Turkish sector of Cyprus (especially Famagusta) to Greek ports (Piraeus, Aigio, Kalamata, etc.), from FYROM and other Balkan countries to Greece, and finally from countries of the former Soviet Union to Greek islands via Turkey.

When cigarette smuggling OCGs get involved in other illegal activities these are usually trafficking in humans, drugs, fuel and arms. In addition, they commit a number of “auxiliary” crimes, including forgery of the necessary documents for the transportation of the tobacco, falsification of documents related to customhouse certification and bribery of officials (customs officers). Some of them are also experts in violent crimes (usually called “protectors”) taking care of debt collection from vendors or peddlers.

Corruption is another tool used by organised crime. It is common for corrupt civil servants to assist the OCGs in tobacco smuggling, especially in providing information about possible investigations in ports and customs. Although according to GR-E2 and GR-E3 “there is no corruption problem in tobacco smuggling (and smuggling in general), civil servants do their best and they have success in their job, despite the problems they face”, GR-E1, researchers, court practice, and recent reports by OLAF insist that there is civil servant corruption and that it is a crucial factor in the whole tobacco smuggling phenomenon. In a notorious tobacco smuggling case in Thessaloniki in 2010, four local police officers were arrested for joining a criminal organisation. According to the Hellenic Police,³⁸² an extended criminal organisation which had installed an illegal cigarette factory in the town of Kassandreia in Chalkidiki and had set up a trafficking network in several European countries was dismantled. The investigation began in February 2010, by way of information received from OLAF, and culminated in September 2010 with the arrest of 20 people (17 Greeks and 3 foreigners), including 4 police officers.

³⁸² Hellenic Police, *Δελτίο Τύπου της Γ.Α.Δ. Θεσσαλονίκης για εξάρθρωση πολυμελούς εγκληματικής οργάνωσης κατασκευής και διακίνησης λαθραίων τσιγάρων*, 30.09.2010 [Press Release of Police Headquarters in Thessaloniki about the arrest of criminal organisation manufacturing and trafficking contraband cigarettes], September, 30 2010.

Organised criminal groups prefer sea shipping for the smuggling. A ship (referred to as “the mother ship” in the criminal jargon) would ostensibly be carrying legal cargo, but when it reaches the shore the tobacco (“milk”) is unloaded by using high speed boats (“daughters”) and transported to isolated beaches where lorries receive it. After that, they keep it in warehouses and they push it to domestic markets or they transport it to markets abroad. Thus, sometimes they combine sea and land routes, especially in cross-border criminal activities.

According to the Deputy Chief of Hellenic Coast Guard, bills of lading and cargo manifests usually contain elements that do not correspond to reality, as for example the companies stated to be sending and receiving are non-existent or the loading of tobacco products is not certified by the authorities of the loading port, but are just signed by the captain. These vessels either remain in international waters and offload the smuggled goods to smaller vessels in order to introduce them illegally into the country or they approach various locations on the Greek coastline and land their illegal cargo directly into lorries waiting ashore. According to the observations of the Hellenic Coast Guard, offloading areas are typically deserted and remote areas with minimal lighting such as Peloponnese, Ionian Islands and Crete. Regardless of how the smuggled tobacco products enter into the country, their transfer towards Central Europe has been observed to occur predominantly from vehicles in external ports via ships from Igoumenitsa and Patras. The illegal cargo is either carefully hidden inside legal cargo, in the event of vehicles, or in specially designed vaults in the vehicle, in the case of transportation of vehicles of all types. Overland, tobacco smugglers have used buses (bus, coach exterior), unbeknownst to the owners and their drivers, where offenders either carry smuggled products as luggage or send it as unaccompanied parcels.³⁸³

Another modus operandi is hiding the tobacco products in legal cargo (e.g. scrap) and avoiding customs checking and searching. According to interviewed experts, there are so many containers arriving in the ports of Piraeus, Thessaloniki, Volos and Heraklion that the Custom Office is unable to check them all, because they do not have either the personnel or the technological equipment to deal with the amount of containers (GR-E2, GR-E3). As an example, none of the Custom Offices has X-ray machines in order to examine the content of the containers properly and Greece is the only EU country that does not have such equipment. It is estimated that in Greek ports, only 2% of the total arriving containers are checked by the Customs Office. Organised criminal groups awaiting such cargo receive information (probably from inside) when their containers are spotted by the authorities and nobody appears to receive them. In most cases the names and the tax ID number of the legal entities or the person who is the formal receiver are fake and the smugglers use forged documents or stolen ID cards in order to receive the cargo.

Also popular is the modus operandi known as “fake transit:” criminal groups present to the Custom Office a cargo of legal cigarettes as

³⁸³ D. Tsiadis, “Presentation at the Foundation for Economic and Industrial Research Conference on Illicit Tobacco Trafficking” (Athens: Unpublished, November 25, 2013).

transit with final destination a Balkan country (Bulgaria, FYROM, Albania, Montenegro, and Serbia), but the cargo never reaches those countries or it reaches the destination country and is immediately illegally returned and sold on the Greek black market without paying any taxes.

Furthermore, in the region of Attica (which covers the city of Athens) the contraband tobacco or cigarettes are usually hidden and kept in warehouses in Koropi, Mandra and Aspropyrgos.

Greece is a hotspot of tobacco smuggling in the European Union and in 2012 it had the 2nd highest percentage point increase in detected illicit trade.³⁸⁴ Hotspot areas in Greece are the city centres and street markets of Athens, Piraeus and other big cities (Heraklion, Patra, Thessaloniki, Volos, Ioannina) and the sellers are, as already noted, mainly foreigners. The popular locations of selling/buying products of tobacco smuggling in the centre of Athens are mainly Stournari Street, Omonia Square and Varvakios Market, where anyone can easily find foreign dealers (mainly from Pakistan and India), who sell in public view popular brands and illicit whites at low prices (about €1 per pack). In the city of Thessaloniki, the hotspots are Aristotelous Square and the area of Phillipou Chalkidaion where mainly women sell illicit whites even in front of mini markets.

As regards the actors in this business, according to one of the experts interviewed, the authorities manage to arrest suspects in less than half the tobacco smuggling cases they investigate because almost always the criminals use fake names (for companies or persons) in the relevant documents making it difficult to track the real identity of the suspects (GR-E2). In many cases the organised crime group hire a legitimate company to receive the cargo and they involve many other real or fake companies, in order to make the connection between them and the illicit tobacco difficult. As for the drivers of the trucks that transport the illegal tobacco from/to warehouses or Customs Office, they usually do not know that they transport cigarettes.

According to another expert, many members of groups dealing in illegal tobacco have criminal records full of tobacco smuggling convictions (GR-E1). Those people stay in prison for a while and when released go back to business using their profits from the past or using money given to them by the organisation as a “welcome back gift.” In the meanwhile, they never testify against the criminal organisation they belong to and in return the criminal group supports them during their dealing with the criminal justice system (they hire lawyers, they give them money for the period of incarceration, they take care of their family). It should be noted that “although the majority of people arrested for cigarette smuggling by the Coast Guard are foreigners, this does not necessarily reflect the foreigners involvement in this trade but their involvement in these ‘posts’ that are vulnerable to (aggressive) law enforcement.”³⁸⁵

³⁸⁴ KPMG, *Project Star. 2012 Results*.

³⁸⁵ Antonopoulos, “The Greek Connection(s): The Social Organisation of the Cigarette-Smuggling Business in Greece”.

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

“A criminal organisation performs its activities in a manner similar to that of a lawful business within the legal market. Criminal activities are able to offer services and goods through the use of violence, intimidation and corruption. [...] In addition, criminal activities are able to deform competition when penetrating into the legal economy, since they can rely on dirty money and capitalise again in legal entities with the proceeds of criminal activities.”³⁸⁶

The source of money used to set up the cross-border smuggling is usually other crimes. According to one of the experts interviewed “never did someone invest legitimate money in such an operation”, at least in the cases he has been handling (GR-E1). All interviewees noted that OCGs use proceeds from tobacco smuggling in order to invest in other criminal activities in the same field.

In a well-known case of tobacco smuggling, the Supreme Court decided that it was proved during the hearing that two members of an organised criminal group were guilty of transferring large amounts of money via the banking system for the purpose of buying new contraband tobacco.³⁸⁷

Regarding the initiating of their operations, OCGs that want to get involved in tobacco smuggling first need to find a contact to lead them to a key person or criminal organisation in the production country, in order to buy the amount of tobacco; and then they have to arrange the transportation and the delivery in Greece. A member of the local criminal organisation sometimes travels to the country of production in order to arrange the details of the transactions. When the first profit comes it is re-invested in further smuggling operations. From then on, the business grows and higher profits allow the criminals to expand to the next level of trade. In addition, they have available a serious amount of money for bribing of civil servants in order to make their smuggling operation easier and more effective.

It is not uncommon for successful organisers of smuggling operations to invest their profits in buying high technology equipment and bulk tobacco in order to set up their own manufacturing of illicit cigarettes. In one case, a Greek leader of a smuggling group in cooperation with a criminal organisation in Bulgaria invested his profits from crime along with money from his Bulgarian partners in setting up such a factory in the area of Chalkidiki, near Thessaloniki.³⁸⁸ In 2010, the Department of Drug Enforcement managed to locate an illegal cigarette production factory in the area of Menidi – near Athens. This factory was producing counterfeited Marlboro cigarettes using tobacco of unknown origin and many people were arrested (many were from the former Soviet countries).

³⁸⁶ Bruggeman, “Η καταπολέμηση του οργανωμένου εγκλήματος: δυνατότητες, προβλήματα και ευκαιρίες, με ειδικότερη έμφαση στην Ευρωπαϊκή Ένωση [Fighting Organised Crime: Capabilities, Problems and Opportunities, with Emphasis on the European Union]”, 316.

³⁸⁷ Areios Pagos 461/2011.

³⁸⁸ Areios Pagos 463/2011, Areios Pagos 473/2011.

27 tonnes of tobacco and 3 million cigarettes were confiscated, along with 5 high technology machines, 1 truck and other cars. This operation was crucial, because the authorities managed to send a message to organised crime groups, that they are not able to set up cigarette production factories in Greece, and they won't raise their profits this way.

Much more information is available about the middle and lower level criminals than the OCGs leaders. Those at the lower levels reveal nothing about their bosses for fear of repercussions against themselves or their families. Criminals at the top of the hierarchy own clubs, bars, etc., but in general they want their fame in the business to be based on tobacco smuggling; they want to be known as "cigarette men" ("tsigarades" in Greek).

These kinds of organised criminal groups are "networking" with civil servants and they often know if they are being investigated. Their relationship with the civil servants protects them and makes crucial information available to them whenever law enforcement uncovers a cargo with contraband tobacco or cigarettes. In such cases, the criminal group abandons the cargo and the opportunity for their arrest disappears as the documents of the cargo mention fake names and tax numbers.

Settlement of payments

The typical method used for payment in the first stage of buying a large quantity of tobacco is cash. Sometimes part of the agreed amount of money is paid at the time of ordering as a guarantee and the rest at the time of receiving the tobacco/cigarettes. In a well-known case in Greece, the criminal group's leader transferred 400 million drachmas (about €1.17 million) through companies that he and his partners had created in Greece and Bulgaria to another criminal group as a guarantee for the funding of illicit trafficking of tobacco and cigarettes; part of this amount was paid every time a delivery of tobacco/cigarettes was made.³⁸⁹ For this scheme, two Bulgarian citizens had established a clothing company in Bulgaria with Greek company managers who at the end were convicted in Greece for cigarette smuggling. After its establishment the company created another company (a transportation company this time) in order to be used in transporting the clothes from/to Greece (another clothing company belonging to the same Greek persons was involved) or to other European countries. However, along with these goods, cigarettes were transported illegally with the complicity of corrupt Bulgarian and Greek custom officers. It must be noted that the Bulgarian company was based close to the borders with Greece and the Supreme Court noted that this company was the connection between the Greek leaders of the criminal organisation and the Bulgarian OCGs. According to the Court, there were several money transactions between the two clothing companies in relation to the official merchandise (clothes), and 400 million drachmas was paid by bank transfer for every new load of illicit cigarettes. In at least two more money transactions, a Bulgarian member of the criminal group agreed to take under his possession £650,000 and £142,500 was

³⁸⁹ Areios Pagos 461/2011.

imported in Greece from Bulgaria as exchange and he transferred the money in drachmas to the Greek clothing company.

As the investors of this kind of operations are usually the leaders of the criminal organisation, they ensure that they will take their share of the profit by using intimidation; to this end, they hire violent criminals who are both their bodyguards and debt collectors. The bodyguards are usually criminals who used to be “godfathers” in night clubs and are experts in violent crimes.

Following the import of the contraband tobacco and its distribution to retailers, payments take place after the sales. That happens mainly because the individual retailers cannot afford to pay in cash up-front before selling the cigarettes to the public.

Costs of doing business

Tobacco smuggling usually involves 70% illicit whites (especially the brands Gold Mount, Sovereign Gold, Raquel, RGD, Cleopatra, Royal, Camelford, Cooper, Camelot) and 30% counterfeit brands (mainly) and legal brands (rarely).³⁹⁰ In general organised criminal groups are smuggling many different brands: in one warehouse, almost 150 different counterfeited brands were found, though most of them were not known in Greece. Often, the legal brands are not cleared and they are sold in the illegal markets. It is interesting to note that the second largest quantity of illicit whites in the European Union was detected in Greece (2.8 billion cigarettes).³⁹¹

Since the 2008 economic crisis in Greece, there has been a significant surge in the smuggling of illicit whites because of their low price; generally, according to the interviewees, whenever the government raises the taxation level there is an increase of the trafficking and selling of illicit tobacco products. When the government announces that the price of tobacco will be increased, the criminal organisations withhold their illegal products from the market for a period of time and only release it only after the legitimate tobacco has a new, higher price.

As an indication of the reduced consumption of legal brands, in 2013 the number of lawful tobacco selling points in Attica was 6,440, down from 10,550 in 2009.³⁹² This presumably was the result of the spread of illicit trade of tobacco/cigarettes in combination with the economic crisis.

For the tobacco companies in Greece – mainly Phillip Morris (brands as Marlboro, Assos, Philip Morris, L&M, Muratti, Zante), Karelias and SEKAP – the cost of a legal cigarette pack is €0.50, while for the organised criminal groups, the cost of an illegal one is €0.10-€0.15 and the end consumer buys it for €1.³⁹³

³⁹⁰ KPMG, *Project Star. 2012 Results*; Newspaper *Imerisia*, June 30, 2014.

³⁹¹ *Ibid.*; Newspaper *Imerisia*, June 30, 2014.

³⁹² To Choni, “Θέλουν να κλείσουν 2.500 περίπτερα [They Want to Close 2,500 Kiosks]”, *To Choni*, January 03, 2013.

³⁹³ Information provided by interviewees from the Hellenic Police and the Financial and Economic Crime Unit.

Additionally, according to the Union of Attica Tobacco Retailers, in some cases – especially in the Asian countries manufacturing tobacco products – the cost of a pack of 20 illicit cigarettes is about 4-7 cents and the selling price is 70 cents, so the profit of the criminal group is huge.³⁹⁴

The main products of tobacco smuggling are popular brands or illicit whites, but nowadays many people buy hand-rolling tobacco (HRT) in a small bag of half a kilo for €10. It is well known in Greece that one kilo of HRT costs €20 and it is easily accessible, even online.³⁹⁵

Since the new trend in Greece is selling HRT and not cigarettes, two of the experts interviewed believe that for every 10 tonnes of illicit HRT, state revenue loses about €2 million from unpaid taxes (GR-E2, GR-E3).

It is well known that some HRT illegal vendors are associates of small producers from Greece, who prefer risking and selling their product illegally to the public without paying any taxes than selling it to the legal tobacco companies.³⁹⁶ This does not seem to be organised criminal activity yet, rather an illicit network. But if its expansion follows the path that it is expected (due to the popularity of HRT in the black market), then it is almost certain that this network will be transformed into a criminal group with the features of an organisation. It is also possible the already existing criminal groups will turn their attention to HRT, if they believe that in this way they will earn more money.

The retailers are almost always foreigners: illegal immigrants from Pakistan or Bangladesh, people from Ukraine, Romania or the former Soviet Union (especially Pontian Greeks who left the Soviet Union) and they sell the illicit tobacco products in the streets or in their shops (e.g. mini markets). Some of them used to sell fake products (purses, watches, etc.) in the past, but the economic crisis made them change their merchandise. They usually take the cigarettes from an apartment in the centre of the city held by a Russian-Pontian man; the vendor has only one carton with him, and when he is on the road, he hides the other cartons in different places close to his peddling location. It is estimated that small vendors earn about €1 on each carton and in some rare cases their profit may be up to €2, while the price of the carton is about €15 on the black market.

In the case of land shipment, it is usual and necessary for the criminal group to rent warehouses. In the district of Attica the illegal tobacco or cigarettes are usually hidden in warehouses in Koropi, Mandra, Menidi and Aspropyrgos (most of the big warehouses have been identified in Menidi and Aspropyrgos). There are also smaller warehouses in apartments in the centre of Athens and Thessaloniki, where they put the cigarettes

³⁹⁴ Ibid.

³⁹⁵ Based on information provided from interviewees from the Hellenic Police and the Financial and Economic Crime Unit, and Theofilopoulos, "Presentation at the Foundation for Economic and Industrial Research Conference on Illicit Tobacco Trafficking".

³⁹⁶ Paschalis, T. "«Στριφτό» και αφορολόγητο [‘Hand-rolled’ and Tax Free]", *Eleftherotipia*, February 05, 2013.

that the sellers receive the merchandise in portions in order to make it available on the black market. The cost of the rental of a warehouse of 1,500 square meters is about €2,000 per month;³⁹⁷ other costs include buying cars, trucks, ships or other vessels, technological equipment for tobacco industry, etc. A significant cost is bribery as corrupt relations with the police can either protect a criminal group from prosecution or they can be used as a “weapon” against competitors.³⁹⁸

Regarding the cost to the government budget, it is well known that contraband tobacco and alcohol are dominated by organised criminal groups operating in China, Poland, Malaysia, Thailand, Ukraine, Russia and the Baltic countries, resulting in state budgets annually losing millions of euros. In developing countries, organised crime penetrates public institutions influencing decision making. The profits of countless illegal activities are legitimised by experts who are recruited by organised crime through their investment in lucrative businesses that provide the necessary legal coverage.

In March 2014, OLAF passed on information to the competent Greek authorities about three suspect containers arriving in Piraeus in Greece. The Greek authorities discovered that two of the three containers were in fact loaded with smuggled cigarettes – a total of 1,990 boxes of contraband cigarettes. While the first container was loaded with 998 boxes of RGD brand cigarettes (that is 499,000 packages or 9.98 million pieces of cigarettes), the second one contained 992 boxes of Bon Classic brand cigarettes (496,000 packages or 9.92 million pieces). Unpaid duties and taxes on these smuggled cigarettes amounted to about €3.5 million.³⁹⁹ Within a week, a similar operation was carried out which uncovered 998,000 packs or 19.96 million pieces of cigarettes. Unpaid duties and taxes on these smuggled cigarettes amounted to more than €3.5 million in this case, leading to a prevented loss of more than €7 million in two recent operations carried out by the Greek authorities.⁴⁰⁰ The investigation continues with authorities seeking to identify the intended recipient of these cigarettes, whose identity and address on the shipping documents were fake (as noted, criminals appear to receive the shipment only when they are sure it is safe, unless the container refers to a legitimate business with another existing company which has nothing to do with smuggling tobacco).

Generally, one container contains approximately 9.6 million cigarettes and the unpaid taxes are estimated to be about €1.4 million. In addition, one truckload of HRT contains approximately 10 tonnes of tobacco and the unpaid taxes are estimated to be about €1.9 million. According to the Greek government, taxes from the legitimate tobacco market in 2013 were only €2.5 billion, while in 2011 the taxes were €3.9 billion. This fall in receipts may be attributed significantly to the growth in illicit trade.⁴⁰¹

³⁹⁷ Areios Pagos 473/2011.

³⁹⁸ Rizava, *Οργανωμένο έγκλημα [Organised Crime]*, 171.

³⁹⁹ OLAF, Press Release No 3/2014, 13 March 2014.

⁴⁰⁰ OLAF, Press Release No. 4/2014, 19 March 2014.

⁴⁰¹ Πασχαλη, “«Στριφτό» και αφορολόγητο [‘Hand-rolled’ and Tax Free]”.

Profits and profit sharing

The legal framework in Greece has no provision about the profits from smuggling in general but only covers the value of the contraband goods with sanctions depending on that. Thus, the authorities responsible for the prosecution of such crimes do not focus on the profits, but on the goods and on the structure and function of the criminal organisation. The forfeiture of criminal assets is provided for in Article 76 of the Penal Code. Additionally, pursuant to Article 46, par. 1 of Law 3691/2008 on the prevention and suppression of money laundering and of the financing of terrorism, the proceeds of any crime falling within the scope of this law, or the property acquired directly or indirectly through such proceeds, are liable to confiscation. Nevertheless, there is lack of statistical data about the confiscated assets or proceeds in general, so it is not possible to estimate the profits from smuggling by using a method related to confiscation of the proceeds.

On the other hand, the persons involved in tobacco smuggling are, as could be expected, unwilling to talk about this mechanism, especially those in the lower levels of the hierarchy – who are the only ones accessible to researchers – because they fear repercussions if it is found out that they have given information about the illicit business.

In general, the retail price of illicit cigarettes is about €1-€1.50 per pack of 20, while the legal ones cost €3.90. According to Papastratos' staff, 85% of the retail price includes taxes of various kinds (e.g. VAT) and only 15% of the total price goes to the industries, the distributors and the vendors.

The possible profit may be estimated if the amount of seized contraband cigarettes is multiplied by their usual price on the black market. Table 40 and Table 41 provide such a calculation based on a retail price per pack of €1.5 and wholesale buying of €0.15.

TABLE 40. ESTIMATED PROFIT FROM SEIZED CIGARETTES IN GREECE (2011 – 2013)

Year	Seized shipments	Number of seized cigarettes	Potential profit (€)
2011	417	744,000,000	50,220,000
2012	1,151	456,000,000	30,780,000
January-August 2013	-	129,404,100	8,734,776

Source: G. Mavraganis, "Presentation at the Foundation for Economic and Industrial Research Conference about the Illicit Tobacco Trafficking" (Athens: Unpublished, November 25, 2013), 50.

Profits can be transferred abroad in legitimate companies and – with the help of tax accountants – can be reinvested through money laundering mechanisms. Money laundering takes place in several forms, the main ones being the following:

- via legitimate companies listed on the Stock Exchange;
- through gambling – buying lottery tickets or bets from people who

TABLE 41. ESTIMATED PROFIT FROM TOBACCO SMUGGLING IN RELATION TO THE AMOUNT OF PACKETS TRAFFICKED IN FOUR WELL KNOWN CASES IN GREECE*

Supreme Court Decision No.	Number of cigarette packs	Potential profit (€)
1213/2011	1,966,400	2,654,640
769/2011	305,500	412,425
473/2011	17,262,910	23,304,928
135/2010	2,209,920	2,983,392

* These four cases and the court verdicts do not cover the organised group's total criminal activity, but just the last one that law enforcement agencies managed to expose.

Source: Supreme Court.

have already won, so by showing those documents they can justify the source of their illegal money;

- via professional football and basketball companies – by reporting higher profit than the real one and have it for themselves as owners or by reporting less expenses than the real ones.

A popular method is buying betting coupons and lottery tickets from the winners or the bookmakers at a higher price than the amount of money that they have won. A Greek cocaine dealer (the notorious Angelopoulos case in 2004), claimed that in a few years he had won more than €8 million from bets in football games and lotteries. The newspapers commented that he must be one of the luckiest people in the world.⁴⁰²

In general, as regards money laundering by organised criminal groups in the Balkans, there is a significant information gap. Most of the illegal profits are sent back to their home regions and the remainder is reinvested in ongoing criminal activities. The problem of tobacco smuggling is very extensive due to the easy access of Albanian groups to large loads of cheap cigarettes manufactured in Eastern European countries. Many countries suffer serious consequences of this trade, especially Greece.⁴⁰³

Access to capital in critical moments

The fact that in Epanodos – a database of the Scientific Center for the Rehabilitation of Former Inmates of Correctional Institutions, a body of the Ministry of Justice, Transparency and Human Rights – there is no evidence of individuals convicted for tobacco smuggling (while 1,286 persons have visited its office) can be explained by the hypothesis that in critical moments the members of organised criminal groups may have

⁴⁰² Α. Βασιλης, “Έμπορος κοκαΐνης κέρδισε 600 φορές στο τζόκερ και το στοίχημα σε 12 μήνες [Cocaine Dealer Won 600 Times in Lotto and Bets in 12 Months]”, *To Vima*, November 01, 2013.

⁴⁰³ Bruggeman, “Η καταπολέμηση του οργανωμένου εγκλήματος: δυνατότητες, προβλήματα και ευκαιρίες, με ειδικότερη έμφαση στην Ευρωπαϊκή Ένωση [Fighting Organised Crime: Capabilities, Problems and Opportunities, with Emphasis on the European Union]”, 316.

access to capital in order to assist a “colleague” who has just been released from prison.

According to interviewees, loan sharks are a common way of financing criminal groups. Especially, officials from the Hellenic Police state that there are many cases where the criminal groups look to loan sharks for the financing of their business. However, the Greek financial crisis has blocked the ability of this illegal market to provide large amounts of money to those that are in need, not least because there is greater risk as far as repayment is concerned. On the other hand, it is in such times when loan sharks thrive.

The Hellenic Police estimates that nowadays the amount of money given to criminal groups by loan sharks ranges between €200,000 and €300,000. These “black bankers” often keep collateral – an expensive car or a promissory note that a house will be bought at a lower price.

5.3. UNITED KINGDOM: THE LOW ENTRY THRESHOLD

Introduction

Historical background, main features of the criminal market and recent trends

The illicit tobacco trade has a very long history in the UK. In the first half of the 18th century, the Isle of Man was used as a warehouse of tobacco and other commodities waiting to be smuggled into the mainland. It was said that every man, woman and child of the island was involved in the illegal tobacco trade in one way or another.⁴⁰⁴ The contemporary trade in illicit tobacco in the UK is an extremely dynamic and mutating market, which has an impact not only on British law enforcement authorities, but also on their continental European counterparts, since countries such as the Netherlands, Belgium and Germany act as transit points for tobacco products destined for the UK.⁴⁰⁵ Since the late 1980s, when the issue became a more serious concern for the British authorities, the trade has undergone various transformations. Although the amount of seized illegal tobacco products has increased since 1999 and remained somewhat stable since 2005,⁴⁰⁶ generally, the nature of the illicit tobacco market has been changing. Specifically:

- From the late 1980s and up until the beginning of the 2000s legal tobacco manufacturers were involved in the smuggling of billions of packs of their own brands. Gallaher (as they were known then) – BAT, Philip Morris, and RJ Reynolds – were major actors in the illicit tobacco business in the UK (and abroad). They created an illegal

⁴⁰⁴ G. Smith, *Smuggling in the Bristol Channel, 1700-1850* (Newbury: Countryside Books, 1989); R. C. Nash, “The English and Scottish Tobacco Trade in the Seventeenth and Eighteenth Centuries: Legal and Illegal Trade”, *Economic History Review* 35, no. 3 (1982): 354-72.

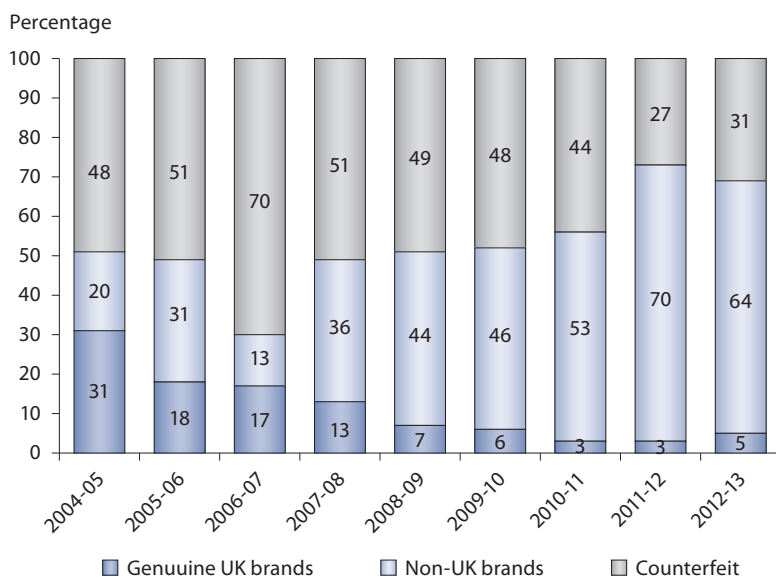
⁴⁰⁵ P. C. van Duyne and G. A. Antonopoulos, *The Criminal Smoke of Tobacco Policy Making: Cigarette Smuggling in Europe* (Nijmegen: Wolf Legal Publishers, 2009).

⁴⁰⁶ Transcrime, *The Factbook on the Illicit Trade in Tobacco Products: Issue 1 – United Kingdom*. (Milan, 2013).

market for their own brand of cigarettes in the UK by facilitating the exportation of cigarettes and then re-importing them into the UK. During that time, the UK became the central hub for contraband cigarettes. The Memoranda of Understanding between the Tobacco Manufacturers' Association (TMA) companies and Her Majesty's Revenue and Customs (HMRC) signed in 2002, 2006 and 2013 have been instrumental in countering the illicit trade in tobacco products in the UK. Tobacco manufacturers are now exporting tobacco to Africa, China, India and elsewhere.

- Since the mid-2000s, counterfeit cigarettes from China and Eastern Europe⁴⁰⁷ (from countries such as Ukraine and Poland) have taken a large share of the market in illegally traded tobacco products in the UK.⁴⁰⁸ In 2004, it was estimated that on average over one million counterfeit cigarettes were seized every day in the UK.⁴⁰⁹ Currently, there are a number of illegal factories that have been dismantled by the authorities in various localities such as Grimsby, Glasgow, Aberdeen, Chesterfield, etc.⁴¹⁰
- From 2007 onwards, illicit whites started appearing in the UK market. In 2012, the UK had one of the highest consumption levels of illicit whites in the EU (1 billion cigarettes) presenting an increase of 49% since 2011.⁴¹¹

FIGURE 26. COMPOSITION OF LARGE SEIZURES OF CIGARETTES IN THE UK, 2004 – 2013



Source: HMRC and UK Border Force data cited in National Audit Office (UK), *Progress in Tackling Tobacco Smuggling* (London, 2013).

whites in the EU (1 billion cigarettes) presenting an increase of 49% since 2011.⁴¹¹

- From 2008 onwards counterfeit UK brands of hand-rolling tobacco (HRT) began to appear in Britain.⁴¹²

Although the composition of the merchandise is changing (genuine UK brands, non-UK brands, and counterfeit products), it does not, of course, mean that specific types of illegally traded cigarettes are not present. Currently, the UK illicit tobacco market is vibrant, with an above average size in comparison to other EU markets (Figure 26).⁴¹³

Within this context it should be mentioned that although

⁴⁰⁷ See A. Shen, G. A. Antonopoulos, and K. von Lampe, "The Dragon Breathes Smoke": Cigarette Counterfeiting in the People's Republic of China", *British Journal of Criminology* 50, no. 2 (2010): 239-58.

⁴⁰⁸ The first significant seizures of contraband cigarettes in the UK were in 2000.

⁴⁰⁹ HMRC, *Counterfeit Cigarettes 2004* (London, 2004).

⁴¹⁰ See Transcrime, *The Factbook on the Illicit Trade in Tobacco Products: Issue 1 – United Kingdom*.

⁴¹¹ KPMG, *Project Star. 2012 Results*.

⁴¹² National Audit Office (UK), *Progress in Tackling Tobacco Smuggling*.

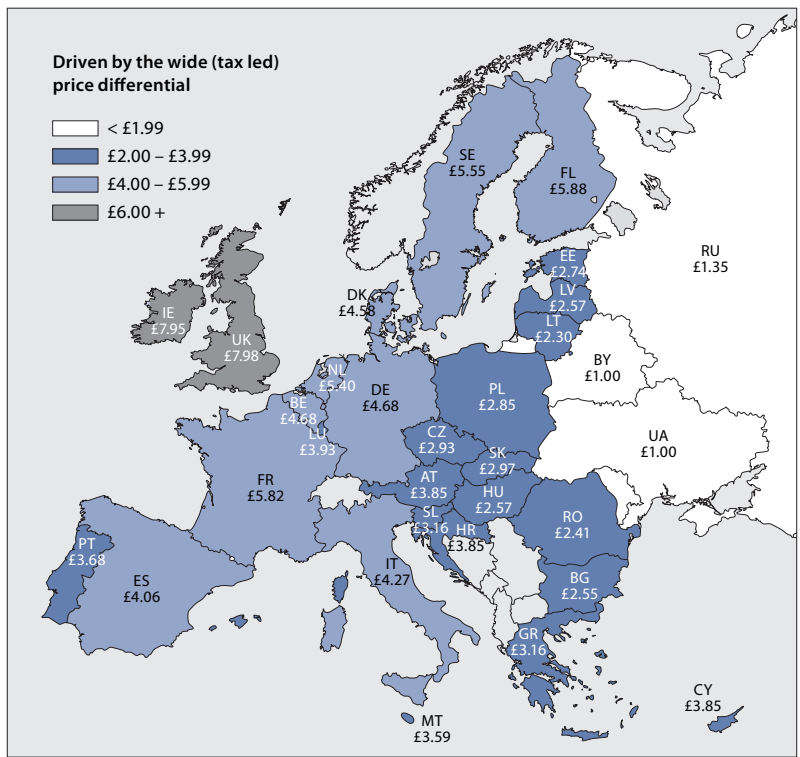
⁴¹³ See KPMG, *Project Star. 2012 Results*.

cigarette seizures have been stable since the mid-2000s, the seizures of HRT have been steadily increasing. It is also worth noting that along with the practical limitations that official statistics possess, **counterfeit** and **contraband** (but legally produced) tobacco products are sometimes mixed in the illegal market; something that affects further the quantification of the illegal market. In addition, according to customs intelligence, when illicit whites hit the market in Britain, almost immediately a Chinese counterfeit version of the illicit white brand Jin Ling also appeared in the British market.

Market overview

According to the TMA,⁴¹⁴ consumer spending on tobacco products in 2012 amounted to an estimated £14 billion, approximately 90% of this was cigarettes and 10% hand rolling tobacco. The tax revenue from tobacco amounted to £12.1 billion (of which £9.5 billion was in excise duty and £2.6 billion in VAT). UK tobacco prices are the highest in the EU and the total tax burden accounts for 88% of the price of cigarettes sold in the country (Figure 27). The most recent consumption figures (2012) show that 51.5 billion cigarettes were consumed in that year and of those 11 billion cigarettes (21%) were UK non-duty paid.⁴¹⁵ The percentage of UK non-duty paid tobacco products consumed in the UK constitutes 16.4% of the overall market. It is also interesting to note that the UK presented the biggest increase in the consumption of contraband and counterfeit tobacco products in the EU from 2011 to 2012 (+6.4%).⁴¹⁶

FIGURE 27. PREMIUM CIGARETTE PRICES (PER 20) IN THE UK, NOVEMBER 2013



Source: TMA, "Facts and Figures". Tobacco Manufacturers Association.

Driven by the wide (tax led) price differential

- < £1.99
- £2.00 – £3.99
- £4.00 – £5.99
- £6.00 +

Tobacco products are expensive in the UK and this has to be seen in light of the relative reduced affordability of tobacco products in the country.⁴¹⁷ While the high taxation rate and the resulting price is a great incentive for the smug-

⁴¹⁴ TMA, "Facts and Figures". Tobacco Manufacturers Association, 2014, <http://www.the-tma.org.uk/tma-publications-research/facts-figures/>

⁴¹⁵ Non-UK duty paid comprises of cigarettes tax paid and non-tax paid from other countries, counterfeit cigarettes and illicit whites.

⁴¹⁶ KPMG, *Project Star. 2012 Results*.

⁴¹⁷ E. Blecher and C. van Walbeek, *An Analysis of Cigarette Affordability* (Paris: International Union Against Tuberculosis and Lung Disease, 2008); Transcrime, *The Factbook on the Illicit Trade in Tobacco Products: Issue 1 – United Kingdom*.

gling of tobacco products, there are additional factors that play a significant role, such as the presence of illegal trading networks, the likelihood of being caught and the severity of punishments,⁴¹⁸ as well as a culture of accepting an illicit commodity as normal and tobacco smuggling as a “service” to the public.⁴¹⁹ Generally, and compared to other illegal markets, tobacco smuggling is a relatively low risk and relatively high profit market.

TABLE 42. NON-UK DUTY PAID CIGARETTE MARKET,% IN OVERALL CIGARETTE TRADE

Region	Non-UK duty paid (2012)
London	29%
East Midlands	25%
Yorkshire & the Humber	23%
South East England	23%
South West England	23%
West Midlands	22%
United Kingdom	21%
East of England	21%
North East England	20%
North West England	19%
Northern Ireland	18%
Wales	14%
Scotland	12%

Source: TMA, *The Non-UK Duty Paid Tobacco Market in London*, 2013.

Illegally traded tobacco can be bought at houses (also known as “tab houses”), at pubs and social clubs, shops, flea markets and car boot sales, at various workplaces or on the street. There was also a reference in the interviews to taxi drivers selling cigarettes in their taxis in Northern Ireland (UK-E1). Smaller quantities are also bought online and sent by the post, although the detection rate is quite high at the UK postal hub (Coventry). Generally, the predominant type of selling or selling practice depends on the locality.⁴²⁰ With regards to consumption of illegally traded and counterfeit tobacco products, there is not a single locality that is unaffected in the UK. However, there are variations at both the national level and at the level of the borough.⁴²¹ On the national level, and according to data

provided by the TMA (2013) there appears to be a high percentage of illegally traded cigarettes in the overall markets of London, East Midlands, Yorkshire & the Humber, South East England, South West England and West Midlands (Table 42⁴²²). Northern Ireland, Wales and Scotland show the smallest percentages in the UK. When it comes to hand-rolling tobacco, however, the picture with regards to market share changes dramatically, with consumption levels of non-UK duty paid products at their lowest in London.⁴²³ It is also interesting to note that

⁴¹⁸ See L. Joossens and M. Raw, “Strategic Directions and Emerging Issues in Tobacco Control”, *Tobacco Control* 21, no. 2 (2012): 230-34.

⁴¹⁹ S. Wiltshire et al., “They’re Doing People a Service’: A Qualitative Study of Smoking, Smuggling and Social Deprivation”, *British Medical Journal* 323, no. 7306 (2001): 203-7.

⁴²⁰ See G. Power, *Illicit Tobacco in Southeast London: A Survey of Smokers* (London, 2013).

⁴²¹ B. Williams and J. Williams, *Tobacco in London: Attitudes to Smoking in the Capital*. (London, 2002).

⁴²² See also G. Siggins, P. Murray, and S. Walters, *West Midlands Regional Illicit Tobacco Survey* (Billingham, 2010).

⁴²³ TMA, *The Non-UK Duty Paid Tobacco Market in London*.

in specific locations there is a concentration of packs from specific countries. For example, a relatively recent study in South London showed that 20% of the packs collected on the street and analysed were Polish. This implies an illicit supply route into specific communities in specific London areas.⁴²⁴

There is very little information about the **consumer population buying illegally traded tobacco**. A survey that was conducted in London in 2001 found that it is younger smokers (47% of those 16-24 years old) rather than older smokers (16% of those aged 65+) who reported buying contraband/counterfeit tobacco in the 5 years prior to the survey.⁴²⁵ The illegal tobacco trade hotspots coincide with areas with higher indices of deprivation and unemployment,⁴²⁶ higher proportions of lone parent households and higher crime rates.⁴²⁷

There is a link between the illicit tobacco market and legal businesses in the UK. Tobacco smugglers/bootleggers may use legal businesses in the transport and storage of the illicit goods. In such cases, the active involvement of individuals from the legitimate economy can be viewed on a continuum of illegality – at one end, some individuals may know explicitly that the activities are illegal and at the other end, individuals may not know at all.

What is also very interesting in the illegal tobacco business is the role of the tobacco manufacturers and duty free shops. Cigarette smuggling is another field of enquiry that exemplifies the blurred distinction between the “underworld” and the “upperworld.”⁴²⁸ First, there is a “systemic synergy”⁴²⁹ between the tobacco industry and the cigarette-smuggling business. Over an extended period of time, “large-scale smuggling would not be possible without at least the tacit connivance of the cigarette manufacturers.”⁴³⁰ It is argued that large tobacco companies as well as local companies export vast quantities of particular brands of cigarettes to countries where there is no great demand for these brands, “turn a blind eye” to cigarette smuggling and sometimes encourage it as “a market entry strategy”⁴³¹ in environments that have seen a recent backlash to smoking such as the UK. A senior HMRC officer interviewed for the study noted with regards to tobacco manufacturers:

⁴²⁴ Power, *Illicit Tobacco in Southeast London: A Survey of Smokers*.

⁴²⁵ Williams and Williams, *Tobacco in London: Attitudes to Smoking in the Capital*.

⁴²⁶ See, for example, Wiltshire et al., “‘They’re Doing People a Service’: A Qualitative Study of Smoking, Smuggling and Social Deprivation”.

⁴²⁷ DTZ Pidea Consulting, 2000 cited in K. von Lampe, *Provisional Situational Report on Trafficking in Contraband Cigarettes* (Research project “Assessing Organised Crime”, Sixth EU Framework Programme, 2005), 21, <http://www.organized-crime.de/AOC-DLV18-vR3.pdf>

⁴²⁸ P. C. van Duyne, “Organizing Cigarette Smuggling and Policy Making, Ending up in Smoke”, *Crime, Law and Social Change* 39, no. 3 (2003): 285-317.

⁴²⁹ N. Passas, “Cross-Border Crime and the Interface between Legal and Illegal Actors”, in *Upperworld and Underworld in Cross-Border Crime*, ed. P. C. van Duyne, K. von Lampe, and N. Passas (Nijmegen: Wolf Legal Publishers, 2002), 11-41.

⁴³⁰ von Lampe, *Provisional Situational Report on Trafficking in Contraband Cigarettes*, 31, 34.

⁴³¹ L. Joossens and M. Raw, “Cigarette Smuggling in Europe: Who Really Benefits?”, *Tobacco Control*, no. 7 (1998): 66.

“They are responsible for smuggling of a lot of duty free cigarettes. Off the Irish and British coast you have many oil and gas rigs. We found that people working on the oil rigs were coming back from the rigs by a helicopter with a lot of sleeves⁴³² of cigarettes. The big companies [tobacco manufacturers] are responsible for this. 20 million cigarettes per year smuggled via the oil and gas rigs. They facilitated the smuggling in the gas rig... you can’t smoke on the gas rig for obvious reasons” (UK-E5).

In addition, with regards to the role of duty free shops in cigarette smuggling he noted: “no one has informed us about... groups getting 6,000 cigarettes each day in, day out. They [duty free shops] ‘turn a blind eye’ because the more cigarettes they sell, the bigger the commission they get from the big companies!” (UK-E5).

Market structure and actors

The illicit trade in tobacco is fragmented with loose networks and groups of individuals who may come together for single instances. These instances involve what is also known in the customs vernacular as “Kamikaze runs”: one off operations, usually of a truckload of cigarettes, using a driver who has no criminal record. Alternatively, these loose networks and groups of individuals may attempt to maintain longer involvement. Large, hierarchical group structures are rare. It is important to note that the market in Northern Ireland is quite different from that in the rest of the UK. Whereas in Britain the market tends to be fragmented and highly competitive with a large number of networks in the business at the level of importation, in Northern Ireland the market is oligopolistic, controlled by 10-12 major wholesalers (UK-E1). These wholesalers often collaborate in importing merchandise.

There seems to be a range of players involved in cigarette smuggling that can be placed on a continuum. The smuggling of cigarettes may be conducted by individuals and is defined by its relatively small scale. These individuals are driven by the price disparities between the UK and a number of other countries. They can be British holidaymakers traveling to other countries primarily in the summer period, truck drivers on jobs to continental Europe, university students,⁴³³ and Eastern European migrants who have permanently settled in the UK returning to their country of origin before coming back to the UK with a quantity of cigarettes.

On many occasions these small-scale smuggling schemes are organised by small groups of people. Small trips are taken into neighbouring countries (e.g. France), every traveller (“runner”) buys the legal quantity of cigarettes allowed for personal consumption and, once in the UK, the person who funded the trip collects the merchandise.⁴³⁴ Groups trading in illicit tobacco are sometimes clustered around a small core of individuals who retain an ongoing presence, around whom more

⁴³² Master cases containing 10 packs of 20 cigarettes each.

⁴³³ See G. A. Antonopoulos, “Cigarette Smugglers: A Note on Four ‘Unusual Suspects’”, *Global Crime* 8, no. 4 (2007): 393-98.

⁴³⁴ See R. Hornsby and D. Hobbs, “A Zone of Ambiguity. The Political Economy of Cigarette Bootlegging”, *British Journal of Criminology*, no. 47 (2007): 551-71.

transitional individuals become involved. This description is true of a smuggling operation we came across where one individual organised several tobacco bootlegging operations over a long period of time. While his involvement was constant over this period, the vast majority of those involved in his operations were involved for short periods. Indeed, some individuals were involved for only a single bootlegging operation before their involvement discontinued. One such example is Big George⁴³⁵ who has been active in the illicit tobacco trade for quite a few years. A retired truck driver, he regularly attends major road arteries that connect the South and the North of the country that are used by truck drivers to rest for the night, and Bed and Breakfast establishments in areas near the border (e.g. Kent). He befriends drivers, pays their dinner, drinks and occasionally accommodation, and asks them to bring him cigarettes from their trip to continental Europe. He gives them the money for the cigarettes, the drivers buy them (in the country they are coming back from) and he gives them £1,000-£2,000 depending on the trip and the quantity they transport (UK-C5).

When it comes to large-scale smuggling, however, this involves **networks** – fluid and dynamic social systems that consist of patterns of relationships among people/actors⁴³⁶ and adapt to operational environments and forms of social control. In the case of large-scale smuggling, there is importation of containers from Eastern Europe (Poland, Ukraine, Russia, Lithuania, etc.), China, or Middle Eastern countries, and these are schemes that require greater sophistication, planning and financing, and involve a constellation of actors. Within these networks, the importance of brokers – those actors that bring together two or more disconnected parts of the network – and the service they offer was emphasised numerous times in interviews:

“Knowledge is everything. Without brokerage nothing happens, nothing is going to function. I would not know where to get so many cigarettes from... I have no information, I haven’t got a clue” (UK-E4).

The smuggler/traders involved in the illicit tobacco trade have no typical profile. The **low entry threshold into this market** means that a wide array of actors may become involved in some way:

“The tobacco trade is ‘every man’s trade’. I can get involved, you can get involved” (UK-E4).

“Anyone can get involved as long as they have a small fund to invest. So the only difficulty is securing the first amount of money to buy the initial quantity of cigarettes and tobacco to import” (UK-C2).

Individuals become involved in tobacco smuggling via trust, familial and kinship, and neighbourhood contacts. Prisons are key environments for contacts and knowledge about schemes (as with many other criminal markets); furthermore, public houses can act as initial points of contact

⁴³⁵ Big George is a pseudonym.

⁴³⁶ See S. Wasserman and K. Faust, *Social Network Analysis: Methods and Applications* (Cambridge: Cambridge University Press, 1994).

“Pubs as a place in which illegal business relations are formed is underestimated”, UK-E2). Finally, an environment of great importance for the formation and consolidation of relationships for the illicit tobacco trade is legal businesses. Legal businesses also operate as the context in which relationships (employer-employee and between/among partners) are forged and transformed into criminal business relationships, and the dependability of individuals is manifested:

“Trust is an important part, you have to trust people. You have to be very secretive, you can’t tell people about it. You have to be business minded, because it has to run as a business... The legal business context is very important in meeting people and appearing dependable, someone who can do the job” (UK-C4).

There are groups of career/organised criminals coming together for a mid-to-long term period to undertake systematic tobacco smuggling activities. However, they are the exception rather than the rule in the business:

“Everyone thinks that there is Mr. Big who will finance criminal activities. And, yes, it will happen but in the majority of cases it is people throwing the money in to get a profit...” (UK-E5).

Previous research has discussed whether tobacco smugglers are involved in other illicit trades and criminal activities.⁴³⁷ Generally, according to research for this report, this appears to be dictated by the scale of the smuggling scheme. In most small scale smuggling schemes tobacco smugglers only deal in tobacco, others in tobacco and alcohol (although selling alcohol alongside illicit tobacco products is only common at retail level). This relates to the following:

- The practical threshold for involvement in tobacco smuggling is lower than for other types of illicit activity. The legal status of cigarettes means that theoretically anyone can, at a minimum, bootleg cigarettes without extensive criminal contacts. This is quite different for other types of organised criminality such as drug trafficking where one may need, at a minimum, to be able to procure the illicit goods in order to enter into the market (UK-E3).
- The moral threshold for involvement in tobacco smuggling is arguably lower than for other illegal markets. As above, the legal status of cigarettes and their availability from legal outlets has a neutralisation effect on individuals involved in this market.

In contrast, in large-scale schemes, the research highlighted that smugglers also deal in drugs and counterfeit products (perfumes, DVDs, luxury clothes). According to a senior customs officer interviewed, during a recent raid at a storage facility, the HMRC found contraband cigarettes alongside stolen goods (motorbikes, mobile phones, etc.) and a significant quantity of illegally produced fireworks (UK-E5). In Northern Ireland, large-scale tobacco smugglers also deal with drugs and arms and they

⁴³⁷ A. Seely, *Cross-Border Shopping and Smuggling* (London: House of Commons, 2002); SOCA, *The UK Threat Assessment of Serious Organised Crime, 2006/07* (London, 2007).

are involved in other “soft” illegal markets such as alcohol, fuel and counterfeit products. Finally, they are involved in the protection/extortion of legal businesses (UK-E1).

Although violence tends to be viewed as an integral part of trading in illegal goods and services and as a feature that is important for the smooth running of such activities, violence at the higher levels of the illicit tobacco market and in the area of street selling is extremely rare. However, instances of violence have been noted and seemed to be employed in order to protect a criminal actor involved in the trade from a leak of information:

“He got the money right and he was going to come and give a statement against me so they went and broke his leg...” (UK-C6).

Violence is also implicitly present and influences decision making with respect to where one is allowed to market his/her merchandise: “there are OCGs in villages around Newcastle that have ‘tab houses’ and you can’t go in there and try to sell your own stuff... otherwise you get a visit...” (UK-E5).

Finally, with regards to the relationship between the illicit trade in tobacco and terrorism/paramilitary groups, primarily in Northern Ireland, the majority of experts interviewed were quite sceptical considering that this link is increasingly promulgated by government and law enforcement rhetoric.⁴³⁸ Overall, there is very little academic or investigative evidence to support this link. However, an investigative journalist living in Ireland that was interviewed for this study suggested that there is some link between the paramilitary groups and tobacco smuggling in Northern Ireland, and that proceeds from the tobacco trade are invested into other illegal markets:

“In Northern Ireland there is significant financing of the real IRA and continuity IRA from cigarette smuggling. Money from cigarette smuggling is then introduced into other illegal markets such as drugs and firearms” (UK-E1).

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

Start-up capital is required by someone to enter the illicit trade in tobacco and the amount depends on the quantity of merchandise they want to trade. There is a wide range of sources for initiating tobacco smuggling operations. The first concerns small scale smuggling/bootlegging, in which **small funds from legitimate work and savings are commonly used**. Using this type of funding allows virtually anyone with a small amount of capital to become involved in the business, from holidaymakers and immigrants, to students and those working internationally:

⁴³⁸ See, for example, W. Billingslea, “Illicit Cigarette Trafficking and the Funding of Terrorism”, *The Police Chief* 71, no. 2 (2004); OCTF, *Annual Report and Threat Assessment: Organised Crime in Northern Ireland*, 2013.

"I went on holidays in Majorca in the summer of 2004 for the first time and of course, one of the first things I noticed was the price of cigarettes. Something like €2-2.50 for Benson and Hedges, Silk Cut, Marlboro, stuff that you would buy back home for double that price or even more. I was 'loaded' in Spain because I was supposed to stay for 2 weeks in Majorca with the savings of a year and a half. I decided not to spend all my money on booze and instead I bought a couple of suitcases of cigarettes which I got back with me when I got home. I sold the cigarettes to my friends and people I knew and some of the sleeves I sold in the cafés and the pubs that I manage" (UK-C1).

Small amounts of money are invested in the illegal tobacco trade not only because larger funds are not widely available to everyone but for two additional reasons:

- A bootlegger has access only to a relatively small market, e.g. covering a small but very specific population such as the case of two Greek students in a university in the north of England supplying cigarettes and tobacco to the Greek students of another university.
- Investing less than one could is an intentional 'detection avoidance tactic' for both the police but also the local extortionists: "... I got a little bigger than in the beginning. But I would not like to be big! No, and that was intentional. When you are 'small player' things are easy. You have a little bit of money, you buy cigarettes and tobacco and that's it. If you are big, the lights are on you. People see you, there is gossip about your business. Next thing you get is a 'tax man' [an extortionist] asking for money. It is better if you have a small business and you know everyone you sell to. You feel safe" (UK-C1).

The second source that was identified was **funds from legal businesses** that the illicit tobacco entrepreneurs own or manage. This was the most straightforward case of funding and the one that tends to be present in the majority of the cases at the levels of importation and wholesale. In a large number of cases legitimate businessmen or owners of large pieces of land (e.g. on both sides of the border in Northern Ireland) invest funds in what is called a "conglomerate", in which legal businessmen are asked whether they would be interested in investing £10,000-£20,000 in a smuggling/importation scheme. The interviewees suggested that it is highly unlikely that an investor would "go in a scheme blind and say 'right, here's £1 million'" (UK-E4). Some investors stick with such a conglomerate for prolonged periods of time, some drop out after a few importations, and some are involved in a single importation. Usually there is a core of investors who know each other through their involvement in various other legal (and occasionally illegal) projects and who are better positioned in the scheme because they know brokers and other strategic individuals involved in the whole process. As the scheme becomes more and more successful, important entrepreneurs "trim down" their investment so that they enjoy a better return of their own investment.

Other similar conglomerates are facilitated by ethnicity. One example from the data is that of a Kurdish businessman who was involved in a

large scheme importing cigarettes with his Polish brother-in-law and his Lithuanian friend. He asked an additional 3 entrepreneurs based in a northeast locality – all of whom were Kurdish and owned shops such as food stores, kebab shops or car-washing businesses – to contribute towards the importation of a container of cigarettes. They invested £20,000 each and, after the successful importation of the merchandise, decided to do it once every month (UK-C3). Individuals investing funds from their legal businesses in the UK illegal tobacco market are not necessarily businessmen owning businesses in the UK. In our interviews we came across a large scheme importing cigarettes from Eastern Europe, which involved two major financiers; a Russian businessman and a Hungarian businessman based in Germany who financed a German wholesaler and expected a return without being involved in the actual smuggling of tobacco. The German wholesaler linked to a Sheffield-based importer in the UK via an Irish broker.

Illegal profits from legal businesses should also be included in this category of sources of capital. The Kurdish wholesaler Aras⁴³⁹ is an interesting example. When he was in the process of collecting as much money as possible to support a small importation scheme from Poland, he “skimmed” (evaded taxes) by not providing receipts for a significant part of his transactions, especially transactions involving Polish or other Eastern European customers. In addition, according to his estimation, for every 5 customers with a total expenditure of £10 or more he overcharged each individual by £2. Given that no analytic receipt is ever provided in his shop, as well as the fact that it is, as he says, extremely rare that a customer notices such an overcharge (especially when a customer buys multiple products), this provides a profit of at least £500 per month. This money was invested in tobacco importation when the schemes were still relatively small-scale.

Thirdly, **illegal activities and businesses** are an important source of funds for the illicit tobacco business. Research for this report came across individuals heavily involved in cannabis dealing and cultivation as well as dealing in other drugs deciding to slowly move into the tobacco trade because the risks were very low in comparison: “...the tobacco business is like a playground for them...” (UK-E2). It is also not unusual for criminals to want to invest a little bit of money into someone else’s illegal tobacco scheme. This is usually the case in small localities in which everyone is familiar with one another and information about successful and profitable schemes flows. Occasionally, these local criminals extort their way into a tobacco smuggling scheme in something that could be described as a “forced investment”:

“So criminals who want a piece of the cake and invest into someone else’s project... Hard men from the local community hear about a successful business in the pub and decide that they want to put a little bit of money instead of extort. This makes them feel like ‘businessmen’, and not like some kind of gorillas...” (UK-E2).

⁴³⁹ Aras is a pseudonym.

In Northern Ireland importers/wholesalers use money from previous criminal businesses to invest in tobacco. Once they have a profit from cigarettes they invest in cycles. There are also consortia in which 2-3 criminal entrepreneurs similar to the ones comprising of legal businessmen invest a sum towards importing a load of cigarettes and then share the profit on the basis of the investment.

Fourth, illicit entrepreneurs in the tobacco business receive **loans from criminals** although this is an extremely rare occurrence which is facilitated, again, by personal relationships forged in previous criminal and/or legal projects, as part of a favour exchange system and because of 'respect'/ reputation. One of our interviewees, for example, obtained a loan from a group of Travellers. This loan derived from the Travellers' profits from their family-based drug smuggling business in a community in the north of England. There was no interest involved because some members of the same Traveller community had benefited from the interviewee in a number of ways. For instance, he offered them small jobs working with friends and colleagues, and supplied them with old furniture as gifts. In addition, the interviewee's sons had been involved in bare knuckle fighting with members of the local Traveller community; something that is culturally valued by the community (UK-C2). Interestingly, however, we have not come across any cases of loans from legal business people.

Fifth, we came across one illegal tobacco trader who desperately wanted to become involved in an imminent cigarette bootlegging scheme and who – in the absence of any immediate sources of funding – resorted to the services of a local loan shark, borrowing £400 in order to buy the merchandise. Unfortunately, because this case was mentioned by an expert (UK-E4) and not by the entrepreneur in question, we do not possess any further information about the interest, payment agreements etc. It should be mentioned, however, that loan sharks are an atypical source of cash for small or large-scale tobacco traders.

Finally, some entrepreneurs noted **multiple funding sources**, which amalgamate some of the sources that are mentioned above or include some ingenious ways of making money. One of the illegal entrepreneurs interviewed mentioned that in his effort to secure the start-up capital for a bootlegging scheme he set up a raffle (a small-scale gambling competition using numbered tickets) with 19 friends from the travelling community. Each of the initiators of the raffle contributed £50 in order to buy a second-hand white van, which was used as the prize for the raffle. 300 tickets were sold for £20 each. The profit was £6,000 (£300 per person). The interviewee used his £300 as the start-up capital to enter the tobacco trading business: "We could have even done it with no van at all, but everyone knows everyone else here. And if you have the van it gives you the legitimacy to do this raffle as many times as you want" (UK-C2). The rest of the start-up capital needed was borrowed from one of his sons who around that time "taxed" a couple of low level drug dealers in a neighbouring locality and was involved in bare knuckle fighting bets. The amount was £700 which was added to the initial £300 from the raffle.

An investor's share is ensured by trust. As mentioned earlier, trust is an integral part of collaboration and in most of the cases of importation and wholesale of tobacco, or in smaller schemes that involve more than one investor. This trust is forged primarily in legal business and in previous legal and illegal projects.

"You have to have a massive, massive, massive element of trust. They have to trust you, like they must love me because every penny I made, I showed them, I told them the truth, they got back. They never lost a penny because of me, the times when there was a loss was when it was in the paper and you had to prove what had gone wrong so that's what I did, had to show them what had gone wrong..." (UK-C6).

However, in the case of the "forced investment", mentioned earlier, by an investor or a "consortium" of investors, the major way in which a share is entrusted is fear of extortion or use of violence by local criminals forcing their way into the scheme:

"These guys are unpredictable and they are not the best partners in the world as they do not really know how to do business. They are known for their capacity and willingness to use violence more than anything else. But if they want to get involved in the business, in your business, what do you do? What can you do? Can you say 'no'? At least if they are part of it, they won't 'tax' you. In this case you, as an investor [in tobacco smuggling] want to make sure that they get their share. Plus you don't have to pay anyone to protect you from others you might want to 'tax' you" (UK-E2).

Settlement of payments

The source of merchandise and the number of suppliers an illegal entrepreneur has depends on the scale of the smuggling scheme as well as the presence of brokers, which can allow links with wholesalers (and financiers) in other countries. Usually small-scale smugglers/bootleggers tend to have different types of suppliers who tend to be duty-free shops or legal retailers in countries with lower prices of cigarettes and tobacco than those in the UK. Very rarely a bootlegger has a number of suppliers who span across the legal and illegal continuum. For instance, one of our interviewees obtained the merchandise from a number of legal retailers in various Spanish towns as well as an illegal wholesaler who operated from a warehouse near Athens. Irrespective of the supplier, there were no special arrangements with regards to payment. Cash is almost always given up-front.

As mentioned earlier, small-scale smuggling schemes are often organised by small groups of people travelling into neighbouring countries to buy a legal quantity of cigarettes they claim is for personal consumption ("runners"). Similar to other small-scale schemes, these operations tend to have a number of legal retail outlets as their suppliers. There are a number of ways in which a person who funds the "runs" ensures that the runner does not steal the money without bringing back the merchandise. Firstly, the runners are recruited from the organiser's local

community and are often members of his/her immediate social circle. Secondly, organisers befriend prospective runners involved. One example of this is the case of Big George (UK-C5) above, who recruited truck drivers. The drivers involved revealed information about their place of origin, residence, family, place of work, etc. This information could then be used in case something went wrong. This information would be obtained before he asked them to participate in the scheme.

Credit is rare in the illegal tobacco business. It is only present in the importation/wholesale level (“...I was so far up the chain... I would have got credit”, UK-C4) and only at the initiation of an importation/wholesale level scheme. Once the first smuggling operation is complete, there is available funding to lubricate additional cycles of the business. The provision of credit is facilitated by trust among actors involved and specifically, the broker who may be able to vouch for the trustworthiness of the entrepreneur receiving the merchandise on credit or – in some cases – may actively be involved in the smuggling. In case of the absence of a broker, credit was facilitated by trust between the supplier and the buyer. In all of the cases in which trust was noted, it had been cultivated during previous legal projects.

A variety of settlements that do not involve money were also mentioned, although these tend to be rather rare in the illegal tobacco trade. Specifically, there is direct exchange of cigarettes with other illicit commodities such as cocaine. This is the case for more versatile crime groups and entrepreneurs and does not involve most of the legal businessmen involved in the trade. In other cases cigarette smugglers obtain a quantity of the merchandise after conducting free runs for a wholesaler in a particular locality: “you do us a run for free and we’ll give you a batch of the product” (UK-E5). Or on one extremely rare occasion the payment was not done in cash but with an asset: “...it was always cash upfront for me, although once I took a boat as payment. It was a Sunseeker Tomahawk, I took it because the guy said it was worth £150,000 so I took it to a boat broker and he sold it for £110,000 after commission and payment for storage I was given a cheque for £75,000 put it in the business account and cleaned the money” (UK-C4).

In case the merchandise is obtained on credit, there are agreements with regards to settlement of payments if there is a contingency such as a load being lost, damaged or confiscated by the authorities: “[Lithuanian wholesalers] were alright with me because when the stuff went missing it was their loss because we had an agreement before we started. I said ‘listen, if it gets took or customs get involved, I’ve got no connection and it’s your loss and end of load...’” (UK-C6).

In wholesale/importation schemes a number of people act as payment facilitators. These are usually people who operate as the brokers bringing together two or more disconnected parts of the scheme. For example, importations in Northern Ireland involve people of Irish origin who live and work in China who facilitate the payment process between the wholesalers and manufacturers of cigarettes in China or the Chinese wholesalers. These Irish brokers have stayed in the country for many

years, they speak the language, and they have previously conducted business with the Chinese. Financially, it is a simple process; the brokers are paid for their knowledge. They are getting paid thousands of pounds per importation towards the upper level (wholesale level) of the business, or in the case of large deals, they can be paid 1% of the profit made by the UK importer. Unfortunately, because of the fragmented nature of the business and because brokers tend to operate on the international level more information is not available.

In the illegal tobacco trade there are no money collectors in the strict sense, as is the case in other trades (e.g. cocaine market), although in the case of one interviewed entrepreneur his sons had acted in this capacity on a number of occasions. With regards to settlement of payments at retail level, customers always paid cash for merchandise. As one of the interviewees emphatically noted, "I always got cash for the cigarettes. Nobody got credit off me, they paid for them or they didn't get the goods. Simple as that." (UK-C6). There are usually no records for the settlement of payments on the international and national level especially when actors from specific groups are involved e.g. travellers. However, during HMRC raids lists with orders for tobacco products have been found.

Costs of doing business

The costs in this kind of business depend on a variety of factors. The scale of the scheme and its logistical complexities, the country of supply, the legality, the number of actors involved, and a number of unforeseen expenses all contribute to the cost.

Buying the merchandise: As mentioned earlier, small-scale smugglers/bootleggers buy and sell relatively small quantities of cigarettes and tobacco primarily obtained from legal retailers. However, occasionally, as is the case with slightly bigger schemes, they will be obtained through illegal suppliers. Often carrying a couple of suitcases from Spain or Greece does not cost anything more than the actual trip to the countries; which the bootleggers will have already paid for. The involvement into a scheme is often a purely opportunistic one. Other small-scale smugglers pay the travelling expenses for their runners plus a small amount for their remuneration:

"The initial amount I used for my first scheme was £500. But it was part of the holiday, so I am not counting the expenses for the trip itself, accommodation, food and drink and so on. I did not plan to bring cigarettes when I went to Spain that first time. So in the trips after that I planned to spend about £1,000 per trip for cigarettes. There is only so much you can carry with you if you are alone. Later, when people who travelled every now and then were in the job, I needed a little more not only because the amount of cigarettes was bigger but also because we needed money for the flights for these people... With the students flying back to Greece and those going to Spain on holiday even sometimes in January, you needed at least £150 per flight, for about 15 trips a year, then another £30 per person for their trouble. Plus the money for cigarettes, each person buying 16 sleeves..." (UK-C1).

When small-scale entrepreneurs buy the merchandise from legal retailers, the price per pack fluctuates between €2-3.50 depending on the brand (€20-35 per master case depending on the brand). When the cigarettes are bought from an illegal wholesaler, sleeves of British consumed brands (Regal, Benson & Hedges, Silk Cut, etc.) are bought for as little as £10 per sleeve/master case. Any changes in the price of cigarettes bought from the (legal) suppliers were on the basis of the taxation in the country the cigarettes were to be legally sold in. With regards to the illegal wholesaler, the difference in price over time is on the basis of increased cost of production of the cigarettes (see UK-C2). Cigarettes in the wholesale/importation level are bought in British pounds for £1 per pack (£500 per box or 50 sleeves). The price has not changed over the last few years, neither has the quantity a wholesaler purchases. The reason for the unchanged quantities over time is that the market/demand the particular importers cover does not change and there is only a limited capacity the wholesalers have to push the merchandise forward into the UK market (UK-C3).

Producing the merchandise: research studies have shown that illegal cigarette factories have been active for many years in several countries.⁴⁴⁰ Relatively recently illegal factories have appeared in the UK as an effort by illegal entrepreneurs to cut down the costs associated with importing cigarettes and tobacco from China, Eastern Europe and other producing countries of contraband merchandise. Interviews for this report provided examples of illegal factories and costs associated with their establishment and sustenance. For example, for an illegal factory in Grimsby, the entrepreneurs rented an old warehouse for the venue of the factory for as little as £25 per week, and bought the cigarette rolling machine online (from alibaba.com) for £7,000. This second-hand rolling machine had been previously owned by a major tobacco manufacturer. There was no detailed information about specific items that are essential for the production phase (compressor, cutter, etc.) and the tobacco. However, it was known that the whole operation cost approximately £60,000 to set up.

“We [customs] found a cigarette making machine in an old warehouse and the necessary cigarette paper and packaging. They got it from big companies. We went to Imperial [Tobacco] and people like that and told them ‘we don’t want you to sell them. We want you to smash them up...you’re shooting yourself in the foot’” (UK-E5).

Less start-up capital is required in order to establish illicit tobacco factories that simply pack tobacco in Britain, such as one discovered by authorities a few years ago in Glasgow. For example, in one of the cases we came across expenses of £200-300 per month for the venue (or even less if the venue is disused), £5,000 to obtain raw tobacco for the initial packaging, £1,000 to buy counterfeit packs and £1,000 a month to employ two Chinese nationals to pack the tobacco.

Transporting the merchandise: Transportation fees vary on the basis of the distance covered and the risk of seizures or arrests associated with

⁴⁴⁰ See, for example, Shen, Antonopoulos, and von Lampe, “The Dragon Breathes Smoke: Cigarette Counterfeiting in the People’s Republic of China”.

specific UK entry points. However, it is possible for the transportation fee to be significantly different for an identical distance covered and possible risk. For example, according to OLAF (2012), in two separate investigations in the UK, one driver received £1,000 per successful channel crossing and the other £10,000. In addition, money for cover loads during the transportation should be added: a number of really low price commodities such as jelly, sand, cattle feed, glass jars and cardboard among others, were identified in our research. The heavy involvement and/or vulnerability of the transportation industry to “transit crimes”,⁴⁴¹ including tobacco smuggling, reduces transportation costs because goods are smuggled by owners of transportation companies, or are planted in their vehicles without their knowledge. For example, one interviewed importer was also the owner of a transportation company. Drivers working for him during legal international projects were unaware that they were also involved in an illegal tobacco smuggling operation: “The drivers of the trucks were just given their normal wages, they didn’t know about the job. It was a legal job to them” (UK-C6).

In another case, the owner of a transportation company and his three legal employees travelled to Spain and Greece on legal business, transporting fresh foods, fish and wine. The fuel and other expenses per trip were paid by the company (or association of companies) that originally commissioned the trip. There were no other expenses because the merchandise was transported by the four individuals (UK-C2). Basically, when the illegal tobacco trader is the owner of a legal transportation company, the illegal business is to a great extent facilitated logistically by his legal business resulting in less transportation expenses.

Payment to actors in the tobacco business

- **Runners:** in cases of small-scale smuggling (e.g. amounts as small as £30 per runner);
- **Brokers:** for example, in the case of the Kurdish wholesale interviewed (Aras), his Polish brother-in-law and his Lithuanian contact received a £2,000 brokerage fee each for their services. Aras’ brother-in-law and the Lithuanian individual got £2,000 each for their services per container imported from Lithuania to the United Kingdom (UK-C3);
- **Couriers:** individuals who are trusted with transporting merchandise and/or money. For instance, the interviews revealed a case of transportation of £1,000,000 tobacco money from the North of England to someone in London. The courier received £5,000 for the service or 0.5% of the money transported (UK-E4). Unfortunately, it could not be established whether this is a standard percentage for the couriers in the illicit tobacco business;
- **Minders:** they are usually people with the physical capital and often accompany the money couriers. Unlike the couriers, the minders are subcontracted on an ad hoc basis and are paid a standard fee per transportation.

⁴⁴¹ E. R. Kleemans, “Organised Crime, Transit Crime, and Racketeering”, in *Crime and Justice in the Netherlands*, ed. M. Tonry and C. J. C. Bijleveld (Chicago: University of Chicago Press, 2007), 163-215.

- **Retail/street sellers:** these are the individuals who have not invested but work for someone else. They receive a daily fee of £50-100 for their work.

The above highlights that payments to actors involved in tobacco smuggling can differ enormously, depending on their role and the size and scope of the operation.

Stashing the merchandise: in many cases tobacco products are simply kept in the trader's house or the houses of relatives and friends. In wholesale cases, industrial units (warehouses) are rented to stash the merchandise. In the cases identified in the research, these industrial units were rented for £50 a month. The security guard working on the premises was given a small fee every month to watch and protect the particular units rented by the illegal entrepreneurs.

Other costs in the illegal tobacco trade involve:

- **Corruption costs:** bribing private security officers primarily at airports and ports; "turning a blind eye" to the crime groups reclaiming merchandise confiscated by customs (as has been the case in Northern Ireland); contacting illegal entrepreneurs in order to inform them that customs officers are not present. Research revealed that the fee for a security guard to contact a criminal group by phone when it is safe to collect confiscated merchandise was £300. Corruption is not, however, a standard cost of the illegal tobacco trade. For example, in the case of a smuggler who used RAF planes to smuggle cigarettes into the UK there were no police or customs checks.
- **Insurance:** Insurance is sometimes bought to protect entrepreneurs if their merchandise is seized or lost. Wholesalers buying the merchandise abroad could pay an extra £50,000 per 10,000,000 cigarettes (the amount of cigarettes in a container) to insure the load. However, "... as is the case with other insurances, you can never be sure whether these insurances pay out" (UK-E4).
- **Extortion:** Major criminals and crime families in Newcastle have been known to extort tobacco smugglers: "we know you are making money from cigarettes and we are going to take a third out of this" (UK-E5).
- **"Test runs":** when a smuggler recruits others for a smuggling scheme or a series of schemes, he either selects from a pool of family members and acquaintances or he asks individuals to conduct "test runs" (with cigarettes or money from cigarettes) in order for the group to see whether he is trustworthy. In one of the cases we came across, tens of thousands of pounds were given to a prospective runner – who was at the time receiving state benefits – to deliver to someone for a fee of £40-50.
- **"Decoy" expenses:** Expenses towards diverting the attention of the authorities and/or misleading legal suppliers of tobacco products. It is known that when a passenger is flying outside of the EU no tax is applicable to HMRC when buying tobacco products (and selected spirits) from duty free shops. If the passenger is flying within the UK or EU the VAT will be accounted for to HMRC by WDF on behalf of

the customer. In one of the identified smuggling schemes, a group of 5-6 smugglers booked return flights from London Heathrow to both Switzerland (outside the EU) and Newcastle, England that arrived at their respective destinations at similar times. The smugglers checked in for both flights, and after the security checks, they provided their boarding passes in order to buy cigarettes at duty free prices. After they bought the cigarettes they flew to Newcastle where they delivered the merchandise, and back to London. The expenses for the flights to Switzerland were what is called here “decoy” expenses (UK-E5).

- **Unforeseen circumstances** only one case was identified in which the entrepreneur had to cover unexpected costs involving an individual working in his legal company and also unknowingly involved in the importation of tobacco. When the driver realised that they were unwittingly involved in a tobacco smuggling scheme, he threatened to keep the truck if he was not paid £3,000 by his boss (and illegal entrepreneur). The issue was resolved by the boss and tobacco smuggler giving the employee the amount requested: “...I met him at a hotel, asked him what he wanted, he said he wanted more money, I asked how much, he said £3,000, it wasn’t much, so I gave it to him” (UK-C4).

Profits and profit sharing

The profit margin from the illegal tobacco trade in the UK depends on a number of variables:

- The type of merchandise sold (i.e. non-tax paid merchandise produced in the UK or abroad, illicit whites, or counterfeit products): Generally, counterfeit products tend to outweigh profit in all other types of smuggling, as they are very cheap to buy and have at least a 200% mark-up. “You can buy a sleeve [10 packs] for £2.50 in China and you can sell them here in the UK for £35-40. There are people taking slices out but you are going to make at least 200% profit” (UK-E5).

The illegal tobacco factory in Grimsby that was mentioned earlier cost £60,000 to set up and before customs intervened and dismantled the factory (within 3 weeks) the profits had reached over £3,000,000. Legal tobacco products bought abroad from retailers appear to have the smallest profit margin. According to participants, the worst case scenario is that the illegal entrepreneurs will have at least a 75% profit on their investment. The profit margins increase with the volume of imported merchandise: “If you buy 10,000,000 cigarettes, the costs are going to be cheaper. It is the same way cash & carry work...” (UK-E5).

- The position of the illegal entrepreneurs in the supply chain: The profits start to diminish as the merchandise moves down the supply chain. Someone in the retail market will make on average a profit of 50p per pack. In terms of wholesalers sharing profit, payments are done when a proportion of the merchandise has been sold and moved to a middle-level broker or retailer. The profits are shared on the basis of one’s investment. In small-scale smuggling schemes, profit sharing is demonstrated according to one’s status within the

bootlegging group and longevity of one’s “employment.” Some actors with only limited involvement are paid a fixed, low fee for their participation. For example, £30, which was the fee paid to runners in various schemes identified in the research. Other actors were paid via a mixture of cash and cigarettes, enabling them to make an additional profit themselves. This opportunity was dependent on ties of trust which were established by long term involvement and as an acquaintance of the main actor(s) outside of the illegal activity. As a result, it is extremely difficult to make generalisations and claims of typical methods of profit sharing (UK-E3).

- Accessibility of consumers to illegal retailers: contraband products sold via legal outlets (e.g. the Polish foodstuff shop mentioned earlier) or pubs where locals attend seem to facilitate transactions.

TABLE 43. EXPENSES AND PROFIT – A UK CASE STUDY

Flight costs	Payment to runners for buying the merchandise	Cigarettes/tobacco	Total expenses for a year’s business	Turnover
£2,500 (for about 15 flights)	£450	Approximately £6,000	£8,950	£12,000
				Net profit £3,050

Source: Interview with UK-C1.

Marketing/promotion techniques: On the wholesale level, the marketing technique is the network itself. The successful “firms” are those that have the ability to promote and push the merchandise to people in lower levels of the supply chain in the UK. On the local, retail level “fag⁴⁴² houses” and known individuals are used to procure cigarettes. Customers are sometimes approached on their own door step by a neighbour with an offer to buy contraband cigarettes. Marketing/promotion occurs somewhat organically via word of mouth as the actors’ status and reputation within specific locales (or a pub/workplace) alerts potential customers to the availability as well as the quality of the merchandise. The longer a bootlegging/smuggling operation is in existence, the lower the need to generate advertising becomes, as existing customers not only return but spread the availability of the goods via word of mouth. The sale of the merchandise via places such as local pubs is often an indication of guaranteed high quality products. On the street, a retailer may offer a pack of cigarettes to a potentially new customer to lure them and establish themselves as their suppliers.⁴⁴³ It should be noted however, that the level of demand in many small localities often outstrips supply rendering the necessity to market/promote the goods unnecessary.

⁴⁴² British slang for cigarette.

⁴⁴³ BBC, Panorama: “Smoking and the Bandits”, 7 March 2011.

In one case, research identified entrepreneurs marketing their products in areas that were outside their usual business radius; they would attend horse racing events in York and Wetherby, or air shows such as the Sunderland International Air Show, and took up the opportunity to sell contraband cigarettes. Often vending machines selling cigarettes were unavailable inside these events (UK-C2).

Spending and investing illegal tobacco profits: Much of the profit made is simply spent on hedonistic pursuits: “Life as party! Cars, gold, someone I know told me he had ‘more gold on him that you can choke a dog with’... dining and wining with local celebrities such as footballers” (UK-E4). Money was spent on holidays, providing or lending money to family members and friends for a variety of reasons including making investments (e.g. one of the interviewees loaned his sister £700,000 towards the creation of a property portfolio in the United States). Profits were also used to pay off debts such as loans or mortgages, buying luxury cars and racing bikes, and paying the tax for these items as well as preserving them. A pattern that can also be identified is that of spending habits that change over time as individuals’ own biographies evolve. Young illegal tobacco traders with limited social responsibilities prefer to spend their profits on hedonistic pursuits. As their lives change and they grow older (getting married and having children), they seek to secure their family’s future (e.g. one entrepreneur paid for his son’s university education in the United States), as well secure their finances via investment in legitimate spheres such as setting up their own businesses. Illegal tobacco traders in general tend to invest in night-time economy establishments (pubs, bars, clubs) and in property (not only in the UK but also abroad in countries such as Spain and – in the case of illegal tobacco entrepreneurs from Northern Ireland- in the Republic of Ireland).⁴⁴⁴ In one case, money was also sent to Iraqi Kurdistan in order for property to be bought (UK-C3). Illegal tobacco entrepreneurs were also found to be investing in the enhancement of their existing legal business (e.g. more and better vehicles, bigger premises etc.) or in establishing new businesses. Examples include pork pie factories and ice-cream factories in South Yorkshire, pawnbrokers and jewellery shops, Polish foodstuff shops and Polish hair and beauty salons in areas heavily populated by Polish and Eastern European diasporic communities.

Naturally, profits from cigarette smuggling are also re-invested in cycles in the illegal tobacco trade. Generally, there is very little commodity hopping among the illegal tobacco traders. However, we came across entrepreneurs who also invested in separate criminal businesses. One example was in counterfeit luxury clothes (UK-C6), another in alcohol smuggling from Greece, Italy and France. After his retirement from tobacco smuggling, UK-C2 financially supported his sons who established a cannabis, cocaine and crack cocaine business in their locality, while relatively recently he also became involved in small-scale illegal money lending.

⁴⁴⁴ According to one of the interviewees, cigarette smugglers also have a great deal of land on both sides of the border (Republic of Ireland and Northern Ireland) – something that also gives them the opportunity to move in and out and evade apprehension by the authorities (UK-E1).

The areas of investment are linked to the individual actors' own contact networks and areas of previous experience and knowledge.⁴⁴⁵ One individual with an existing job in food supply sought to expand his business using his illicit profits. Actors are typically restricted to investing in areas in which they held some prior experience or expertise, therefore, examples of investment in offshore bank accounts were rather atypical cases since most entrepreneurs did not know people who could assist with the practicalities of setting up an account. This difficulty is exemplified by the words of one of the criminal entrepreneurs interviewed: "I was in it a long time, made lots of money but it was difficult to spend it. Yeah, you could buy the best carpets for your house, furniture etc. but you couldn't buy a house or a car... they would start asking questions" (UK-C6).

Money laundering: As mentioned earlier, proceeds of crime were invested in the establishment of a legitimate business. However, it should be noted that illicit proceeds were *not* laundered through this legitimate business thereafter. The legitimate business was, therefore, the product of the illicit activity and did not finance the illicit activity itself. Money laundering on a sophisticated, complex and systematic scale was not evidenced in the research. Illicit profits were used to establish licit business interests insofar as this may be regarded as money laundering. However, as mentioned above, illicit proceeds were not subsequently laundered through these legal businesses once they had been established. There was, however, a case of tobacco profits being laundered through a legal business owned by an illegal tobacco wholesaler owning a transportation company:

"I would transport bands and their productions to different countries while they were on tour. I worked for people like The Spice Girls, Bon Jovi, Robbie Williams, Olly Murs, etc... I would change the invoice from the bands I was working for. If the invoice was for £100,000 I would change the invoice to £200,000 or £300,000 or would add things on to the bill as extras for the bands which was normal in my type of business" (UK-C4).

Access to capital in critical moments

There are a number of critical moments in the illegal trade in tobacco which include: (1) the merchandise and transportation means being confiscated by the authorities at UK ports and airports; (2) the illegal entrepreneurs being arrested and/or fined by the authorities; (3) the merchandise being lost; (4) the merchandise being stolen by competitors or others; (5) the merchandise being destroyed or damaged (e.g. the tobacco products being warehoused in a leaking industrial unit) (UK-E5). These critical moments require access to capital not only in order for the entrepreneurs to re-enter the business but also to cover legal expenses.

When the cigarettes and tobacco in small-scale schemes are confiscated at the UK border, entrepreneurs easily re-enter the trade by re-investing

⁴⁴⁵ See also X. L'Hoiry, "'Shifting the Stuff Wasn't Any Bother' – Illicit Enterprise, Tobacco Bootlegging and Deconstructing the British Government's Cigarette Smuggling Discourse", *Trends in Organised Crime* 16 (2013): 413-34.

money from their legal work and/or savings. Due to the reasonably small scale of the bootlegging operation, the loss of profits did not seem to be insurmountable. It appeared that seized shipments are more like an inconvenience as the money invested was not so large as to require any special/extraordinary action in order for the entrepreneurs to be able to re-enter the business. According to the interviewees, entrepreneurs in the mid-level of the illegal tobacco business have the biggest problem in accessing funding when merchandise is lost because these are relatively smaller players who want a larger piece of the action:

“They have a little something aside from legal business and invest it in tobacco smuggling. If they lose it, it is more difficult. Depends on whether they have some more money aside to get involved again. But there are many who can cover for them, there are many who can operate as mid-level. I think these are the people who have the biggest problem, financially speaking. Because wholesalers have money, whereas retailers buy such small quantities that it is not a big deal if they lose the merchandise” (UK-E1).

In relation to large-scale schemes, money from previous successful importations is re-invested. Because profits are so large and the penalties (in comparison to drugs, for example) are low, customs intelligence suggests that entrepreneurs do what they call “bulk container rolls”, i.e. simultaneous importations of 5-6 containers on the same day at different ports throughout the UK. The profit margins are so big, particularly with the counterfeit cigarettes, that if one container is successful there is still a considerable profit to be made (UK-E4). As one of the interviewees also noted: “You do 2-3 successful runs and you’ve made a considerable amount of money... you can put some to one side to cover legal bills or whatever but then they’ll buy some more tobacco” (UK-E5). Thus, effectively, the high profitability of the illegal tobacco trade allows the entrepreneurs involved in importation/wholesale of tobacco products to enjoy relative security from the financially critical moments of the trade.

There was reference to a “contingency fund” that existed in the late 1960 and early 1970s among the dock workers in Hull port, a fund that is not still present in the tobacco business. In the late 1960s and early 1970s dock workers in Hull port used to be heavily involved in small-scale tobacco smuggling on a daily basis after having established good working relations with some members of the ferry crew and other sailors. They all invested small amounts of money in the scheme and for the first months *all* proceeds went into a fund that would cover their legal defence in case of any arrests by the authorities (UK-E5).

Finally, more organised and resourceful entities can take action instead of seeking funds to cover the loss involved when merchandise is confiscated by the authorities. For example, there was reference to a couple of cases in Northern Ireland in the 1990s, which involved paramilitary groups raiding HMRC warehouses in order to reclaim the cigarettes confiscated. However, this is not a typical way of solving similar problems in the UK illegal tobacco market.

Loan sharking is not an integral aspect of the financing of the illicit tobacco trade. Only two cases were identified. The first involved a retailer who resorted to a local loan shark to secure £400 in order to participate in an imminent smuggling scheme. The second was a case of an illegal tobacco trader who, after retiring from tobacco smuggling, invested some of his profits into small-scale illegal money lending.

5.4. SWEDEN: FROM SMUGGLING TO WAREHOUSING

Introduction

In many other countries than Sweden, illicit tobacco has historically played an important role as a source of income among organised crime groups. In recent times, however, narcotics have supplanted it as the dominant commodity – even though illicit tobacco still has a central role to play in some regions and groups.⁴⁴⁶ While the great chronicler of the Swedish trade in illicit tobacco has yet to make an appearance, it is clear that illicit tobacco has played a far less important role for organised crime than has the smuggling and bootlegging of alcohol. This type of criminality saw the light of day during the days of World War I, when the Swedish state instigated a system of alcohol rationing, later superseded by an especially stern alcohol policy characterised by high taxation.⁴⁴⁷

According to individuals interviewed for this report, the illicit tobacco trade was only a minor problem until the 1990s. The sharp increase in the tobacco tax in the 1990s was singled out by several interviewees as the starting point for the large-scale trade in illicit tobacco.⁴⁴⁸ With Sweden's entrance into the EU in 1994, another important precondition that got the wheels of the illicit tobacco trade spinning was fulfilled as the borders towards Europe were opened up. Prior to this, "there were [customs officials] poking their noses in every border crossing", and transporting larger shipments of tobacco was indeed a risky business, an ex-smuggler points out (SE-C3). The open borders significantly lessened the risks, and consequently shipping considerable quantities into the country became possible.

"Back then, whole truckloads were being brought into the country in large scale smuggling operations. There were lorries arriving weekly." (SE-C3). There was involvement from established criminal figures, and it was they who organised the large-scale schemes. Individuals from the Balkan countries got "a certain percentage for every carton passing

⁴⁴⁶ K. von Lampe, "Explaining the Emergence of the Cigarette Black Market in Germany", in *The Organised Crime Economy. Managing Crime Markets in Europe*, ed. P. C. van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2005), 209-30; K. von Lampe, "The Cigarette Black Market in Germany and in the United Kingdom", *Journal of Financial Crime* 13, no. 2 (2006): 235-54.

⁴⁴⁷ P. O. Johansen, *Den illegal sprite. Fra forbudstid til polstreik* (Oslo: Unipub, 2004).

⁴⁴⁸ EBM and SKV, *Punktskatter och brottsbekämpningens utmaningar. [Excise Fraud and Challenges for Law Enforcement.]* (Cooperation between the intelligence units at the Economic Crime Authority and the Swedish Tax Agency. Stockholm, 2011); D. Vesterhav, "Bilderna av organiserad brottslighet i svensk dagspress 1995 – 2002 [The Image of Organised Crime in the Swedish Daily Press 1995 – 2002]" (University of Stockholm, 2003).

through Montenegro" (SE-C3). They forwarded shipments of cigarettes to contacts in Sweden, where criminal entrepreneurs ran the distribution networks.

Today the situation is different. There has been a decrease in outright smuggling in favour of economic crime schemes, and the remaining trade in smuggled cigarettes is handled mainly by individuals.⁴⁴⁹ However, the findings in this study indicate that some of these individuals either are members of larger networks or act as retailers for them. In this new situation, a large proportion of the illicit tobacco which is brought into the country gets here by way of companies responsible for importing a large number of tobacco shipments, and who at least initially report these to the authorities. As a consequence of the EU duty suspension regulation – where the excise duty payment is suspended until the tobacco reaches the consumer – licensed companies are allowed to store these shipments in tax warehouses after importing them.⁴⁵⁰ Tax payment is deferred until the tobacco is picked up from the warehouse – but instead of generating tax revenue, the tobacco gets diverted to the black market.⁴⁵¹ Aside from this, there are also cases where legal haulage companies get used as covers for smuggling of cigarettes.

Establishing whether a tobacco product is illicit is not always straightforward. The packets often feature the correct warning labels in Swedish, as prescribed by law. Besides this, a lot of the cigarettes inside them were initially imported legally, and all the relevant documentation is seemingly in order. Boxes of illicit tobacco get mixed together with legal tobacco in the tax warehouses, and this process is later repeated in the cigarette racks of retail shops and convenience stores – everything calculated to obstruct successful inspection. Other cigarette packets either lack Swedish warning labels or are equipped with foreign language ones.

Counterfeit well-known brand name cigarettes also circulate on the Swedish market, although their share of sales is comparably small. Interviewees explain this with additional production costs associated with the small Swedish market – producing counterfeit packaging with warning labels in Swedish rather than, for instance, any of the major European languages is less profitable.

Furthermore, a small share of the illicit tobacco market is occupied by shisha tobacco, with the same thing going for the quintessentially Swedish tobacco product, snus.⁴⁵² However, as snus is more or less produced for the Swedish market specifically, international legitimate players would be hard pressed to justify any smuggling of this product into the country.

⁴⁴⁹ SoRAD, *Tal om tobak 2012. Tobakskonsumtionen i Sverige 2012 [Numbers on Tobacco 2012. Tobacco Consumption in Sweden 2012.]* (Stockholm, 2012).

⁴⁵⁰ EBM and SKV, *Punktskatter och brottsbekämpningens utmaningar. [Excise Fraud and Challenges for Law Enforcement]*.

⁴⁵¹ SKV, *Skattefelskarta [Tax Fraud Map]* (Solna, Swedish Tax Agency, 2008); Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]* (Stockholm: Swedish National Council for Crime Prevention, 2011).

⁴⁵² A moist powder tobacco product derivative from a variant of dry snuff in Sweden.

Market overview

Annual cigarette sales have dropped to 780 cigarettes per person,⁴⁵³ a level at which it has remained stable during the last few years. However, a new market segment has appeared – the occasional smoker. As is the case in many other Western European countries, Swedish ex-smokers are concentrated in the generations born in the 1960s or earlier. There has been a sharp drop in the popularity of smoking in the country since the middle of the 1980s.⁴⁵⁴ Figures from the early 2000s indicate that this trend is continuous.⁴⁵⁵ In 2010, the share of daily smokers was 13% among Swedish women and 12% among Swedish men.⁴⁵⁶ Another study arrived at somewhat lower figures: 8.3% of Swedish women and 11.1% of Swedish men were considered daily smokers.⁴⁵⁷

Smoking is most commonly practiced by individuals with low income and few qualifications, as well as among certain immigrant groups. Young people are heavier smokers than older ones. In addition, women tend to smoke more than men. In 2010, 36% of male secondary grade pupils had at least some kind of smoking habit, compared to 43% of their female classmates.⁴⁵⁸

The **level of taxation** on consumption in Sweden is high, as are the excise duty taxes for tobacco. The Swedish consumer might expect to pay €5.6 for a packet of cigarettes – this in comparison to the cost of €2.9 and €2.7 respectively in neighbouring countries like Poland and Estonia.⁴⁵⁹ At the same time, however, cigarettes are considerably more expensive in adjacent Norway (€9.8) as well as in the UK (€8.3), a situation which has resulted in Sweden serving both as a destination and transit country in the illicit tobacco trade.⁴⁶⁰

Surveys conducted in recent years indicate that **illicit cigarettes occupy 12 to 17% of the market share** in Sweden.⁴⁶¹ The popularity of illicit tobacco is greatest in a geographic area stretching from the southern parts of Sweden up to the Mälaren Valley, with prevalence especially high in Skåne County, and in major urban areas. The Öresund Bridge in particular is an important link connecting continental Europe and

⁴⁵³ Statens Folkhälsoinstitut, *Tobak. Kunskapsunderlag för folkhälsopolitisk rapport 2010 [Tobacco. Knowledge Base for Public Health Policy Report 2010]* (Stockholm: Public Health Agency of Sweden, 2011).

⁴⁵⁴ Ibid.

⁴⁵⁵ SoRAD, *Tal om tobak 2012. Tobakskonsumtionen i Sverige 2012 [Numbers on Tobacco 2012. Tobacco Consumption in Sweden 2012]*.

⁴⁵⁶ Statens Folkhälsoinstitut, *Tobak. Kunskapsunderlag för folkhälsopolitisk rapport 2010 [Tobacco. Knowledge Base for Public Health Policy Report 2010]*.

⁴⁵⁷ SoRAD, *Tal om tobak 2012. Tobakskonsumtionen i Sverige 2012 [Numbers on Tobacco 2012. Tobacco Consumption in Sweden 2012]*.

⁴⁵⁸ Statens Folkhälsoinstitut, *Tobak. Kunskapsunderlag för folkhälsopolitisk rapport 2010 [Tobacco. Knowledge Base for Public Health Policy Report 2010]*.

⁴⁵⁹ HUI, *Marknaden för oregistrerade cigaretter i Sverige [The Market for Unregistered Cigarettes in Sweden]* (Stockholm: HUI Research AB, 2013).

⁴⁶⁰ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*; RUC, *Underrättelserapport Röken. Illegal cigarethandling. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]* (Gothenburg, Regional Intelligence Centre, 2012).

⁴⁶¹ HUI, *Marknaden för oregistrerade cigaretter i Sverige [The Market for Unregistered Cigarettes in Sweden]*; See also Tullverket, *Lägesbild Organiserad Brottslighet 2011 [Situational Report Organised Crime 2011]* (Stockholm, Swedish Customs, 2011).

southern Sweden. The lowest market share is found in the northern parts of the country. Thus, the prevalence of illicit tobacco is a reflection of geographical proximity to European markets.

However, the concentration of illicit tobacco in the south does not mean that there are no regional variations. In a mid-sized city such as Gävle – located by the coast of the southernmost part of the northern province of Norrland – illicit tobacco carries a market share as big as 38 per cent. This figure was the result of a major survey – in which using methods such as test buying and counting discarded packages were used – carried out with the cooperation of the Swedish Retail Institute (HUI) and the security company Securitas. According to interviewees, this significant figure may partly be explained by the presence of a free port and by the city's geographic location, close to both Stockholm and a major highway which provides direct access to Norway and the significantly higher price level there.

Sources of illicit tobacco

Illicit tobacco is produced in several different areas and is imported into Sweden from a number of countries. Legal tobacco manufacturers constitute important sources in this trade because they have the advantage of being able to offer sought after high-quality cigarettes by well-known brands. Previously, the only brand name cigarettes such as Marlboro, Prince or Blend were found on the Swedish market. In the words of an offender: "You couldn't sell anything else." It was too risky trying to market inferior goods – the main thing was unloading the shipment quickly: "When dealing in larger shipments of 25 pallets, you'd better be able to offer quality products" (SE-C3).

Yet another type of brand name products is the national brand, such as different Polish cigarettes. These cigarettes are considered house-hold names in Poland and are at the same time sought after in Sweden as well. However, according to one of the offenders interviewed, these cannot compete with Marlboro or Prince in terms of marketability.

The issue of the origin of a cigarette has grown more complex. A highly diverse range of nations was identified in the research, including China, Eastern European countries like Ukraine, Poland, Hungary, Russia, as well as regions like the Middle East, and possibly even Africa.⁴⁶² This is hardly a surprising development, given that it follows the general globalisation of legal trade.

Unlike for illegal goods, tobacco is dealt with using both illegal and legal retail trade networks. Illicit cigarettes are marketed openly in spaces where the access and influence of authorities is limited. From the point of view of the offenders, the major advantage of trading out in the open is that it is there that their customer base is located. This makes the trade in illicit tobacco highly efficient compared to narcotics or

⁴⁶² Cf. RUC, *Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

prostitution. Furthermore, the fact that legal sales channels “rub off” on the products on offer – these are perceived as “white” by customers – leads to greater profit margins.⁴⁶³ To consumers, the cigarettes seem reasonably priced rather than illegal. Moreover, in one survey, 54% of the consumers who participated agreed that “it is acceptable to purchase cheap cigarettes” (cheap denoting packets costing SEK 40 (€4.2) or less, which does not even cover taxes and fees).⁴⁶⁴

The extent of criminality

Tobacco sales are the source of roughly SEK 10 billion (€1 billion) in tax revenues annually.⁴⁶⁵ The tax on tobacco thus represents a significant source of income for the state. The importance of the tobacco trade is clearly reflected in the policy of the current government, with a tax hike proposed in order to strengthen the fiscal situation of the state. The annual shortfall is calculated to be SEK 2 billion approximately, but this figure also includes the sums lost from illicit alcohol sales.

This SEK 2 billion shortfall in revenues may be compared to a total tax gap calculated at upwards of SEK 130 billion (€16 billion) by the Swedish Tax Agency.⁴⁶⁶ This loss may not seem that large when compared to the larger sums involved. Tobacco obviously becomes a marginal phenomenon if compared to the total value generated by all trade and production of goods and services. If tobacco is considered from a relative point of view, the shortfall in state revenue becomes significant. Furthermore, widespread excise tax evasion means that free competition is negatively affected. Several interviewees mentioned that shopkeepers may find it hard to refuse illicit tobacco when the competitor further down the street offers consumers cheap cigarettes. Sometimes shopkeepers try to do something about the uneven market by tipping the authorities off about competitors who sell illicit tobacco. However, at the end of the day, this criminality is underpinned by consumers, who enjoy being able to purchase cheap cigarettes.

Obstacles to combating illicit tobacco

While the fight against drugs has been highly prioritised by customs and police officers for decades, the commitment towards counteracting the smuggling of alcohol and tobacco has been less intense, which probably has to do with these goods being considered less “foreign” than socially accepted products. With importers now turning from smuggling to the more advanced methods of excise duty evasion – where companies are used as criminal instruments – this type of criminality has become increasingly harder to get at. The primary function of the customs – identifying illegally imported goods – has

⁴⁶³ SKV, *Skattefalskarta [Tax Fraud Map]*; Brå, *Storskaliga Skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

⁴⁶⁴ HUI, *Marknaden för oregistrerade cigaretter i Sverige [The Market for Unregistered Cigarettes in Sweden]*.

⁴⁶⁵ SKV, *Skattefalskarta [Tax Fraud Map]*.

⁴⁶⁶ *Ibid.*; RUC, *Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

in part become irrelevant as the very act of importing the goods may now in itself be legal.

When illicit tobacco is openly sold in retail shops, this prompts the need for comprehensive and joint inspection measures by the police, the municipalities, and the Tax Agency. In addition, as the trade at the retail level involves smaller quantities spread across a large number of entrepreneurs, this naturally makes for less serious individual offences.⁴⁶⁷ Yet another problematic aspect is the fact that illicit and legal tobacco is often mixed, which complicates the process of establishing to what extent the products are untaxed.

Generally speaking, the knowledge of law enforcement of the criminal landscape is limited. In the case of advanced excise tax evasion schemes, this is often not possible without employing measures like surveillance and phone-tapping – resource-intensive methods that are generally reserved for types of criminality associated with harsher penalties than tobacco-related offences. Such intelligence-led enforcement only becomes available when substantial sums are involved, such as a container-load of illicit tobacco and revenue shortfalls upwards of SEK 15 million (€156,000).

Market structure and actors

Import and distribution

Interviewees noted that links to organised crime groups are sometimes evident already at the point of production. This may be exemplified by the fact that Italian and Russian groupings are running factories of their own; at least the Russians run operations to get their products into the country, either through smuggling or importation. As in other cases the illicit cigarettes that are brought in are so called illicit whites.⁴⁶⁸ Even though principals, companies, and brands may come and go, forensic analysis has established that the cigarettes in some cases are produced in the same location; the same machinery has been used to manufacture the cigarettes.

One interviewee added that illicit whites may originate from countries characterised by low production costs, where industry groups have observed the overcapacity of certain factories. These are kept in operation despite the fact that the wheels – supposedly – stay idle during large parts of the day. This indicates that they are used to manufacture illicit whites in parallel to cigarettes that are intended for the legal export market. According to one offender, there used to be clear divisions in the market, with one group smuggling counterfeits and the other trading in illicit whites. Today the situation is more diverse – business is done with whoever is available. Public officials tend to think along similar lines because of the plethora of brands that are available on the market.

⁴⁶⁷ Ibid.

⁴⁶⁸ RUC, “King Size” – Samverkan mot illegal cigarettantering [King Size – Collaboration against Illegal Handling of Cigarettes] (Gothenburg: Regional Intelligence Centre, 2012).

The need to start looking outside the borders of Sweden was noted during the research. In many cases the straw man is the only representative on the ground in Sweden; the principals are to be found abroad, as is the money. Getting a grip on the complex import schemes can also be quite a challenge, a fact which is described by a public official:

“We see how containers that are transported across Europe exchange identification codes. According to official documents your first container contains, say, construction material, the second cigarettes. The construction material is being transported between EU countries, the cigarettes are just in transit in EU. The shipment containing the cigarettes moves on – but now equipped with the documents for the other container, and it is free to do so as it appears to be a transport between EU countries. Such manoeuvres make the cigarettes hard to find.”⁴⁶⁹

The illicit tobacco business has a quick turnover. Sales channels are already in place, and the goods are quickly passed further on to the consumers. The only reason one would invest in these kinds of extensive logistical networks is to support a business operation which is reasonably stable. In fact, it is almost a precondition; bringing the cigarettes into the country might be easy but getting them to the consumer is the difficult part. This can be done either by setting up an extensive logistics network or establishing contacts with different retail shops. Customers may also be alerted about incoming tobacco shipments by shop owners; public officials responsible for supervisory activities have noticed increased activity in the vicinity ahead of arrival. One offender described the distribution network as follows:

“The trade is swift. They ring people up to tell them that they are sitting on a shipment; they sell it on straight away. Shipments get passed on quickly. Maybe a lorry or two gets caught, but the other ones make it through the net cast by the customs without a hitch. Losing a shipment now and then, that’s something you can afford. But everyone involved in the next step in the chain are just waiting for the goods to purchase it, pick it up, and sell it on – everyone wants to make a buck.” (SE-C1)

Some informants describe vans or lorries pulling of the road and vehicles quickly turning up to collect their share of the cargo. It doesn’t take long to unload the cargo so that it can be handed over to those in the next step of the chain. A law enforcement official described how a lorry carrying smuggled tobacco was intercepted:

“As the lorry made a halt in the middle of the night, several pick-up trucks turned up. We went into action after they had unloaded 20 per

⁴⁶⁹ The report on the illicit tobacco trade in Sweden draws on, among other things, a seminar discussion with 19 experts from a number of relevant backgrounds: employed in the tobacco industry, at public authorities involved in detecting and investigating the illicit tobacco trade, etc. Where no individual code is provided, the quote refers to a view shared at that discussion.

cent of the cargo. The guy who had brought in the shipment – the distributor – was sitting in a car only a couple of kilometres away. It was he who had called in the people who were collecting the shipment.”

In addition, the secrecy requirements are not quite as high for distributors of illicit tobacco as for dealers in goods such as narcotics, according to one offender. The risks might be slightly increased when the distributor utilises legal transport networks, for example bringing in cigarettes and legally imported goods side by side. This is because the cargo might be inspected by both the haulage firm and the company on the receiving end. Another downside is that this makes the shipment much more transparent in terms of tracking the distance it has travelled and by what route.

The size of distribution networks vary according to the scale of the trade. One general rule of thumb, however, is that there are fewer middle-men involved compared to the narcotics trade. This might be because tobacco is a legal good which anyone can purchase in a regular convenience store. Another reason might be that illicit tobacco reaches the market through the same channels as the legal and taxed tobacco. According to one official there is a lot of illicit tobacco arriving by boat, possibly because port security is perceived as being more lax. Another alternative is taking care of the shipment out to sea, with goods being transferred from larger vessels onto recreational crafts which can then easily land without arousing much suspicion.

The middle-men who serve as retailers in the chain of distribution are also those the authorities know the least about. Their knowledge is greater when it comes to importers, large-scale distributors, and the corner shops that end up selling some of the tobacco. Some officials imply that some wholesale market spaces are used by retailers of foodstuffs who also act as middle-men selling illicit tobacco. In the opinion of one offender, these entrepreneurs have not acquired enough competence in the Swedish language for them to be able to run businesses that are fully legal; they live outside mainstream society and make a living as grey-zone retailers.

Further illustrating the importance of having a reliable distribution network are the examples, although few, indicating the existence of failed retailers. A public official tells of an interrogation of a retailer who supposedly had purchased something like 20,000 or 30,000 cigarettes from a man he chanced upon in a shopping mall. It is hard to confirm the veracity of this story, but it could possibly be interpreted as a sign of a failed attempt at setting up a distribution network, leading the man to actively seek out retailers instead. This is supported by additional data indicating that retailers sometimes have had a hard time locating suitable buyers for their goods.

Players

During the last few years Swedish authorities have stressed the fact that organised crime has entered the illicit tobacco market.⁴⁷⁰ A seminar participant describes this process as follows:

“Today organised crime is the same as economic crime. It’s all a big mess, with different players hanging out with each other. Having 2 million cigarettes means that SEK 1 million ends up in your coffers, all at the risk of getting 2 years in prison. Try the same thing with amphetamine and we are talking about 12 years behind bars.”

However, this in no way means that the odd individual operator cannot be found plying his or her trade on the market. These are first and foremost private individuals who travel to low-tax countries to purchase cigarettes, which they then sell on using their own social network (see below on the frequent small-scale illegal imports). According to a public official with comprehensive knowledge of the field, the trafficking of these operators is usually limited to alcohol; nowadays, the cigarette trade is the domain of organised crime. The following picture of the individual operator emerges from the description by a public official of a small-time player attempting to increase his turnover by formalizing his business:

“We have this guy who drives around in his own car to sell his goods. Information about his activities spreads through social media. Now he is on his way starting his own company. He has learned the ropes. He has no need for corner stores as he is living in a smaller town.”

In contrast with smugglers, those who primarily rely on tax warehousing were described by interviewees as somewhat more business-like or “the scammer type of person.” The smugglers instead tend to be mentioned in connection with traditional organised crime and have a high intimidation capital (the ability to frighten people due to a reputation of being violent or connected to “dangerous” people⁴⁷¹). Well-established criminals from groups capable of mobilising substantial intimidation capital are most commonly seen on the lower levels of the distribution networks. Other members of these groups may however assume a more business-like profile, and consequently tend to show up in connection to distribution networks relying on tax warehousing as well.⁴⁷² In this way, traditional smugglers and economic criminals are brought together, which sometimes leads to new constellations being formed. A public official summarises this development:

⁴⁷⁰ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*; Tullverket, *Lägesbild Organiserad Brottslighet 2011 [Situational Report Organised Crime 2011]*; RUC, *Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

⁴⁷¹ See Brå, *Otillåten påverkan mot företag. En undersökning om utpressning [Unlawful Influence against Businesses. A Study on Extortion]* (Stockholm, Swedish National Council for Crime Prevention, 2012).

⁴⁷² See also Tullverket, *Lägesbild organiserad brottslighet 2011 [Situational Report Organised Crime 2011]*.

“You notice this when you conduct phone surveillance of people [active in organised crime circles]. They are always on the lookout for new business opportunities. There is a great capacity for invention. They are moving on, from narcotics and alcohol to tobacco.”

Different collaborative efforts between different players are known, especially on the retail side – a pattern also seen on the Swedish narcotics market.⁴⁷³ These collaborative arrangements have been used for mutual trade as well as support in times of crisis. However, few people have been able to substantiate this by citing specific examples. Such behaviour may therefore not be all that common.

The advisory roles of different types were brought up during the research. The main type is the legal advisor probing for legislative loopholes (the one used in tax warehousing scheme being one example).⁴⁷⁴ Another example is a lawyer actively seeking out and becoming a partner in a criminal tobacco scheme.

Some officials consider the demand for people able to function as business intermediaries to be greater than for advisors. Such intermediaries are often on a good footing with foreign suppliers and can help out new players on the Swedish market by guaranteeing their reliability. There are some known cases where interpreters have served in this capacity. Another sought-after functionary is the problem-solver, preferably the one with a talent for sorting out the logistical structures which often turned out to run less smoothly than originally planned. In the words of one public official, “their organisational structures are totally chaotic.” On the other hand, the well-established players in the world of organised crime have very good access to networks and contacts. One public official describes these players as follows:

“Individuals who commit crimes through companies holding excise tax licenses are suit-wearing multilinguals who know how to conduct themselves. They make their own pleas in court and display a knowledge which is almost encyclopaedic” (SE-E3).

Two other major factors that influence organisational structures are profitability and the extent of a player’s available resources. After having studied the local market one seminar participant identified a pattern of capital-rich players having control over quite a few more steps in the chain of distribution than the others. Most of the others involved are independent entrepreneurs who engage in mutual trade in order to try to turn a profit for themselves.

Together with results from a previous study on large-scale tax offences, the data collected in this research makes it possible to distinguish five separate criminal *modus operandi* used in the illicit tobacco market.

⁴⁷³ Brå, *Narkotikadistributörer. En studie av grossisterna [Drug Distributors. A Study of the Wholesalers]* (Stockholm: Swedish National Council for Crime Prevention, 2007).

⁴⁷⁴ See RUC, *Supen. Rapport om punktskattebedrägeri med alkohol [A Report on Excise Fraud with Alcohol]* (Gothenburg, Regional Intelligence Centre, 2012); Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster’s Costs]*.

These are: fraud by means of tax warehousing, mixed operations, frequent small-scale illegal imports/smuggling, and so called distance trade.

Fraud by means of tax warehousing

As previously mentioned there has been a decline in smuggling in favour of schemes in which businesses are used as criminal instruments. According to a seminar participant, seventy Swedish companies hold excise tax licenses (granting them the right to use tax warehouses) but the market is almost entirely dominated by just one of these – Swedish Match (which controls roughly 94% of the market). Law enforcement intelligence estimates that around 10% of the smaller companies are created to be involved solely in illegal business.⁴⁷⁵ This whole situation is largely said to be a product of people learning how to set up their schemes by the aid of a manual (which has been seized by the authorities) written by someone after having discovered a loophole in the law.⁴⁷⁶ Several of the interviewees confirm this excise duty evasion scheme as the most commonly used method for importing illicit tobacco. The procurement of companies holding a tax excise license is the basis for this type of criminality, companies which are then used to bring in large quantities of cigarettes (mainly – these are used for alcohol as well).⁴⁷⁷ This scheme makes importing and transporting the cigarettes fully legal. Even though there is a strong association to illicit whites for this method it may be used for trading other types of tobacco as well.

In formal terms the criminal offence is only committed later, when the perpetrator neglects to declare the commercial transaction, withholding excise duty and VAT. During a respite period of about 70 days the culprits can devote themselves to importing as large quantities as possible until their company shows up on the radar of the authorities because of unpaid taxes and fees. Once the authorities start seeking out the company representatives, the whole company board – initially composed of respectable and economically well-to-do members – would be replaced by the principals with a straw man who doesn't know anything about their activities. If the principals are to secure a steady supply of tobacco they must therefore constantly try to acquire new companies to assume control over. To the outside observer this might look like a business deal between two independent companies, but the reality is that the companies are getting replaced while the actual owners remain the same.⁴⁷⁸ As a public official explains:

“We have seen a shift in the pattern of the usage of these companies. Nowadays they are sometimes put on hold for 3-4 years until they are activated. This indicates that they have other companies under their control in the meantime. The bar for going through the application

⁴⁷⁵ EBM and SKV, *Punktskatter och brottsbekämpningens utmaningar [Excise Fraud and Challenges for Law Enforcement]*.

⁴⁷⁶ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*; RUC, *Supen. Rapport om punktskattebedrägeri med alkohol [A Report on Excise Fraud with Alcohol]*.

⁴⁷⁷ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

⁴⁷⁸ *Ibid.*

procedure has also been raised. But follow-up inspections are tricky; it takes resources of a different magnitude to carry them out. We cannot forcibly revoke licenses [of currently inactive companies] – if we tried this, they would reply that they were just about to get going with the importing business.”

This changing pattern could also have been caused by the fact that acquiring a company that holds an excise tax license has become increasingly harder. Thus the accumulation of reserves has become a prime concern to the offenders. A couple of public officials bring up the problems associated with attempting to find out who really signed the company papers and who really controls the company.

If players don't choose to purchase or set up the companies themselves (usually working through straw men) they may instead turn to hijacking already existing businesses.⁴⁷⁹ One of the interviewees had been approached by some men who assisted him in setting up a company, later used to import tobacco, and in his description these advisors come across as very convincing and agreeable people. They knew the tricks of the trade and just wanted to show him how to go about securing all the necessary permits as smoothly as possible – in order for them to later start using his company as a criminal instrument in their illegal trade. The interviewee describes the cigarettes vanishing into thin air somewhere between the border and his tax warehouse:

“As soon as they had crossed the border, they knew the address of the bonded warehouse, but then [the driver] was instructed to not bother about going there, let's drive directly to this other location. And all this without me knowing anything about it.” (SE-C2)

Mixing illegal and legal operations

The mixing of illegal and legal business practiced by certain entrepreneurs came up in the research as especially common in the world of tax warehousing. This involves bringing in shipments (often containing the same type of product) without paying taxes at all and manipulating receipts so that they match the quantities that are officially brought into the tax warehouses – a manoeuvre the operators may be more or less talented at.⁴⁸⁰ According to information in a tip-off received by one agency, false invoices are offered as a premium service in addition to the cigarettes themselves. Sometimes they have been able to establish the authenticity of invoices found during inspections by checking the invoice number against the records at Swedish Match. In other words, mixing underground and above-board activities may be practiced higher up in the distribution chain as well as at further down among retailers and store owners.

One public official quotes risk-management as the main reason for mixing legal and illegal activities. One of the offenders rather considers this strategy as a method for increasing – or creating – profit margins.

⁴⁷⁹ Ibid.

⁴⁸⁰ See also RUC, *Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

Large-scale illegal imports/smuggling

If the transport is arriving from another EU country, this is referred to as importing; in all other cases the correct term is smuggling. Considering these together is warranted given the similar nature of their method of transportation. As mentioned in the introduction, until a few years ago, large-scale smuggling used to be the dominant mode of operation. Smuggling still occurs, albeit on a more modest scale. On this, public officials, industry representatives, and offenders are more or less in agreement. One offender speculates that even though there are still lorries being used for transportation, smuggling in general is increasingly small-scale. According to a second offender, lorries used to be the method of choice, but that people are now using freight-shipping of containers as well. A person mentioned in one of the interviews is said to have started a legal haulage company which was simultaneously used for smuggling tobacco and other goods.

At a later stage, the smugglers pass the tobacco on, either to shops or to people in their own private networks, often comprised of small-scale individual retailers who purchase 100 or so cartons. An offender says that he consistently turns down any offer to buy these cheap cigarettes, since he is convinced that there are substances in them that are even more toxic than those found in regular cigarettes. A couple of interviewees single out a market square as one of the places where such cigarettes may be purchased if you know who to ask.

Frequent small-scale illegal imports/smuggling

When it comes to small-scale imports and smuggling there is no longer such a clear-cut connection to organised crime. This is the arena of independent operators acting on their own initiative. Nevertheless, there are examples where such cigarette running operations are coordinated in a way resembling how fencing works. Those involved meet up at an agreed upon spot where the cigarettes are to be transferred to the buyer. Even though each individual brings only a small amount of cigarettes, these will quickly add up to substantial quantities. In one example, a businessman owned several corner shops and a taxi company at the same time, and he used both businesses to facilitate his involvement in the illicit tobacco trade. In addition to this, vans are used in intense, small-scale trafficking operations, with the vehicles carrying 50,000 – 100,000 cigarettes rolling off the morning ferry. Another alternative might be a group of passengers filling their suitcases to the brim with tobacco products.⁴⁸¹ Often these mules are people on long-term sickness or in retirement who are just trying to make their money last a bit longer at the end of the month. It may also be the case that the smuggling is organised along ethnic lines, with groups of Russians and Poles often being identified by interviewed offenders.

⁴⁸¹ See Tullverket, *Lägesbild organiserad brottslighet 2011 [Situational Report Organised Crime 2011]*; Brå, *Storskaliga Skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

Others choose to operate independently. An offender relates the following:

“Some people living in Sweden make some extra money by going on ferry trips where they purchase what they then smuggle into the country. They make about 3-4 trips a month or so. I can’t understand them – there is too much of a risk getting caught and the profits are too low. They have to pay for their own ferry tickets, and maybe also even the petrol for the drive to the boat and further down into Europe. What’s more, they seldom buy more cigarettes than they can fill a suitcase with – this doesn’t add up to much money, but lots of time and effort. Sometimes they don’t buy more than 10 cartons. People make similar trips to Germany in order to purchase liquor. The fuel costs alone are enough to make such trips expensive. They dream about getting rich, but they do not have any contacts among organised criminals. So they go at it alone instead” (SE-C1).

Unlike with synthetic drugs and doping substances, the internet has only a very minor role to play when it comes to the trade in cigarettes.⁴⁸² Cigarettes might not weigh much, but they are nevertheless quite bulky, so the shipping costs makes mail-ordering prohibitively expensive for the private consumer. In the very few cases where interviewees mention people who purchase cheap tobacco products online, most of this trade seems directly targeted at the consumer, with organised crime not being involved to any significant extent. On the other hand it would seem that the internet is used as an important channel for purchasing snus.⁴⁸³

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

Start-up capital was singled out in the research findings as the most critical issue. Once the operation is up and running it generates enough profit to open up for investing in further criminal schemes. An expert explains:

“As the wholesalers need an unbroken flow of goods they need motivation to invest using their own resources. The money circulates within the system. Once you’ve brought in a shipment, you’ve automatically secured the initial capital needed for the next round. This makes for a self-financing cycle.”

Several public officials underscore that it shouldn’t be too difficult to attract financiers, as the tobacco market is perceived as very stable. Financiers happily invest in such a market. This is corroborated by stories told by some of the offenders about loans being repaid quickly thanks to the enormous profit margins.

⁴⁸² SoRAD, *Tal om tobak 2012. Tobakskonsumtionen i Sverige 2012 [Numbers on Tobacco 2012. Tobacco Consumption in Sweden 2012]*.

⁴⁸³ Ibid.

Some, although not that many, financiers are said to act on the black tobacco market. Often they come from the world of organised crime and function as moneylenders or just purchase shares in cigarette shipments. There are also suspicions that some people within the legal business community are participating in this trade as financiers. At the very least they are using resources from legal activities to invest in criminal ones. Financiers rarely busy themselves with the practical side of things, but their names pop up in frequently when the trade in illicit cigarettes is discussed.

According to research findings, it is likely that co-financing solutions are prominent here. This involves a pair or a group of 5-6 people that know and trust each other joining forces. Examples are mentioned of members in a distribution group taking turns collecting the initial capital needed for procuring the next shipment. The person who functions as financier in one operation might be in charge of distribution and logistics in the next. An offender describes his experiences of this as follows:

“Some guys join up and start pooling money together. The first might contribute drug money, the second brings [capital] from economic crime to the table, and the third puts in money generated by frauds. And so they’ve managed to assemble some initial capital. The important thing is to get things, the operation, rolling, just once. Then you’ll get your investment back with a profit. The main thing is securing ‘short-term start-up capital’” (SE-C3).

Some of the interviewees think that additional economic criminality is used to source capital. This might involve, for instance, undeclared work (not least in the construction and restaurant sectors), reversed money-laundering (i.e. making a profit from transforming legal money in bank accounts into cash, which can then be used for waging illicit workers), VAT and invoice fraud, and asset-stripping of companies. One offender and a couple of public officials are familiar with cases where there was a connection between the trade in illicit cigarettes and undeclared work. In the words of a public official:

“Some people in the construction industry need to secure cash in order to pay for undeclared work. A cigarette wholesaler might sit on SEK 500,000 in ready money, and thus the construction company buys the cash using IOUs relating to other goods or services. This means that the real source of the money used for purchasing cigarettes might be an honest construction industry entrepreneur, and that the cash profits generated by the trade in illicit cigarettes pays illicit workers employed by dishonest construction industry entrepreneurs.”

Access to capital in critical moments

According to one offender, things were tougher in the 1990s, when straight-up smuggling was the dominant mode of operation. Huge quantities of cigarettes were moved, and if the authorities were successful, huge quantities were also being seized. Back then, it took substantial financial reserves to be able to compete successfully – and to survive after having

your shipments seized. The same offender claims that things are not as bad nowadays:

“If you’ve been in the business for a while you’ve built up considerable reserves. Sure, you might lose the odd lorry, but this isn’t the end of the world. You can always get back up on your feet again” (SE-C3).

Other interviewees agree that the market’s incredible profitability translates into financial reserves. One public official relates how Swedish customs agents doing surveillance have observed how anxious offenders have abandoned their cars and suitcases, sometimes returning if they think the coast is clear, but sometimes also just leaving them as they are. If the profits are as handsome as indicated by seminar participants and as offenders say, then moneylenders should be willing to help out with additional capital in critical phases. Wholesalers sometimes grant retailers credit, according to intelligence reports.⁴⁸⁴

The emerging picture is completely different to the one in a previous study of the drug market.⁴⁸⁵ Here, the subject of the credit system was brought up in more or less all of the interviews. There were plenty of stories about stressed-out distributors frantically driving around trying to collect debts from retailers, with the retailers in turn having a difficult time trying to scrape together enough cash to be able to repay them in time. Such stories were few and far between in this study, the tobacco market is instead described as being far less risky.

Settlement of payments

Settlement of payments is a blind spot for the authorities, and few interviewees have anything to say about it. One offender mentioned that a single shipment is enough to repay the loan for the initial capital in its entirety. This means that a debt can be repaid in less than a month’s time. The same individual is familiar with the workings of the illegal credit market, and says that a hundred thousand SEK can be borrowed against an interest rate of 8,000 a month. Borrowing money to invest in the illicit tobacco trade is viewed as a safe investment, although in the case of a seized shipment, the debts quickly soar because of the high interest rates. As long as creditors know that they’ll be able to get their money back with added interest, postponing repayment is usually possible to arrange.

Further down the ladder there is the small store owners who can be intimidated into selling cigarettes, a situation described by a customs officer and a number of people involved in inspections work.⁴⁸⁶ The store owners – perhaps not daring to do anything else out of fear of the supplier – sell the cigarettes and hand over the money when

⁴⁸⁴ RUC, “King Size” – Samverkan mot illegal cigaretthantering [King Size – Collaboration against Illegal Handling of Cigarettes].

⁴⁸⁵ Brå, Vart tog alla pengarna vägen? En studie om narkotikabrottslighetens ekonomihantering [Where Did All the Money Go? A Study on the Financial Management of Drug Crime] (Stockholm, Swedish National Council for Crime Prevention, 2007).

⁴⁸⁶ See also RUC, Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes].

the distributor shows up again. Here, settlement of payment more resembles extortion than normal business strategies, for offenders use their intimidation capital to secure payment compliance.⁴⁸⁷

Costs of doing business

There are many different types of costs associated with the illicit trade of cigarettes. Some interviewees and seminar participants underscore that costs are low, especially considering the kind of profitability involved. In particular those who combine illegal with legal operations can cut their costs; after all, they have already taken care of the initial investments of legal business, which can then be used for illegal side activities as well. This setup is also generally perceived as decreasing the risk of being detected, which at least in the long run could be considered as a gain in terms of lowered costs. This of course assumes that the same people control the legal as well as the illegal operations. If someone else's legal business is used for the transportation there is always the risk of being detected by the legal entrepreneur, who may report to the authorities.

Production and purchases

There is a limited production taking place inside the borders of Sweden, first and foremost of snus and shisha tobacco.⁴⁸⁸ Undeclared production means that purchases and transportation of raw materials such as raw tobacco, molasses, and other products must be protected from prying eyes. Occasionally the raw tobacco is pretty finely shredded already when it is imported, and since raw tobacco is exempt from taxes, detection is hampered. Some public officials relate how they have discovered counterfeit packaging resembling the looks of a major foreign manufacturer of shisha tobacco. In the words of an official:

“The attempt was a rather good one; they had used the same type of box, with the right kind of plastic lid and paper cover. The only snag was that they designed it with [two of the symbols] in the logo the wrong way around, and there was some minor difference in the text used on the packaging. The attempt wasn't 100% successful. I had to assist the authorities in identifying this as a counterfeit product” (SE-E3).

If the cigarettes that are produced are of substandard quality, this might increase the risk of them being detected. An example are the illicit whites carrying badly designed warning labels in Swedish. Nevertheless, importing tobacco is described as a rather straight forward business despite possible pitfalls like these. A container-load of cigarettes might cost roughly SEK 1 million (preferably to be paid in advance), but at the same time, this shipment is worth about SEK 10 million to the purchaser. Bank transfers and invoices are likely used for payments, but there have been instances when cash has been used. Cash payment would

⁴⁸⁷ Brå, *Otillåten påverkan mot företag. En undersökning om utpressning [Unlawful Influence against Businesses. A Study on Extortion]*.

⁴⁸⁸ RUC, *Underrättelserapport Röken. Illegal cigarethandling. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

likely lead to more questions being asked by the producers in the legal tobacco market, however. One of the interviewees adds that the production cost for a packet of cigarettes (including the cigarettes) is SEK 1, this while SEK 55 is a standard retail price.

On the black market, cigarettes which have already been taxed but that have been diverted by means of theft can be purchased. Research for this report did not identify this as a major problem. The major tobacco distributors are responsible for efficiently overseeing their flow of goods, and it seems like they consider this a high priority issue. An industry employee claims that only small amounts of tobacco gets diverted, and it is mostly stolen by employees working on the ferries and in airports. As long as the products carry duty-free markings, they are easy to detect.

Logistics

The logistics of the tobacco trade differs from many other types of tax offences or organised crime schemes in that it is relatively straightforward and simple in comparison – the scheme is more or less about the distribution of goods to already existing and quickly activated networks.

Some entrepreneurs choose to invest in their own vans or lorries. According to one seminar participant, this is done in order to secure comprehensive control over the operation and to prevent insight. There is less need to involve legitimate business, whose employees might react to deviations from a planned route or the unloading of shipments somewhere else than at the tax warehouse. Some public officials think it probable that at least some of the drivers carrying smuggled goods are accompanied by escort vehicles or similar security measures. In some cases the offenders send out smaller shipments first as a feeler, this because of the huge sums that are involved. It has been noticed that multiple vehicles declare the same EMCS control code at the border. This method becomes impossible if the authorities issue control reports and check the codes that are declared, thereby increasing the risks (and consequently also the costs) for the illegal entrepreneurs. This type of problem is present in other European countries as well.

It becomes necessary to secure apartments, smaller industrial spaces, or warehouses for the production, repackaging, and storage of larger quantities of merchandise.⁴⁸⁹ These kinds of facilities are easily rented, and if the offender is running illegal and legal business in parallel they are already available. Authorities may grow suspicious if the facilities are oversized in relation to the lesser quantities of legal products that the warehouses are supposed to be housing.

In the case of small-scale smuggling and importing of goods transport vehicles become unnecessary. Here, logistics is limited to buying tickets

⁴⁸⁹ RUC, *Ragnarök. Slutrapport* (Malmö, Regional Intelligence Centre, 2014); Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

to travel by boat, air, or some other means of transportation, and using bags or suitcases to carry the tobacco in.

Wages and compensation

Some of the interviewees claim that it is easier to distribute tobacco than, for instance, drugs. As there are fewer people involved, there is no need for as many wages or fees.⁴⁹⁰ One offender mentions that important contacts are made during times of imprisonment. The contacts increase the chances of being offered better jobs in the criminal market. One such job could be transporting tobacco into Sweden.

A powerful position in the illicit tobacco market may be coveted enough that people who step back are richly compensated if they transfer their established contacts and market shares to a successor, all according to an offender:

“Lots of people reason that they’ve done their stint for now. There are more people who make their bit of money and then step back than those who grow too greedy. It is not uncommon for people pulling out of the business to hand it over to someone else in exchange for a certain percentage of the profits” (SE-C3).

Surely remunerations vary in this market, as it does in other markets. In our data, there are examples of people getting paid SEK 10,000 – 30,000 for taking care of a transport. According to one offender, drivers sometimes unknowingly transport the illicit tobacco, something they of course receive no extra compensation for. Some interviewees provided examples of drivers who receive extra pay “under the table”, or of transports being followed by escort vehicles – an indication that something suspicious is going on. One specific case is said to have involved tens of thousands of Swedish kronas in bribes. One interviewee came across cases of drivers who at least claim that they have been intimidated into taking on transport assignments, although some interviewees and seminar participants believe that unwitting collaborators are more common than intimidated ones.

Assignments involving small-scale imports are taken care of by people who are not in the position to negotiate. What kind of money they are making is unknown, but there is no one who thinks there are major sums involved. An expert describes the situation as follows:

“In the case of the corner shops, the cigarette traffic is taken care of by unemployed and individuals on welfare. To us, it would seem that they get paid peanut money for this, but to them it is a lot of money. One can, for example, earn SEK 5,000 for driving a vanload of cigarettes to Norway.”

⁴⁹⁰ Brå, *Vart tog alla pengarna vägen? En studie om narkotikabrottslighetens ekonomihantering [Where Did All the Money Go? A Study on the Financial Management of Drug Crime]*.

Security costs

In contrast to trade in goods such as narcotics, the security expenses associated with the tobacco trade are far lower.⁴⁹¹ According to some seminar participants, risks are also outsourced to different accomplices. These accomplices can transport larger shipments of tobacco or act as straw men paid to assume positions in the companies during the period of tax evasion. This arrangement protects the organisers/distributors. In addition, it is quite possible to discuss the trade rather openly, and the demand for cheap cigarettes among the law-abiding public is strong.

As the distribution seems especially legal when using tax warehouses there is no need for stealth. Costs are mainly limited to compensating straw men and making sure there are new businesses ready as the lagging tax debts catch up with the previous company. According to an interviewee, the costs associated with setting up such a company are around SEK 140,000 (€17,000). He had heard that the company market value was approximately SEK 400,000-500,000 (€50-60,000). This figure is corroborated by a Swedish Tax Agency employee:

“We investigate the financing of companies applying for tax warehouse licences before we authorise them. There is no exact set limit, but some hundreds of thousands of SEK are involved. On [the classified online advertisement site] blocket.se one can find such companies for sale at prices ranging from SEK 300,000 to 400,000, so that’s probably more or less what they cost.”

The fact that setting up the companies is so time-consuming, coupled with their time-limited usefulness, indicates that organisers make sure that they have access to a constant pool of companies, either through efforts of their own or by acquiring them as off-the-shelf companies. Players that are especially cautious run several companies at the same time, which they switch between when doing business inside of Sweden. It is thought that replacing a company used for trading with a legitimate foreign supplier all too often causes mistrust on the side of the supplier and endangers the relationship with them.⁴⁹² The companies that hold tax excise licenses are central institutions to the Swedish tobacco market, legal as well as illegal. A public official tells of companies that were just started suddenly reporting a turnover of SEK 42 million. The lifespan of these companies is 9 months at the most, after which the company is terminated. Bringing in large quantities quickly is therefore an urgent priority.

There are signs that distributors attempt to modify their schemes if they perceive an increased risk of getting caught. They also try to modify their approach if they discover regulatory or law enforcement loopholes. One such example is the transition from smuggling to excise duty evasion. One

⁴⁹¹ Ibid.; J. Skinnari, “The Financial Management of Drug Crime in Sweden”, in *Cross-Border Crime Inroads on Integrity in Europe*, ed. P. C. van Duyne et al. (Nijmegen: Wolf Legal Publishers, 2010), 189-215; L. Korsell, D. Vesterhav, and J. Skinnari, “Human Trafficking and Drug Distribution in Sweden from a Market Perspective – Similarities and Differences”, *Trends in Organized Crime* 14, no. 2-3 (2011): 100-124.

⁴⁹² Brå, *Storskaliga skattebrott. En Kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

offender relates how he went from using transport lorries to containers back in the days because he thought it would reduce the risk of detection. Such changes may however confer additional direct costs (for purchasing/renting containers) and temporarily reduced capacities.

The efforts of inspection authorities may also prompt retailers into putting more effort into hiding their cigarettes.⁴⁹³ During inspections, browsing through the packets or checking back-office spaces is often enough. Offenders and officials alike agree that it is harder to purchase illicit cigarettes in communities where there is an active inspection program. A police officer describes the experience of working with inspections carried out by the police, the Swedish Tax Agency, and the municipality:

“If we’ve been working the retail shops hard they grow increasingly cautious about whom they are selling to. It is mostly regulars who get to buy. When they ask for the cigarettes they are told that they should come back later the same afternoon. Then they go and get the cigarettes from their storage somewhere.”

The experiences of working with tobacco inspections in Malmö has led to some positive experiences, especially since the representatives of the local authorities successfully secured the trust of shop owners, allowing them to purchase cheap cigarettes despite not being regulars. Some interviewed officials suspect that the lion’s share of the cigarettes is probably hidden in a storage facility. Cars parked nearby are sometimes used for intermediate warehousing. In some cases the titles to these mobile warehouses were held by straw men. The lessened visibility of illicit cigarettes signals that illicit cigarettes are forbidden and makes them less accessible to the common smoker. This is especially true for distributors who – in contrast to the small shop owners – only offer their goods to their own closed social circles. According to interviewees, these circles consist of clubs or social networks, often featuring a high proportion of individuals of the same ethnic background as the distributors of the cigarettes.

Other types of security are the previously mentioned escort vehicles, as well as counter-surveillance activities directed against law enforcement. There are confirmed cases of smugglers putting the Swedish customs at a ferry port under surveillance. This involved taking photos of customs officers outside the entrance and tracking their movements, suggesting that a larger organisation is responsible for the cigarette trafficking. Another method used is to tip off customs about a coming shipment, so that they will concentrate their forces on this transport and possibly missing out on others.

The mutual trust between involved parties is especially important for reducing security costs.⁴⁹⁴ According to officials, the profitability strengthens

⁴⁹³ RUC, *Ragnarök. Slutrapport*.

⁴⁹⁴ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*; Brå, *Vart tog alla pengarna vägen? En studie om narkotikabrottslighetens ekonomihantering [Where Did All the Money Go? A Study on the Financial Management of Drug Crime]*.

this loyalty, and those who are left out fear the powerful principals. While other organised crime markets are characterised by greater use of violence, things are comparably calm on the illicit tobacco market. Since there is enough money to be made on the market, a hypothesis is that players can secure stable positions of power. There is no need to use violence to collect debts or solve conflicts about market shares. Yet there is one type of situation where intimidation is often involved. Public officials and intelligence reports both mention cases of shopkeepers being pressed into selling illicit tobacco.⁴⁹⁵ One official had experiences of inspections during which weapons were found; perhaps the profitable nature of the illicit tobacco trade means that there is an increased risk of violent robberies, which is unlikely to come to the attention of the authorities. Yet another official described how the illicit tobacco trade led retail shops engaging in price wars, with violence being the end result. Perhaps the violence that does occur on this market tends to be relegated to areas outside of the more organised networks of distributors. Another possibility is that given the amounts of money involved in the higher levels of the organisation makes people too scared to talk to the authorities. An interviewee, who had been drawn into the illicit tobacco trade against his will, describes the situation as follows:

“The thing is that they never had any honest intentions and if their intentions aren’t honest and they’ve got this kind of money, then I’d rather opt to protect myself and my family. Because should I try to point somebody out or try to find out where they are, then things might take a turn for the worse; for me, my family, our relatives, and so on. And this was also the advice given to me by my lawyer; according to him these sums are so large that the people responsible for the whole thing probably aren’t the kind of people you’d really want to single out or have prosecuted” (SE-C2).

A final type of cost is the management of cash. There is always a risk of theft associated with cash, and in today’s society it has become increasingly hard to handle large amounts of cash without attracting attention. Offenders therefore prefer to have cash transferred into bank accounts as soon as possible despite the risk that authorities could trace these transactions. According to one offender, it has become much harder to have dirty money transferred into the banking system, in Sweden as well as other parts of Europe. This is the result of tighter regulations governing money-laundering and foreign transactions into tax havens.⁴⁹⁶

Profits and profit sharing

As mentioned earlier, profits in the illicit use of tax warehousing are considerable. One official mentioned that a container-load of cigarettes brings profits in the region of SEK 6–7 million. Since these kinds of operations could hardly be run by one single individual, the eventual

⁴⁹⁵ RUC, *Underrättelserapport Röken. Illegal cigarettantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

⁴⁹⁶ Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster’s Costs]*; J Skinnari, “Svart och kriminell ekonomi [Illicit and Illegal Economy]”, in *Gå på pengarna! Antologi om tillgångsriktad brottsbekämpning. [Follow the Money! Anthology on Criminal Assets Recovery]* (Stockholm: Swedish National Council for Crime Prevention, 2014), 29–46.

shares of the players who jointly finance a shipment are never really that spectacular.

As with other illegal markets, revenues are never evenly distributed. According to one official, the big earners here are the importers. Drivers and other helpers are hardly the ones who are getting rich – to these accomplices it might seem that they are making a lot of money, but these sums are small in relation to the business as a whole. They are in a similar situation to those running the corner shops where consumers buy the tobacco, for whom the main reason for offering illicit tobacco is because it helps them to break even or turn a modest profit. On the other hand, there are also cases where the side business of selling illicit tobacco seems profitable, as shopkeepers manage to pay fees and fines following visits from supervisory authorities. An offender summarises the situation:

“The smugglers bringing Russian cigarettes into Sweden make a lot of money. How much you earn is determined by the size of your shipment. A distributor in Sweden pays SEK 30 apiece for cigarette cartons. This means that you make between SEK 15 and 100 per carton, depending on how much you can sell them for” (SE-C1).

Another method the organisers may use to increase their profits is to trick someone further down the chain into taking all the risks and then scamming them out of their expected winnings. The most blatant example of this is hijacking of businesses that hold tax warehouse licenses in order to import large quantities of merchandise. An interviewee relates his experiences of such a scam:

“As long as you got this company going you could sell it later and make a rather hefty profit from it. I used my capital share, which was worth SEK 100,000. And then there were some running expenses, some application forms and so on, but I’d get back five times that amount. You can sell the company once you got it up and running. You just appoint new board members and directors and sell it, because securing an excise tax license is a hard thing to do. And once I was authorised I was supposed to sell the company without ever having to bring any goods into the country at all. /.../ A profit of SEK 400,000 – to my mind, this seemed pretty good for just a few years of work” (SE-C2).

Some seminar participants considered the possibility for the profits from the illicit tobacco trade being used to finance other types of crime.⁴⁹⁷ One seminar participant considered that this makes excise duty evasion much more serious than other types of economic crime: rather than white-collar criminals who want a little extra, the tobacco business is used to finance other types of criminality, often of a more serious nature. A public official related the case of an illegal gambling den which was partly financed by money from the illicit tobacco

⁴⁹⁷ RUC, *Underrättelserapport Röken. Illegal cigaretthantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*; RUC, *Supen. Rapport om punktskattebedrägeri med alkohol [A Report on Excise Fraud with Alcohol]*.

trade. In some cases an illegal nightclub is used as a marketplace. Furthermore, interviewees claim that there are often other illegal goods – such as illicit alcohol, narcotics, pirated brand-name products, stolen goods, or similar items – to be found where illicit tobacco is offered.

Sweden is sometimes seen primarily as a transit country to Norway, as the criminal entrepreneurs know that there are even greater profits to be reaped there;⁴⁹⁸ another destination country is the United Kingdom.⁴⁹⁹ A specific case was described by a public official:

“Another wholesaler active in the region is involved in trading across the Norwegian border. Large quantities end up there; significantly higher taxes means that there is more money to be made if the cigarettes are brought there. Nevertheless they sell off some of the cargo on the way there, possibly because they want to be able to cover for any losses should they get caught in some control as they try crossing the border into Norway” (SE-E3).

Significant parts of the profits are thought to be used for conspicuous consumption⁵⁰⁰ – nights out on the town, gambling, cars, clothes, traveling to foreign countries, etc. – which can leave the offenders with little left at the end of the day. In the words of a public official: “They live in run-down 1970s detached houses that are sold for SEK 700,000 on property websites.” A significant proportion of them are unable to move to areas with higher status because of insufficient funds, and many on the lower levels of the distribution could be heavily indebted. An official described a case in which law enforcement officials found IOUs revealing that people down the chain owe the organisers as much as SEK 700,000, possibly from gambling debts.

Those who earn more also tend to be better at managing their profits. An official participating in the seminar believed that there is a difference between dealers in tobacco and drugs in that the former tend to be more business-minded and manage to save up money for use in other activities. The tobacco distributors invest in legal companies or purchase real estate, moves that also help in laundering money. In some cases they only make such investments and transactions outside of the country. The players may also be members of international groupings that are active in other countries, where they tend to purchase their real estate.⁵⁰¹ In cases when the legal businesses run by criminal entrepreneurs are not doing very well they can get propped up by injections of illegal proceeds.

⁴⁹⁸ RUC, *Underrättelserapport Röken. Illegal cigarettantering. [Intelligence Report the Smoke. Illegal Handling of Cigarettes]*.

⁴⁹⁹ Ibid.; Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

⁵⁰⁰ Skinnari, “Svart och kriminell ekonomi [Illicit and Illegal Economy]”; Brå, *Vart tog alla pengarna vägen? En studie om narkotikabrottslighetens ekonomihantering [Where Did All the Money Go? A Study on the Financial Management of Drug Crime]*. Brå, *Storskaliga skattebrott. En kartläggning av skattebrottslingens kostnader [Large Scale Tax Fraud. A Mapping of the Tax Fraudster's Costs]*.

⁵⁰¹ RUC, *Ragnarök. Slutrapport*.

Aside from the financiers in the illicit tobacco market, loan sharks were also mentioned as investors. According to an interviewed official, there are a few individuals active in a Swedish city who lend criminals money at a 10% monthly interest with the size of the loans ranging from SEK 500,000 to SEK 1,000,000 (€52,000-€104,000). Loan sharks fulfil an especially important role among ethnic minorities, where chances of securing bank loans are slim.⁵⁰² One criminal entrepreneur mentioned that a specific network of ethnic cigarette-dealers probably got off the ground by borrowing from individuals within their own ethnic milieu as they could not apply for a regular bank loan. Several of his friends are professional moneylenders. There is a large illegal credit market catering to the needs of people who cannot get a loan on the regular credit market for one reason or other.

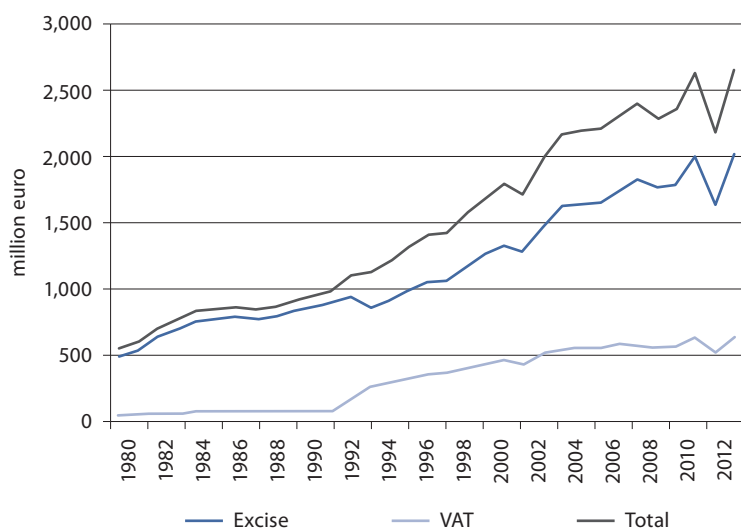
5.5. BELGIUM: THE RISE OF THE ILLICIT WHITES

Introduction

The consumption of cigarettes in Belgium increased after the Second World War. In the Belgian-Luxemburg Economic Union, around 8.5 billion cigarettes were consumed in 1950. The sales of cigarettes rose to 16.9 billion cigarettes in 1980 and declined to 11.6 billion in 1997.⁵⁰³ The high number is due to the increased purchases made by British tourists because cigarettes were priced twice as high in the UK than in Belgium.⁵⁰⁴ Due to sharper controls at the UK borders, the sales of cigarettes decreased from 2001 onwards. In 2011, 9.9 billion cigarettes were sold in Belgium.

The fiscal revenues from tobacco products in Belgium have increased significantly over a period of thirty years. Anticipating a different method of collecting excises in January 2011, producers built up additional stock in 2010. As a result, ostensibly fewer cigarettes were sold in 2011.⁵⁰⁵ In 2012,

FIGURE 28. FISCAL REVENUE FROM TOBACCO PRODUCTS IN BELGIUM



Source: OIVO, *Documentatiemap Roken* [Documentation File on Smoking] (Brussels, 2012), 73; Belga/TE, "Tabak steeds grotere bron van inkomsten voor schatkist [Tobacco Source of Increasing Larger Revenues for the Treasury]", *Knack*, 2013.

⁵⁰² Brå, *Otillåten påverkan mot företag. En undersökning om utpressning* [Unlawful Influence against Businesses. A Study on Extortion].

⁵⁰³ OIVO, *Documentatiemap roken* [Documentation File on Smoking].

⁵⁰⁴ Ibid.

⁵⁰⁵ Ibid.

and also in 2014,⁵⁰⁶ the government increased the excises on cigarettes⁵⁰⁷ which will increase fiscal revenues.

Due to the lower prices on tobacco products, Belgium has been an interesting country for smokers in France and the UK. Within a decade, the prices for cigarettes in France increased by €2.96 (in 2009). This is also the reason why the Belgian coast and on the border with France is dotted by tobacco shops.

Belgium is generally being recognised as an attractive country for cigarette smugglers. Due its geographical location at the heart of the European Union and the port of Antwerp it is considered to be an attractive operating base for smugglers. Most contraband found or confiscated in Belgium was not meant for the domestic market, but for transport to other countries.⁵⁰⁸

There are relatively low punishments for smuggling.⁵⁰⁹ On the one hand, the maximum prison sentence remains rather low: until 2013, a maximum prison sentence of 2 years could be imposed for fiscal fraud. In 2013, however, the government introduced a new law that created a new crime – serious fiscal fraud – that can be punished by a prison sentence of maximum five years.⁵¹⁰ However, considering the fact that in other countries (such as in Italy) a person can receive up to 15 years imprisonment,⁵¹¹ the punishment in Belgium remains relatively low. Smuggling is punished by a maximum prison sentence of one year. The fines, on the other hand, can be high. In 2010, a 33-year old man was sentenced to a fine of €185,000, after the police found 18,300 packs of cigarettes in his home.⁵¹²

Finally, there are a lot of storing facilities in and around Belgium's main port of Antwerp (one of the largest ports in the world).⁵¹³ In a period of almost two months, the Belgian customs authorities had confiscated 151 million counterfeit cigarettes (six containers) in the port of Antwerp.⁵¹⁴

⁵⁰⁶ S. Delafortrie and C. Springael, *Accijnzen Op Tabak Verhoogd [Excises on Tobacco Increased]* (Brussels, 2013).

⁵⁰⁷ Belgisch Staatsblad, "Programmawet van 22 Juni 2012", *Belgisch Staatsblad* (Brussels, 2012). art. 39.

⁵⁰⁸ T. Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market", *Tobacco Control* 17, no. 1 (2008): 60-65.

⁵⁰⁹ A. Balcaen, K. Verposet, and T. Vander Beken, *Situation Report on the Cigarette Black Market in Belgium* (Report of the Sixth Framework Program: Assessing Organised Crime: testing the feasibility of a common European approach in a case study of the cigarette black market in the EU, unpublished, 2006).

⁵¹⁰ CTIF-CFI, *19e Activiteitenverslag 2012 [Activity Report]* (Brussels, 2013).

⁵¹¹ Balcaen, Verposet, and Vander Beken, *Situation Report on the Cigarette Black Market in Belgium*.

⁵¹² Itobac, *Boete van 185.000 euro voor illegale sigarettenhandel [Fine of 185,000 euro for Illegal Cigarette Trade]*, 2010.

⁵¹³ Joossens and Raw, "Cigarette Smuggling in Europe: Who Really Benefits?"; Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

⁵¹⁴ X, "Crombez vernietigt miljoenen illegale sigaretten [Crombez Destroys Millions of Illegal Cigarettes]", *Deredactie.be*, June 29, 2012.

Moreover, the illicit tobacco trade is not a priority for the Belgian government.⁵¹⁵ It is not mentioned in the National Security Plan 2012 – 2015⁵¹⁶ and is not being monitored by members of the central directorates of the Belgian Federal Police (BE-E2).

Besides being a transit country, there is also a market in Belgium for the illegal cigarette trade. A study of street vending in Brussels⁵¹⁷ indicates that it is a practice that has reportedly been initiated by certain members of the Polish community in Brussels who started selling Polish cigarettes to each other informally some years ago. These practices gradually evolved to a black cigarette market in Brussels.

A number of Belgian institutions are competent to fight this phenomenon. First of all the customs authorities (part of the Federal Government Service Finances) which collects excises and taxes. Customs are also responsible for the fight against contraband and counterfeit. The police services focus on the perpetrators involved in contraband and counterfeiting. Customs, however, do not investigate these activities and merely confiscate the goods which may impede police investigations as confiscations might alert the criminals. It is therefore not always easy to create synergies in the field.⁵¹⁸ This was also reflected in the data gathered during this study. While data from the customs authorities provide general insights into the market structure and actors, data from the police provide more information on the financial constructions and financial management of the illegal tobacco trade in Belgium. In case the customs authorities make a seizure of cash, the competent judicial authorities are informed about the seizure and take over the investigation. Every year the Belgian customs administration makes a number of referrals concerning suspicions/seizures of cash to the Financial Intelligence Processing Unit (CTIF-CFI).⁵¹⁹ In 2012, 1,308 referrals were made to the CTIF-CFI.⁵²⁰ Within the Belgian Federal Police, the Directorate of Combating Economic and Financial Crime is competent of investigating the illegal tobacco trade, but considering the fact that the phenomenon is not a priority for the Belgian government, the Directorate is not engaged with the illegal tobacco trade (BE-E2). Within the decentralised Belgian Federal Police, only one unit is permanently investigating this crime: the organised excise fraud section of the economic and financial crime unit of the Federal Police of Antwerp (BE-E2).

⁵¹⁵ D. Boels and N. Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]", in *Illegale En Informele Economie*, ed. D. Boels et al. (Antwerpen/Apeldoorn: Maklu, 2013), 71-92.

⁵¹⁶ Federal Police, *Nationaal Veiligheidsplan 2012 – 2015 [National Security 2012-2015]* (Brussels, 2012).

⁵¹⁷ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵¹⁸ J. Buys, "Fraudebestrijding in België: quo vadis? Een blik in de reisbrochure [Combating Fraud in Belgium: Quo Vadis? A Look at the Travel Leaflet]", *De Orde van de Dag* 51 (2010): 17-28.

⁵¹⁹ The CTIF-CFI, established by law in 1993, is a central part of the Belgian preventive anti-money laundering and counter-terrorist financing system, and is an independent administrative authority with legal personality supervised by the Ministers of Justice and Finance.

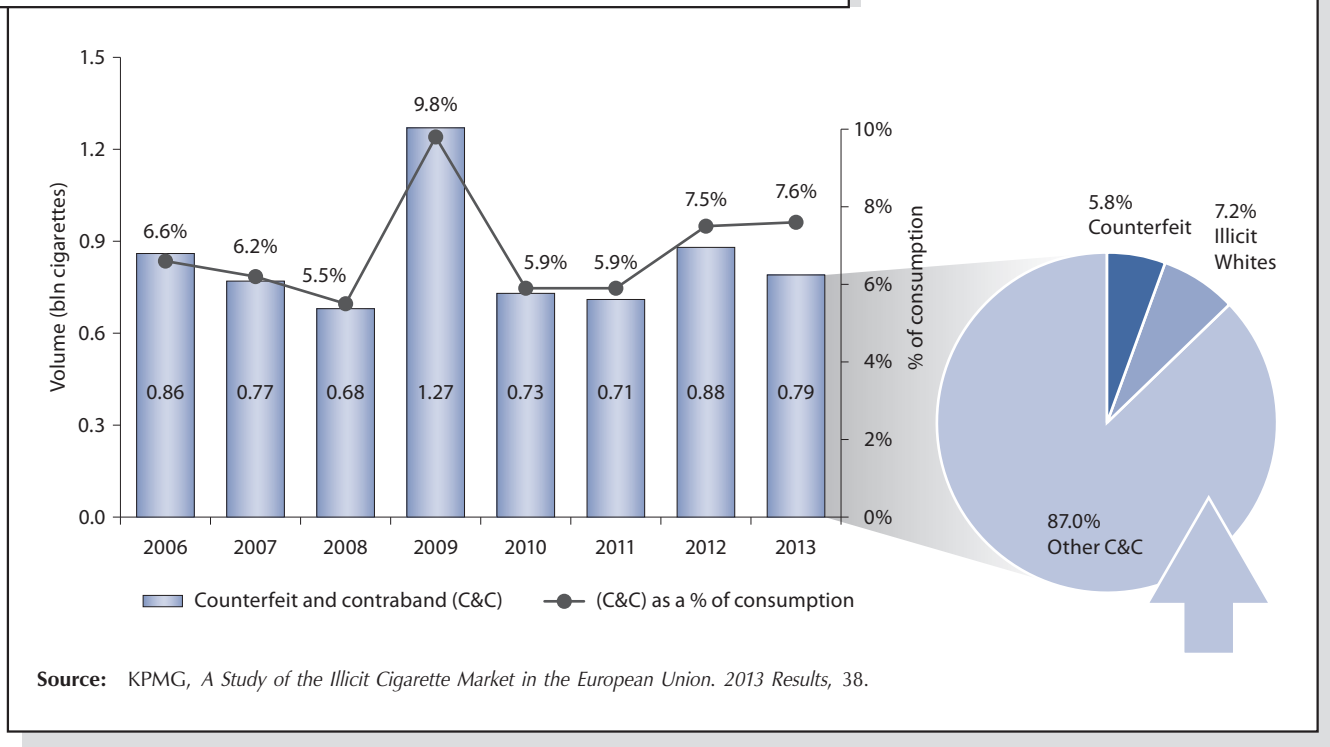
⁵²⁰ E. Rottiers, *Belgian Customs Authorities, National Investigations*, 2014.

Market overview

While the illicit cigarette trade slowly declines at the European level, it increases in Belgium. A study conducted in 2013 by KPMG, found that 7.6 percent of the cigarettes smoked in Belgium were illegal; this corresponds to 790 million cigarettes. The share of illegal cigarettes has been rising for a third year in a row and costs the Belgian Treasury around €145 million in evaded excise tax.

Illegal cigarettes are divided into three categories: smuggled, counterfeit and illicit whites. The sales of the latter are particularly on the rise. At the moment, around 60 million out of the 790 million illegal cigarettes consumed in Belgium are reported to be illicit whites. Throughout Europe, the consumption of illicit whites increased by 15 percent in 2013, while the illicit cigarette trade declined from 11.1 percent in 2012 to 10.5 percent in 2013. Consumption of illicit whites grew from 17.1 billion cigarettes in 2013, 33 percent of overall counterfeit and contraband consumption.⁵²¹

FIGURE 29. MANUFACTURED COUNTERFEIT AND CONTRABAND CIGARETTE VOLUMES AND SHARE OF OVERALL CONSUMPTION IN BELGIUM, 2006 – 2013

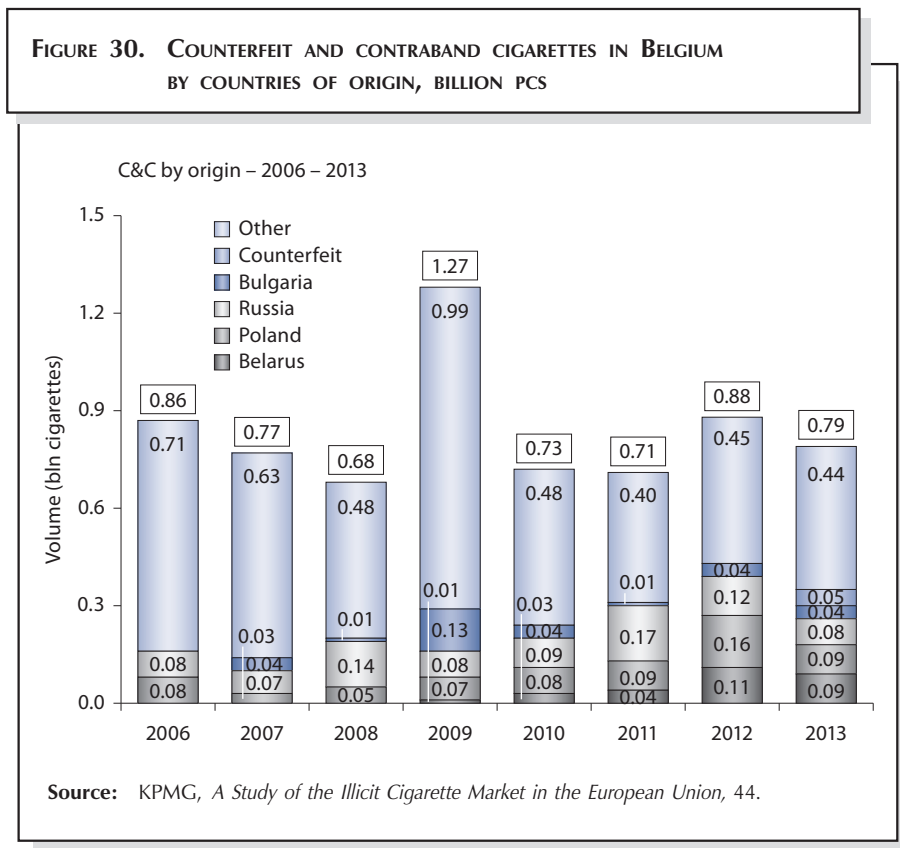


Source: KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*, 38.

The number of counterfeit and contraband cigarettes declined in Belgium which was found to be driven by a decrease in Belarusian, Russian and Polish volumes.

According to KPMG, the primary flows of counterfeit and contraband comes from East European markets. However, KPMG asserts that counterfeit cigarettes do not appear to be a significant issue in Belgium as they only

⁵²¹ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.



make up 5.8% of the counterfeit and contraband;⁵²² counterfeit Marlboro cigarettes originate from illegal factories in China.⁵²³

Contraband cigarettes, on the other hand, are more popular. The largest contraband brand is L&M, largely smuggled from Poland and Russia. Winston is the second most popular contraband and smuggled from Belarus, Moldova, Russia and Ukraine.⁵²⁴ Another study has found that Belgium mainly serves as a transit country through which cigarettes are being smuggled mostly to the United Kingdom,⁵²⁵ corroborating the findings of KMPG that there is a flow from east to west.

A number of authors have claimed that the legal tobacco industry is involved in the illegal tobacco trade as well.⁵²⁶ Others argue, however, that – partly because of the lawsuits brought against the tobacco industry – the European Commission and the industry have reached agreements that force the industry to take action against counterfeited cigarettes. The tobacco industry also invests a great deal of money in tracking counterfeit cigarettes.⁵²⁷

⁵²² Ibid.

⁵²³ Boels and Klima, “Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]”.

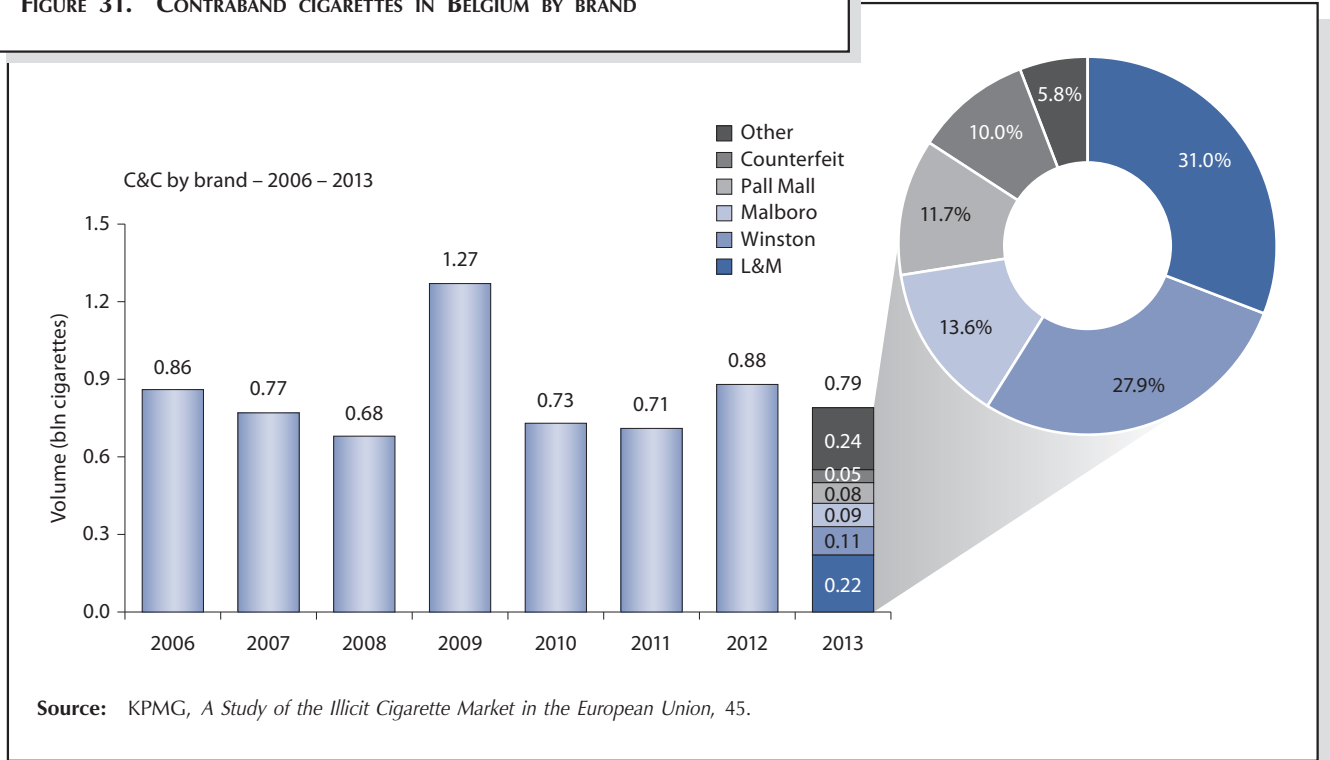
⁵²⁴ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

⁵²⁵ Vander Beken et al., “Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market”.

⁵²⁶ Joossens and Raw, “Cigarette Smuggling in Europe: Who Really Benefits?”

⁵²⁷ Boels and Klima, “Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]”.

FIGURE 31. CONTRABAND CIGARETTES IN BELGIUM BY BRAND



Market structure and actors

Generally, cigarettes are being supplied to the black market through bootlegging and large-scale smuggling of brand-named or counterfeit cigarettes.⁵²⁸ The difference between bootlegging and large-scale smuggling is that while bootleggers do pay lower excise taxes, large-scale smugglers try to avoid paying them altogether. Bootleggers exploit the price differences of tobacco products between countries.⁵²⁹ Prices for a pack of 20 cigarettes differ greatly among the EU member states. In 2013, a pack of 20 cigarettes cost around €4.88 in Belgium. In all neighbouring states, except for Luxemburg (€3.95) a pack of cigarettes was more expensive: €8.15 in the UK, €6.50 in France, €5.29 in the Netherlands, €5.02 in Germany.⁵³⁰ Bootleggers would, for example, purchase tobacco products in Luxemburg, pay excise taxes in that country, but sell them in the UK on the black market. The organisation of these activities usually does not require sophisticated schemes or investments as cigarettes are transported by car or van.⁵³¹

While bootleggers tend to shuttle between countries, large-scale smugglers attempt to import as many cigarettes onto the black market at once by using trucks or containers. Large-scale smugglers would need more sophisticated schemes and bigger investments as they require knowledge

⁵²⁸ Vander Beken et al., “Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market”.

⁵²⁹ Hornsby and Hobbs, “A Zone of Ambiguity. The Political Economy of Cigarette Bootlegging”.

⁵³⁰ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

⁵³¹ Vander Beken et al., “Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market”.

of customs procedures and experience in transporting containers abroad.⁵³² Large-scale smuggling is based on the misuse of the in-transit system that allows a temporary suspension of customs duties, excise taxes, and VAT payable on goods originating from or destined for non-EU countries. There are two possibilities to abuse that system: either the cigarettes never leave the EU and are being sold on the domestic black market or they are indeed being shipped abroad, but re-imported illegally afterwards.⁵³³

With regard to the cigarettes that are being shipped, a distinction is made between genuine brands and counterfeit cigarettes. The latter are often imitations of brand-named cigarettes, including the packaging, seals and stamps.⁵³⁴ A Belgian study conducted in 2006 indicated that most counterfeit cigarettes seized by the Belgian customs authorities originate from non-EU countries such as China and Russia.⁵³⁵ More recently, illicit whites have become increasingly popular in Belgium, according to the KPMG study; the main brand sold in Belgium appears to be Yun Yan.⁵³⁶

A number of supply lines have been identified by researchers.⁵³⁷ The first supply line is from China to Belgium, which primarily consists of counterfeit cigarettes; the second supply line originates in Greece. Greek smugglers would supply cigarettes to Bulgarians who transport the merchandise to Belgium where it is being distributed by members of the Polish community. The cigarettes supplied by the Greek do not originate in Greece, but Cyprus. There is also a smaller supply line organised by bootleggers from Eastern Europe who distribute cartons of cigarettes bought in their home country.

Counterfeit cigarettes produced in China are being transported by shipping containers. Several intermediate stops are made to conceal the origin of the cigarettes. Cover loads and forged documents serve to hide the true nature of the products being shipped. Cigarettes originating in Eastern Europe and Greece are transported by road.⁵³⁸ In the Belgian case file analysis,⁵³⁹ the method most frequently used in transporting cigarettes was to hide them behind licit merchandise in trucks or containers. Cigarettes were also hidden in secret compartments of the vehicle, in the cover load or elsewhere in the vehicle. The study also

⁵³² L. Joossens, *How to Combat Tobacco Smuggling through the WHO Framework Convention on Tobacco Control* (Proceedings of the WHO Second World Conference, Durban, International Chamber of Commerce, 2001).

⁵³³ von Lampe, "The Cigarette Black Market in Germany and in the United Kingdom"; Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵³⁴ von Lampe, "The Cigarette Black Market in Germany and in the United Kingdom".

⁵³⁵ Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

⁵³⁶ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

⁵³⁷ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵³⁸ Ibid.

⁵³⁹ Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

concluded that compared to the techniques used in drug trafficking, the methods of concealing cigarettes and tobacco products were less sophisticated.⁵⁴⁰ Cigarettes are spread over several trucks in order to make sure the cigarettes arrive at their final destination and, if caught, the driver would receive low punishment.⁵⁴¹

Once at their destination, the cigarettes are being stored and spread over several warehouses. Within 38 hours the cigarettes are loaded on other vehicles to supply customers. Street vendors hide their stock between parked cars, behind lampposts, in shops or houses.⁵⁴² The transportation of the contraband seems to rely heavily on legal transport means. Numerous legal actors are involved in the illicit tobacco trade: rental companies, transport companies, car rental companies, warehouses, maritime personnel, customs officers, shipping companies, banks. Most legal actors are not aware they are being used in the illegal tobacco trade, though questions are being raised whether or not owners of warehouses are as innocent as often thought.⁵⁴³

Information provided by the Belgian customs authorities indicates in which stages of the supply chain operations of organised crime groups have been involved in Belgium: the transportation of illicit whites, the production, transportation, distribution on both the wholesale and retail level of genuine brands, and the production and transportation of counterfeit brands.⁵⁴⁴ As mentioned above, the judicial authorities in Belgium have the competences to investigate the illegal cigarette trade with regard to the persons involved and have therefore identified additional stages of the supply chain in which criminals have been engaged: the production of illicit whites, the distribution (wholesale and retail) of illicit whites and counterfeit brands.⁵⁴⁵

A Dutch study⁵⁴⁶ identified different functions and levels in the illegal tobacco trade:

- The local level with local vendors who directly sell to consumers or to other vendors;
- International traders who function within multinational networks;
- Intermediaries who get the cigarettes to the market;
- Professional transporters who are mainly involved in the cross-border transport of the contraband. These are legitimate licensed firms or one-man enterprises;
- Isolated groups of individual entrepreneurs who buy large quantities of tax free cigarettes legally.

⁵⁴⁰ Ibid.

⁵⁴¹ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵⁴² Ibid.

⁵⁴³ Ibid.

⁵⁴⁴ Interview with E. Rottiers, Belgian Customs Authorities, National Investigations.

⁵⁴⁵ Interview with K. Van de Perre, Belgian Federal Police Antwerp, economic and financial crime unit, section on organised excise fraud.

⁵⁴⁶ van Duyne, "Organizing Cigarette Smuggling and Policy Making, Ending up in Smoke".

A Belgian study found that the majority of those involved in the illicit cigarettes trade worked as intermediaries (39.3%), followed by international traders (29%), professional transporters (25.2%) and local traders (6.5%).⁵⁴⁷ Similarly to the Netherlands and Germany,⁵⁴⁸ in Belgium there was a significant level of interaction between tobacco smugglers and legitimate entrepreneurs; the latter were mainly found in the transport business (truck drivers) or logistics (warehouse managers). In Greece, additional functions include street sellers, scouts or lookouts, warehouse guards, kiosk owners, truck drivers and protectors.⁵⁴⁹

In Brussels, there are largely two groups that operate on their own territory: East European vendors (Poles and Romanians) and North African vendors (Moroccans, Tunisians and Algerians). A 2013 study⁵⁵⁰ identified four functions in street vending: vendors, errand boys, customer recruiters and observers. Not all vendors use errand boys, whose main function seems to be guarding the cigarette stock during market hours. The role of observers is open to debate as a police officer in the study assumed there must be observers in play, while a street vendor claimed that is merely fiction. The latter argued that the vendors recognise police officers from a distance. Concerning the relation between the two groups identified in the study, the researchers posit two hypotheses. The first one is that both groups operate independently from each other. Based on their information, observations and interviews, however, Boels and Klima have found more evidence that supports a second hypothesis: the East European group serves as a supplier to the North African group and some of the latter group would even work for the East Europeans. This would mean that the East European group would have access to a larger market. In terms of *modus operandi*, the study found that warehouses are being changed regularly to avoid detection and false shipping documents are being used. The different branches of the organisation would be kept separate: both the supply chain and distribution chain would be stand-alone operations in order to avoid the risk of taking down the whole organisation once one link of the chain is detected. Cash payments are also being kept completely separate from the transportation of the cigarettes. Street vendors would only know their supplier.

According to the Belgian customs authorities, the *modus operandi* used by the smugglers is container shipments, overland shipments and ant smuggling of illicit whites, counterfeit brands and genuine brands (without having paid excise and VAT duties).⁵⁵¹ This is quite similar to the *modus operandi* found by the police.⁵⁵²

⁵⁴⁷ Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

⁵⁴⁸ See van Duyne, "Organizing Cigarette Smuggling and Policy Making, Ending up in Smoke"; von Lampe, "The Cigarette Black Market in Germany and in the United Kingdom".

⁵⁴⁹ Antonopoulos, "The Greek Connection(s): The Social Organisation of the Cigarette-Smuggling Business in Greece".

⁵⁵⁰ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵⁵¹ Interview with E. Rottiers.

⁵⁵² Interview with K. Van de Perre.

There are indications that those involved in the illicit tobacco trade are organised. An organisation active on the black cigarette market would consist of around 10 to 20 people.⁵⁵³ According to the Belgian customs authorities, most organisations are internationally based organised crime groups. When a seizure is made in one country it is often seen that the organisation continues its criminal activities in another area/country.⁵⁵⁴

Based on Belgian customs and prosecution files concerning the illegal tobacco trade in the period from 2000 to 2006, 243 persons involved in cigarette smuggling were identified; ten of them were women.⁵⁵⁵ The women performed various subsidiary functions within the different networks: car owner or company owner. The modal age of those involved was between 35 and 45, but the vast majority was older than 35 years. The majority of the suspects had a Belgian nationality. Of those suspects with another nationality, three were dominant: British, Dutch and Polish. Out of the 44 cases studied, family connections between the suspects were found in eight cases. In 28 cases use was made of legal transport companies that were set up as legal companies. In 25 cases warehouses were being used to store the cigarettes. Not surprisingly, the vast majority of suspects identified were (n=73) were either truck drivers (n=24) or business managers, employees at transport companies or shipping agencies, lessees of warehouse etc. (n=49).

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

Based on the cases they have worked on, the Belgian Federal Police assert that criminal organisations involved in the illegal tobacco trade have the necessary means to start a smuggling operation. They do not need external financiers or investors as they re-invest the profits from one smuggling operation to initiate and sustain the next (at least this is what has been found during the investigations). Those involved in the illegal tobacco trade often have a criminal background.⁵⁵⁶

The connections between the cigarette smugglers and investors are reported to be diverse: in some cases family relations have been found;⁵⁵⁷ in other cases there were also legal business links. A number of managers of shipping offices often seem to re-appear in cases concerning the illegal tobacco trade. Finally, there are a number of criminal and ethnic links as well. During the previous five years, the police reported that they have been dealing with Turkish, Greek and Polish criminal organisations.⁵⁵⁸

⁵⁵³ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵⁵⁴ Interview with E. Rottiers.

⁵⁵⁵ Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

⁵⁵⁶ Interview with K. Van de Perre.

⁵⁵⁷ Vander Beken et al., "Crossing Geographical, Legal and Moral Boundaries: The Belgian Cigarette Black Market".

⁵⁵⁸ Interview with K. Van de Perre.

Settlement of payments

With regard to the *modus operandi*, there is a preference for cash transactions because they are difficult to trace.⁵⁵⁹ According to information received from the Belgian customs authorities, declaration formalities are mostly paid for in cash; the rent of illegal warehouses is also mostly paid for in cash. Most cash transfers are carried out by cash couriers who are mostly people at the bottom of the organisation.⁵⁶⁰

As in other criminal markets (such as organised VAT fraud), the way payments are being settled depends on the level of trust among the actors. The standard operating procedure is that everything is paid cash up-front. This is especially the case when new entrepreneurs enter the market.⁵⁶¹ In their study, Boels and Klima interviewed a street vendor who told them that he started out as a customer recruiter. He did not have sufficient means to start his own business and buy cigarettes from a supplier. The reason might have been that the customer recruiter had to pay everything up-front.

There were a number of cases in which payments were settled after the delivery of a container of cigarettes but this only occurred when the actors have been cooperating with each other during a certain amount of time. In some cases revolving credit has been used as well (payments are done when a proportion of the merchandise has been sold). With regard to buying cigarettes from a supplier/vendor, police investigations have shown that payments occur simultaneously.⁵⁶²

Police investigations have also brought to light that criminal organisations do not hire specific personnel that facilitate the payment process. Very often, known persons are engaged for the settlement of payments: high ranking persons within the organisation or people that can be trusted, especially in international cases. In some cases, the money was also being transported by the truck driver who initially brought the container with cigarettes to the place of destination. It also occurred that someone from within the organisation is appointed to change money in currency exchange offices. In short, the criminal organisations involved in the illegal tobacco trade tend to do everything by themselves due to lack of trust. Complex money laundering schemes, payment platforms or bank accounts are not used very often, according to the police.⁵⁶³

Costs of doing business

The costs in this kind of business vary and depend on the nature of the “project” that is being set up. In a recent case, the police discovered that it costs around €100,000 to ship a container filled with counterfeit cigarettes from China to Belgium. Included in this amount are the costs for production in China, the transportation (within China, from China to Belgium and within Belgium), customs and other costs. Roughly estimated, criminal organisations pay €0.10 per counterfeit pack all

⁵⁵⁹ Boels and Klima, “Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]”.

⁵⁶⁰ Interview with E. Rottiers.

⁵⁶¹ Interview with K. Van de Perre.

⁵⁶² Ibid.

⁵⁶³ Ibid.

costs included. These cigarettes are being sold for €0.15 or €0.175 per counterfeit pack to the vendors or traders. The criminal entrepreneurs will probably ask a higher price once they sell the cigarettes to the end customers, but the police focuses on large-scale distribution and not on the sales being made to individual customers.⁵⁶⁴

In the study conducted by Boels and Klima,⁵⁶⁵ a Polish street vendor told them he buys cartons of cigarettes from his supplier for around €20 a carton. That supplier would buy the cigarettes in Russia or Ukraine for around €17 a carton. After a raid in Brussels, the police confiscated 130 cartons of cigarettes and €3,685 cash money.⁵⁶⁶ In other words, buying a significant number of cartons can be considered as a threshold for street vendors (especially when one likes to make an interesting business deal with the supplier). A hundred cartons would cost €2,000, but considering the amount of money and number of cartons seized by the police, a street vendor or supplier would need more to meet the demand.

Profits and profit sharing

Based on the cases the police have investigated during the past five years, the criminal organisations were operational for about one year before being caught. Although the profit made during this short period of time depends on a number of factors, one may very well conclude that the illegal tobacco trade is quite lucrative. Information about two investigations was provided by K. Van de Perre to illustrate this assertion.⁵⁶⁷ In the first investigation which ran between 2012 and 2013 around 290 million counterfeit cigarettes were seized. During the second investigation which ran between 2013 and 2014, that figure amounted to 160 million. These cigarettes were a mere portion of the total number of cigarettes traded in those years. Numerous containers, filled with cigarettes, passed the borders without ever having being checked by the police or customs. The police therefore asserts that the number of confiscated cigarettes are peanuts compared to the ones that have been sold on the market. Only during the second investigation the illegal capital of the organisers had been calculated. The criminal organisation would have earned around €39 million between 2013 and 2014. As the police had no information about the costs the criminal organisation had made, the costs had not been deducted from this amount.

The profits and payments within the organisation are reportedly being shared based on the position within the organisation. The profits are transferred entirely to the top of the organisation. According to Van de Perre,⁵⁶⁸ in all cases he has investigated only the top of the organisation live a luxurious life, while the warehousemen, drivers and others on the bottom of the organisation receive little from the profit made by the illegal tobacco trade. The same study asserts that those involved in

⁵⁶⁴ Ibid.

⁵⁶⁵ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵⁶⁶ Nieuwsblad, "Illegale handel in sigaretten opgerold [Illegal Cigarette Trade Shut Down]", *Nieuwsblad.be*, 2010.

⁵⁶⁷ Interview with K. Van de Perre.

⁵⁶⁸ Ibid.

the illegal tobacco trade, live a less luxurious life compared to those involved in other crimes such as money laundering, drugs and human trafficking.

Interviews with cigarette vendors and errand boys suggest that errand boys do not have a high position in the organisation and that they are being paid less than the vendors. A Polish street vendor would earn around €50 on a Sunday. Errand boys, however, earn more than customer recruiters, as vendors have to rely on the former to protect the cigarette stock. Customer recruiters would earn one euro on each carton that is being sold.⁵⁶⁹

Because the payments largely occur up-front or by delivery, and the fact that the money is usually transported by people they can trust, financiers and investors are quite sure they would get their share of the profit.⁵⁷⁰ The money earned from the tobacco trade is being transported physically to the entrepreneurs, often in the country where these entrepreneurs reside. No complex banking or company structures are being established to channel away the money. These profits are usually spent on personal expenses and a lavish lifestyle. Some re-invest the profits in another illegal tobacco trade scheme; others re-invest the profits in property or other assets.⁵⁷¹

Access to capital in critical moments

When caught, most organisers operating at the black cigarette market tend to recommence their activities or continue with their activities as soon as possible. Based on police investigations, it appears that criminal entrepreneurs take into account setbacks. They keep in mind that some of the shipments can be seized and they calculate the differences in the overall price. Criminal organisations have a built-in risk analysis. Similar measures have already been discussed above (like spreading the cigarettes over several trucks or warehouses). One or more losses can be compensated by next shipments.⁵⁷²

In most cases risks are being shared. For example, the risk in the transportation of the cigarettes between the place where they were produced to the place of shipment is being carried by organisation A (the Chinese organisation, for example). Organisation B (the criminal organisation that distributes the cigarettes in Belgium) bears the risks from the place of shipment to the place of distribution. Payments are made based on the risks.⁵⁷³

⁵⁶⁹ Boels and Klima, "Waar rook is, is vuur? Straatverkoop van niet-legale sigaretten. [No Smoke without Fire? Streetvending of Illegal Cigarettes]".

⁵⁷⁰ Interview with K. Van de Perre.

⁵⁷¹ Ibid.

⁵⁷² Ibid.

⁵⁷³ Ibid.

5.6. FRANCE: LOW RISKS AND COMFORTABLE PROFITS

Introduction

Organised crime in France has remained at constant levels, with a high tendency to blur the limits between legal and illegal spheres, often coming close to being white collar crime. Furthermore, the growing role of the internet in purchase methods enables new patterns of criminal business.

The criminal statistics État 4001⁵⁷⁴ only relate to crimes brought to the attention of the police and the gendarmerie. Organised crime appears in 21 crime indicators in État 4001, corresponding in 2012 to 28,770 offences and crimes – 1% of the total recorded criminality. Actually, the physiognomy of organised crime has shifted towards more “productive” activities (drug trafficking, human trafficking, gambling, counterfeiting) and fewer predation activities. Bank robberies, for example, have significantly decreased between 2012 and 2013 (-44%), as well attacks of armoured vans (-16%).⁵⁷⁵

Drug trafficking still dominates organised crime in terms of turnover, level of profit and the number of people involved. In 2013, cannabis seizures have increased (75.7 tonnes or +39.15%), among which 70.9 tonnes of resin (+38.7%) and 4.8 tonnes of marijuana (+45%); cocaine seizures are stable at 5.61 tonnes in 2013. With the number of prostitutes in France estimated at 30,000 (2013), human trafficking is also a very lucrative activity. Recently, forty-five procuring networks linked with transnational organised crime have been dismantled in France: 26 from Eastern Europe, 7 from Africa, 6 from Latin America, 4 from Western Europe and 2 from China.

In France, the financing of organised crime is neglected both by the law enforcement and the judiciary, and by the research community. To a certain extent, this is a blind spot in the intelligence analysis dealing with organised crime. Public policies in the field of security are still focused on the act of crime itself. Judicial investigations focus on predicate crimes and to a much lesser extent on the profits and the way they are laundered; investigators are interested in the preparation of the crime when it enables them to prevent the commission of the crime.⁵⁷⁶ When police carried out a search, discovering cash is attributable to the

⁵⁷⁴ État 4001 is a collection of institutional statistics based on a terminology of 107 indexes corresponding to the nature of offences. It has 12 columns allowing the counting not only the number of incidents recorded and brought for the first time to the knowledge of the police or the national gendarmerie, but also incidents revealed, or offences for which people are held in custody or held as suspects. The central directorate of the police collects and classifies these statistics.

⁵⁷⁵ Observatoire national de la délinquance et des réponses pénales, *La criminalité en France. Rapport annuel [Crime in France. Annual Report]*, Paris, 2014.

⁵⁷⁶ Art. 450 1 of the Criminal Code: “a criminal association consists of any group formed or any conspiracy established with a view to the preparation, marked by one or more material actions, of one or more felonies, or of one or more misdemeanours punished by at least five years’ imprisonment. Where the offences contemplated are felonies or misdemeanours punished by ten years’ imprisonment, the participation in a criminal association is punished by ten years’ imprisonment and a fine of €150,000. Where the offences contemplated are misdemeanours punished by at least five years’ imprisonment, the participation in a criminal association is punished by five years’ imprisonment and a fine of €75,000”.

product of crime and not to the preparation stage. In brief, there is no evidence of systematic knowledge on the process of financing criminal activities.

In France, SIRASCO⁵⁷⁷ – the intelligence service within the judicial police specialised in organised crime – lacks reliable data on this topic. To the extent that the issue is researched, it is when there is a link between organised crime and terrorist acts. An appropriate approach would be indirect, such as investigating the profit generated by trafficking, where the political and media pressure is on depriving criminals of the fruits of their crimes. From a historical point of view, the fact that France was a colonial empire meant there were a lot of exchanges (goods, individuals, capital, etc.) between colonies (South-east Asia, Africa, West Indies) and mainland France. Opium, kif, piasters⁵⁷⁸ or cigarettes were among the main objects of illegal activities.

Market overview

In the history of organised crime in France, there is a kind of founding episode. The story took place on 4 October 1952, when a Dutch cargo ship, “Combinatie”, left Tangier with 2,700 cigarettes boxes on board but was hijacked and looted not so far from the Corsican coast. The captain was an experienced trafficker and seems to have been an accomplice. In fact, he obtained the reimbursement of the boatload from the insurance company. The smugglers won on both sides, the insurance premium and the profit generated by the sales of diverted cigarettes. These actors used part of the profit in an international drug trafficking of heroin from Turkey to France and from there to North America known as the “French connection”.⁵⁷⁹

Fast forward to 2012, and most of the 62,133 tonnes of tobacco sold in retail shops was in the form of cigarettes (51,456 tonnes). The net decrease compared with 2011 (-3.4%) was the sharpest drop since 2005. However, one out of five cigarettes smoked in France was not purchased in a French tobacco retail shop. Cross-border purchases account for three quarters of the cigarettes smoked, and the remainder come from duty-free shops, bought online and contraband purchases. In 2012, customs seized 371 tonnes of tobacco, or 20% less than in the record 2011 year. The turnover generated by tobacco was €17.9 billion in 2012, up 2.3% compared with 2011. Nearly 9% of the turnover went to the tobacco retail shop owners, 13% to manufacturers and distributors, and practically 78.5% to the state, which thus collected €14 billion in taxes (including VAT) in 2012, nearly 1.8% more than in the previous year.⁵⁸⁰

⁵⁷⁷ Abbreviation for Le Service d'Information de Renseignement et d'Analyse Stratégique sur la Criminalité Organisée.

⁵⁷⁸ Kif is a mix of tobacco and hashish, during the French Protectorate (1912 – 1956), there was a formal regulation of cannabis named “Régie du Kif et des Tabacs”. Piaster was a currency from the Cochin China (former French colony), the different change rates between France and this region was illegally exploited to earn money in fast trading.

⁵⁷⁹ Colombié, Lalam, and Schiray, *Les acteurs du grand banditisme français au sein des économies souterraines liées au trafic de drogues [The French Milieu within the Illegal Economy Linked to Drug Trafficking]*.

⁵⁸⁰ Ministère de l'Économie et des Finances, *Douane, résultats 2013 [Customs Results 2013]*. Bureau Information et Communication, 2014.

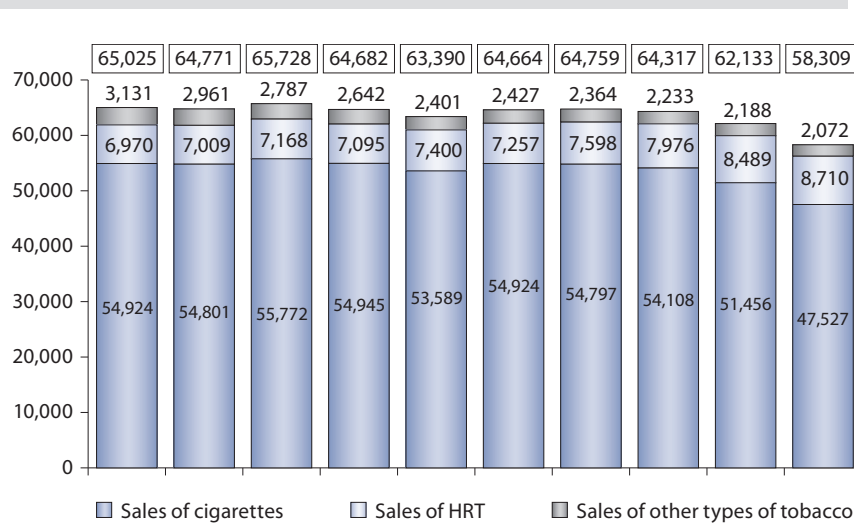
After a **decrease in daily tobacco use** from 2000 to 2008 among 17-year-olds, the trend reversed from 2008 to 2011, increasing by 10%. In this age group, 32.7% of boys and 30.2% of girls smoked on a daily basis. In 2011, French 15-16 year-olds ranked 6th in Europe in terms of tobacco use in the preceding month. Daily tobacco use among 18-75 year-olds was up from 2005 (28%) to 2010 (30%). This increase was greater in women than in men.

TABLE 44. DAILY CONSUMPTION OF TOBACCO PRODUCTS BY AGE AND GENDER IN FRANCE (IN %), 2010

	18-25 years old	26-44 years old	45-64 years old	All	Male	Female
Share	10	12	24	17	25.9	8.5

Source: French Institute for Health Prevention and Health Education (INPES), *Health Barometer 2010*.

FIGURE 32. TOTAL TOBACCO SALES IN FRANCE (CIGARETTES, HRT AND OTHER TYPES OF TOBACCO, IN TONNES), 2004 – 2013



* Other tobacco types include cigars and cigarillos, pipe tobacco, chewing tobacco and snuff.

Source: Logista, 2014.

In 2012, customs recorded 10,968 offences (13,258 in 2011) linked with tobacco and cigarettes smuggling. 371 tonnes of tobacco were seized (462 tonnes in 2011), which represents a value of €80 million. Among the 371 tonnes seized, 263 tonnes were cigarettes (i.e. 71%); 45 cases involve seizures of higher than one tonne.⁵⁸¹

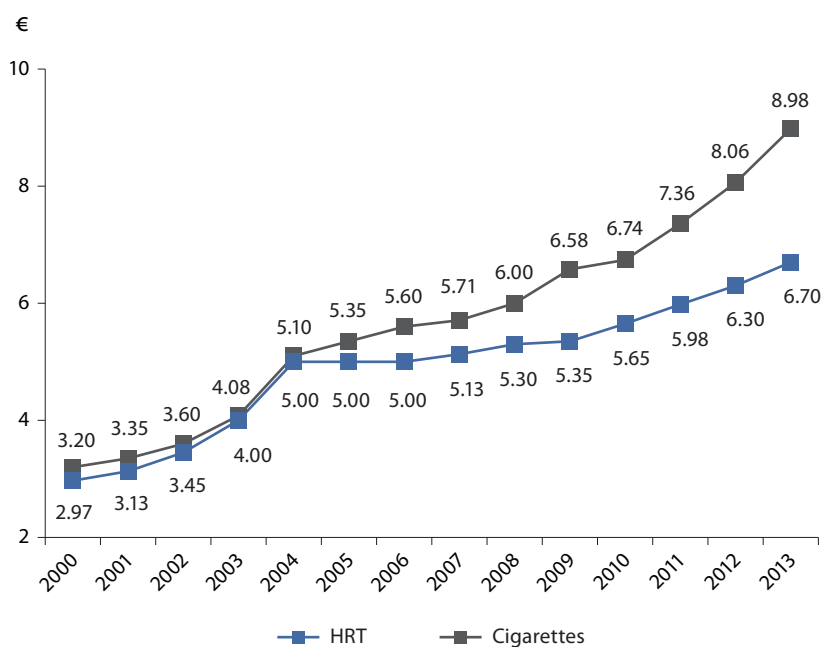
In France, the difference between registered cigarette sales and cigarettes reported as being smoked was approximately 20% in 2010.⁵⁸² Most of this difference can be explained by legal tax avoidance (cross-border shopping in neighbouring countries) rather than by large scale smuggling. France is considered a transit country

regarding the illicit flows of tobacco because the major destination countries are the UK and Ireland, a large part of cigarettes disseminated around the country, close to the biggest agglomerations. According to a customs officer based in Paris (Customs Regional Directorate): “[...] even if the smuggling is organised by criminals, the latter are not estab-

⁵⁸¹ Direction générale des douanes et des droits indirects, *Rapport annuel de performance [Annual Performance Report]* (Paris: Ministère de l'économie et des finances, 2013).

⁵⁸² N. Lalam et al., *L'observation du marché illicite du tabac en France [Observation of the Illicit Tobacco Market in France]* (Paris: INHES), OFDT, 2012).

FIGURE 33. MEAN ANNUAL SELLING PRICE (€) OF THE MOST POPULAR CIGARETTE BRAND (PACK OF 20) AND HRT (40 GRAMS) IN FRANCE, 2000 – 2013



Source: French Customs Authority (2014).

lished in France. We find re-lays there, but no nerve centre. The head is based especially in Eastern Europe and the Balkans.”

The French market remains interesting for the smugglers despite the existence of a quite regulated legal supply chain taking into account the monopoly of distribution and the strict control by French customs. A specific development is the decrease of cigarette sales (volume) and the rise in value (Figure 32). Hand-rolling tobacco (HRT) is increasingly popular among smokers for financial reasons.

Otherwise, the main distributor of cigarettes in France – Logista – has been a victim of armed robberies and some of its trucks have been assaulted

by commando groups using the same methods as in assaults on cash-in-transit vans.

As evident from Figure 33, public health considerations have increased significantly the taxation of cigarettes (price rise is mostly due to higher tax and excise), which prompts smokers into searching for illegal cigarettes. OCGs, therefore, consider it useful to invest in smuggling and counterfeiting them.

Market structure and actors

In France, three main supply networks of illicit tobacco can be distinguished,⁵⁸³ which more or less correspond to the classification made by Luk Joossens:⁵⁸⁴

- **Large-scale organised smuggling** involves the illegal transportation, distribution and sale of large consignments of cigarettes and other tobacco products. Large-scale smugglers generally avoid all taxes on tobacco products either by diverting them from the legal market while they are in the wholesale distribution chain (where they are transported untaxed), in transit between their country of origin and their declared destination, or by smuggling counterfeit tobacco products.
- **Small-scale smuggling** or bootlegging involves the purchase, by

⁵⁸³ Here, the case of cigarettes smuggled by tobacco multinational companies will not be analysed as it deserves a separate study.

⁵⁸⁴ L. Joossens, *Effective Tobacco Control Policies in 28 European Countries* (Brussels: European Network for Smoking Prevention, 2004).

individuals or small groups, of tobacco products from low tax jurisdictions in amounts that exceed the limits set by customs regulations, for resale in high tax jurisdictions.

- **Ant smuggling** refers to organised and frequent crossing of borders by a large number of individuals with relatively small amounts of low taxed or untaxed tobacco products.

This classification is relevant in the case of France:

- The networks linked to the traditional “Milieu”⁵⁸⁵ and transnational criminal organisations that are involved at the wholesale level;
- The networks of independent groups with a strict division of labour (supervisor, storer, fund raiser, etc.);
- the micro-networks, some based on ethnic ties.

One of the keys to understanding the financing needs of cigarettes smuggling is to have a rough idea of cost-accounting aspects. Whether the activities take place in France or abroad will have an impact on the nature and volume of capital and labour costs. There is no evidence of illicit factories producing cigarettes in France even though there was an attempt in Marseille (see below). If the involvement of legal factories in the international smuggling seems to be evident,⁵⁸⁶ in France this aspect is not very well researched. Tobacco companies deny that they increase supply into lower-tax jurisdictions to boost sales, but a close observation of Andorra refutes this claim. There are, of course, the agreements with the world's 4 largest tobacco manufacturers that EU has signed during the 2000s. On the other hand, the lobbying of these manufacturers remains important in France, especially among members of the French parliament⁵⁸⁷ trying to influence the legislation.

According to customs officers, France is still a transit country because UK and Ireland are countries where the mark-ups are significant. French OCGs offer their logistical skills to other groups (from Italy, Russia, Balkan countries). Integrated structures from the production to the distribution are not common.

An example of the type of player is a wholesaler arrested in the port of Marseille as the organiser of a network involving two captains of merchant ships. Cigarettes were bought in duty free shops all over the Mediterranean and illegally imported in France (4,000 cartons each month). The investigators point out that the income was around €40,000 a month and the business had lasted for many years suggesting that a few port employees must have been corrupt.⁵⁸⁸ In another instance,

⁵⁸⁵ A term used for a type of high profile organised criminals operating in the metropolitan areas of France; also referred to in French as “grand banditisme”.

⁵⁸⁶ In the 2000s, the European Commission launched civil proceedings against RJ Reynolds (RJR), Philip Morris International (PMI) and Japan Tobacco International (JTI) for involvement in cigarette smuggling and money laundering, and applied for an injunction to prevent smuggling in the future.

⁵⁸⁷ E.g. Club des parlementaires amateurs de havanes (The club of cigar-admiring members of parliament).

⁵⁸⁸ Direction régionale des douanes de Marseille, service presse, [Regional Customs Directorate in Marseille, Press service], 2014.

in 2014, in the south of France (Vitrolles) the French authorities seized in a customs clearance agent 10.5 tonnes of cigarettes in a container from China. It seems that the cigarettes were intended for the domestic market because the health warnings on the packs were in French. In the same affair, the investigators discovered 11,579 pairs of shoes (Nike and Converse) in a warehouse. This example suggests that criminal entrepreneurs are involved in several businesses without knowing how the process of financing operates. The market value of these 520,000 cigarette packs was estimated at €3.5 million. A customs officer of Marseille suggests that “it is very likely that many clandestine warehouses are linked together in the south of France even if it is difficult to prove, which gives an idea of the organisation.”

Wholesale level

Most of the actors of wholesale smuggling are career criminals, either involved exclusively in the illicit tobacco trade or in other transnational crime such as drug trafficking, human trafficking, or counterfeiting.

The economies of scale dictate that the quantities at stake at this level should be over one tonne of cigarettes. On average, **each euro invested can expect between two and three euros in return**, which makes the activity very profitable. Of course, the possibility of criminals being arrested and the merchandise being seized exists but is very low. “French organised crime has moved into the trafficking of cigarettes – and of meat – because the profitability is huge and the penal risks lesser than those in drug trafficking.”⁵⁸⁹ Thus, there is a discrepancy between the profitability of this illegal activity and the severity of the possible sentencing – less than 2 years.

In France, in most cases at the wholesale level, cigarettes smuggling is intertwined with the business of commodity counterfeiting (shoes, clothes, luxury products). An infamous criminal arrested in the beginning of the 2000s – “Jacky Le Mat”⁵⁹⁰ – was involved in an attempt of cigarettes manufacturing in the suburbs of Marseille. The Russian mafia lent their support to this project. Police officers have discovered many machines likely to produce cigarettes in huge quantities which were expected to be transported in stolen refrigerator trucks in order to supply the French market. These groups try to maximise profits through collaborative agreements with one another, like a producers' cartel. Contract enforcement, however, could be a problem: whereas the breakdown of a legal cartel may lead to a price war, the breakdown of agreements among illegal organisations tends to result in violence.

Small-scale smuggling

According to law enforcement bodies, the two levels (wholesale and retail) are compartmentalised. They suggest that the retailers pay for their orders in cash, the quantities handled being dozens of cartons. For

⁵⁸⁹ Interview with an officer at the Directorate of Customs in Marseille, May 14, 2013.

⁵⁹⁰ Jacques “Jacky Le Mat” Imbert is a French organised crime leader who first came to prominence in the 1960s Marseille.

each carton, they earn between €20 and €30. Part of the distribution is done by undocumented immigrants, especially in Paris and Marseille, some of them also implicated in thefts. It may be excessive to define this method of selling as organised crime, but it is undoubtedly a mode of informal economy.

In France, a group known to be involved in ant smuggling are the Senegalese Mouride⁵⁹¹ migrants. New routes are set up so as to mobilise various religious resources, but are a means of search for new commodities or new contacts for business. A minority among them get involved in illegal activities such as trafficking of crack cocaine, cigarettes smuggling or counterfeiting. Prior to the sharing of profits the financing is made by a collective of several individuals. Their ability to travel in the major cities of the developed world is a real asset for quick-selling.

The city of Marseille in the south of France is an important crossroad. The informal trade there is quite dynamic and supervised by informal “notaries”⁵⁹² since it needs powerful intermediaries to function. Being recognised as people of word and honour, they are dispute settlers, and ease tensions in case of conflict, thus maintaining certain order in these networks which are always in motion. These illegal commercial relationships (fluid and less structured) operate thanks to participants keeping their word since there are neither written contracts nor legal guarantees that accompany formal business.

Financing and financial management

Sources of capital for criminal operations

The history of the French Milieu tends to confirm the hypothesis of separate function between the financiers and the operatives. The former participate in the financing of cigarette imports without being in contact with the merchandise; the latter take care of the organisation from the contacts (supply), transportation, storage, counter-surveillance, and the distribution. The fundraisers expect a return on capital which is usually decided *ex ante*.

The close links between the financiers and the operatives (friendship, family, etc.) point to the crucial role of trust between the players. Moreover, the time during which the capital is mobilised will vary widely according to different factors, such as the distance, the means of transport, whether a sea route or air transport is chosen and the state of the demand.

Proceeds from other crimes have also been used to finance cigarette smuggling. In South-East France, armed robbery is considered as the

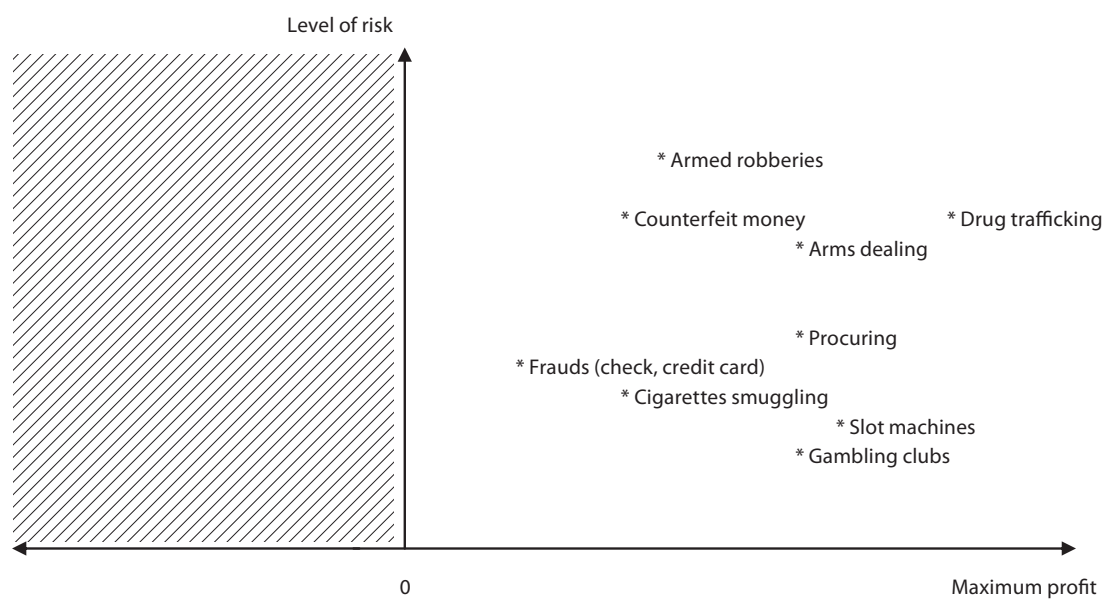
⁵⁹¹ Religious movement initiated by Cheikh Ahmadou Bamba in the city of Touba (Senegal), as a transnational religious company. Mourides are settled throughout the world, and have created a transnational trade organisation. The message of this brotherhood is inspired by a kind of Weberian “salvation by labour”. The Mouride ethos has been transformed in a real business spirit – to make money is all the better perceived since it enables the financing of the brotherhood.

⁵⁹² A. Tarius, *La mondialisation par le bas. Les nomades des économies souterraines [The Parallel Globalisation. The New Nomads of the Underground Economy]* (Paris: Balland, 2003).

way to begin a criminal career. In the hierarchy of criminal activities, this type of offence will provide a strong reputation for the perpetrator in the underworld. Gradually, this way of launching an illicit business has spread in most of the French regions (North, Ile-de-France, Rhône). French “grand banditisme” has targeted the centre-fort, the place where the armoured vans gather to count the paper money. Armed robberies against these centres (around 150 in France)⁵⁹³ are justified, firstly, by the fact that the amount of money is quite significant and, secondly, by the difficulty of assaulting banks and postal offices.

Since the beginning of the 1970s, French organised crime has exploited the illegal slot machines placed in cafes, bars and restaurants. In the eighties, members of parliament were worried of homicides linked to the “war of slot machines”. “To ensure guaranteed colossal profits without any great effort, a whole organisation was set up with front companies and straw men as managers.”⁵⁹⁴ For an investment of less than €4,000, a slot machine can yield between €100 and €300 a day, which is divided between the broker and the manager. The rate of return of these machines oscillates between 40 and 50% (against 85% in casinos).⁵⁹⁵ Some organised crime groups could own at least

FIGURE 34. DISTRIBUTION OF CRIMINAL ACTIVITIES IN FRANCE ACCORDING TO RISK AND PROFIT



Source: T. Colombié, N. Lalam, and M. Schiray, *Les acteurs du grand banditisme français au sein des économies souterraines liées au trafic de drogues [The French Milieu within the Illegal Economy Linked to Drug Trafficking]* (Paris: INHESI, Ministère de l’Intérieur, 2002).

⁵⁹³ Délégation à la prospective et à la stratégie, *Criminalité organisée [Organised Crime]* (Paris, October, 2008).

⁵⁹⁴ P. Piazza, “Les machines à sous en France: Orientations étatiques et addiction au jeu [Slot Machines in France: State Directives and Gambling Addiction]”, *Psychotropes* 13 (2007): 3-4.

⁵⁹⁵ J.-M. Costes and J. Etienne, “Taux de retour au joueur, addiction et blanchiment [The Return Rate to the Gambler, Addiction and Money Laundering]”, *Les Notes de l’Observatoire Des Jeux*, no. 1 (2012).

100 machines, generating significant profit. Part of this money is being reinvested in criminal activities such as drug trafficking and tobacco smuggling.

Although the issue of the specialisation of OCGs in one type of crime remains controversial, as evident from Figure 34, cigarette smuggling is in the same group of high reward and low risk crimes as illegal slot machines. Interviews tend to confirm the versatility of OCGs, having as their final goal the making and laundering of money. The distribution along the vertical axis of risk and horizontal of profit provides a static picture and of course there are many combinations. The criminals could use alternatively legal and illegal resources, or a mix of them. The financiers make a basic calculation including risks of being arrested and goods being seized versus the rate of profit in a certain period of time.

At the small scale smuggling level, retailing cigarettes is within the reach of migrants with no resources, coming from emerging and developing countries (China, Tunisia, Libya). To launch a retail business, many actors are prone to use their own money, however, some ethnic groups rely on mutual aid.

Profits and profit sharing

The profitability of cigarette smuggling is quite high, according to a customs administrator in the Intelligence and Investigation Directorate of the French customs: “A container can hold 10 tonnes of cigarettes. In reality, we find between 6 and 8 tonnes by container which amounts to €2.8 million in commercial value.”

Because of the proximity of Andorra where the price of cigarettes is low compared to those in France, the smuggling of tobacco products has grown these last years, in particular around the city of Toulouse. The protagonists are former cannabis dealers and they use fast cars. This type of smuggling is hierarchically structured, having at its lowest level around thirty street peddlers (place Arnaud Bernard, in Toulouse). In six months, one smuggler had put in place an organisation selling 3,000 cartons bought in Andorra and transported by cars; his business has generated a profit of €40,000.⁵⁹⁶

Customs intelligence officers mentioned the development of water pipe tobacco smuggling from UAE. The *narghileh* bars are places where this product can be found; the legal revenue from these bars is used to finance the illegal purchase of this type of tobacco.

One key aspect that needs to be taken into account relates to the individual vs collective financing variable. In the first case, one individual could raise the total amount of the investment, which seems to be rare but possible; in that sense, the opportunity cost should be low. At the high levels of the business, this person is a well-established criminal, frequently known as a “juge de paix.”⁵⁹⁷ According to the Director of

⁵⁹⁶ Direction de la sûreté départementale de Haute-Garonne et Service national des douanes judiciaires [Local Public Security Police and National Customs Judicial Enquiries Department].

⁵⁹⁷ Justice of the Peace.

TABLE 45. SOURCES OF FINANCING BY SMUGGLING LEVEL IN FRANCE

Source level	Illegal source	Legal source	Hybrid
Wholesale smuggling	<ul style="list-style-type: none"> • Slot machines • Gambling • Procuring • Extortion 	<ul style="list-style-type: none"> • Personal savings • Commercial activity • Personal assets • Wages 	<ul style="list-style-type: none"> • Totality • 50%; 50%
Small scale smuggling	<ul style="list-style-type: none"> • Fraud (means of payment or state allowances) • Drug dealing • Thefts and receiving 	<ul style="list-style-type: none"> • Wages • Personal savings • Mutual aid (informal finance) 	N/A

Source: N. Lalam, D. Weinberger and A. Lermenier, *Etude portant sur la mise en place d'un dispositif experimental d'observation de la consommation de tabac issu de la contrebande [Study on an experimental implementation of an observatory of illicit tobacco consumption]*, Rapport pour la Mission interministérielle de lutte contre la drogue et la toxicomanie, Paris, July 2011.

the National Customs Judicial Enquiries Department, collective financing is more common due to the possibility of sharing risk. The organisers ask different persons if they are interested in financing an operation of cigarettes importation, a process that could be named the “financing round.” They use arguments such as the rate of profit, the speed of return on investments and risk analysis. Among the investors, the level of contribution could be evenly spread or quite different, depending on the mark-up and material considerations.

In cigarettes smuggling, when a contract is defaulted on (internal reasons can include betrayal, denunciation; external reasons could be disruption, seizures), quite often the player at fault becomes indebted and will work free of charge for the criminal organisation. This situation of indebtedness will be valid for one time or more depending on the amount of money at stake. Unlike in drug trafficking, murder is exceptional in cigarette smuggling. Globally, the risks associated with cigarette smuggling are lower than those of drug trafficking, particularly the penal risks. Consequently, costs of shipments are lower in the first case (for instance the cost of corruption). In case of loss, it is easier to recover because of the high profit rate.

Access to capital

The **tontine** is a peculiar form of cooperation in the field of credit. The loan is made without any interest, any guarantee and any market. Although this practice dates back to the 17th century, globalisation has given a new boost to these exchanges, such as the remittances between developed and developing countries. A tontine includes also the mutual obligation that bind the members of a group. “If someone doesn’t abide by the adopted code of honour, the individual risks cutting all ties with the community and becoming a pariah.”⁵⁹⁸ The capacity to recover the

⁵⁹⁸ M. Lelart, *La tontine [The Tontine]* (Paris: AUPELF-UREF, 1990).

debt is high due to social and moral constraints. Members of the tontine network pool their monetary savings, to be lent alternately to each of them (a kind of credit cooperative). The members of the tontine share similar interests or common relations which strengthen the social control and guarantee the functioning of the system. In the tontine, money circulates very quickly. The tontine evolves in a framework at the edge of the legality without being systematically illegal. It escapes the regulation of public authorities. Part of the small scale cigarettes smuggling in Africa (Senegal, Mali, Cameroun, Benin, Togo, Mauritania) and in Asia (China, Vietnam) is financed by this system.

A similar system is the hawala,⁵⁹⁹ “an informal channel for transferring funds from one location to another through service providers – known as hawaladars – regardless of the nature of the transaction and the countries involved.”⁶⁰⁰ It exists and operates outside of, or parallel to formal banking or financial channels. Actually, hawala works by transferring money without moving it, which allows for the establishment of a network for conducting the transactions. In that sense, trust appears to be fundamental to implement the system. Hawala is understood in its role in money laundering, but not much as part of criminal financing in general. In a context of asymmetric information, under which the information gap will be exploited if, by doing so, the better-informed party can achieve some advantage. But the role of trust limits this kind of opportunistic behaviour and strengthens loyalty. In the case of cigarettes smuggling, it is therefore an important component on both sides, operational and financial.

5.7. CZECH REPUBLIC: FINE-CUTTING PROFIT IN DISORGANISED ILLICIT TRADE

Introduction

The Czech Republic is a historically important hub of the European illegal tobacco trade. Today, the territory of the country is valued not so much for its market but as a centre of money laundering and a relaxation place for white-collar criminals from Eastern Europe. As for the market, according to the experts interviewed, it has two key features: there is **strong fragmentation of its distributional dimension** and being a **high-profile and risky business causes demand to outstrip supply**.

The only persistent trend in the illegal tobacco business is the so called “**eastern trail**” which starts in post-Soviet countries (Russia, Ukraine, Moldova, Belarus) and uses upper (Poland) or lower (Hungary – Slovakia) routes to transport genuine brands without paying excise and VAT duties to the countries in Western Europe, incl. the Czech Republic. En route, long-vehicle transportation is substituted by “car-trains” consisting of several cars traveling together, having one pilot car in the front and one

⁵⁹⁹ According to the country, the name changes: Fei-Ch'ien (China), Padala (Philippines), Hundi (India), Hui Kuan (Hong Kong), and Phei Kwan (Thailand).

⁶⁰⁰ M. El-Qorchi, “Hawala. How Does This Informal Funds Transfer System Work, and Should It Be Regulated?”, *Finance and Development* 39, no. 4 (2002).

counter-surveillance car in the rear. The Asian sea route (China – Western European sea ports, Balkan route) which was continually perceived as one of the dominant ways to import illegal tobacco products in the past is not clearly functioning nowadays. Similarly, the traditional Balkan path is considered to be just a back-up plan in cases of strong police and customs profiling of the eastern trail.

A shift is identified also in the area of the production of counterfeit cigarettes, which used to be exclusively the domain of the Vietnamese community. However, currently the production is both **ethnically diverse** with the presence of Czech, Ukrainian and Moldovan people and **marginalised** because of its easy detection by law enforcement. It has been mostly replaced by the trade in fine-cut tobacco.

Nowadays, the illegal tobacco market in the Czech Republic is **strongly decentralised** and consists especially of cigarettes and tobacco imported from East European and Balkan countries.⁶⁰¹ Decentralisation and fragmentation hinders research of the financial management of the business with illegal tobacco products, where the only identifiable common pattern is cash payment.

Market overview and structure

In 2013, the **total cigarette market** in the Czech Republic declined by an estimated 3.3% in comparison with the previous year to 19.8 billion pieces, mainly reflecting the impact of increasing prices, the unfavourable economic environment, the increased prevalence of an illicit trade in tobacco products and the continued growth of lower-taxed fine-cut tobacco (CZ-E8). However, according to the Ministry of Health of the Czech Republic,⁶⁰² the smoking rate has not decreased and reaches up to 30% of the population.

PMI holds the leading position in the tobacco business in the Czech Republic (other important official actors are British American Tobacco, Imperial Tobacco, Japan International Tobacco, Geco, Danczek or Tobacco Trading International) holding up to 50% market share. This means that the illegal tobacco trade affects especially PMI's profits. The overall **share of illegal tobacco products is around 3%** of national consumption,⁶⁰³ with the exception of the city of Cheb (Western-Bohemia) in which according to CZ-E8 and CZ-E9 the consumption of illegal tobacco products reaches 14% of the total tobacco consumption. As will be later explained, this exception is caused by the close position of Cheb to German borders.

Between 2009 and 2012, there was a continual increase of detected cases of illegal tobacco trade; however, at the same time the overall amount of seized illegal cigarettes decreased. This trend is in contrast with apparent seizures of other tobacco products.

⁶⁰¹ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results.*

⁶⁰² Ministry of Health, *Zpráva o zdraví obyvatel České republiky [Report on the Health of Czech Citizens], 2014.*

⁶⁰³ KPMG, *A Study of the Illicit Cigarette Market in the European Union. 2013 Results.*

TABLE 46. VOLUME OF THE ILLEGAL TOBACCO TRADE IN THE CZECH REPUBLIC (2009 – 2012)

Year	2009	2010	2011	2012
Number of detected cases	368	404	681	749
Cigarettes (million pcs)	40	29	10	17
Tobacco (tonnes)	142	118	143	431
Revenue leakage (million €)	6.1	5.8	1.84	21.02

Source: Annual Reports of the Customs Administration.

The illegal tobacco market is characterised by several interconnected modes of operation – import-exports, distribution and production (Table 47). A further breakdown reveals three patterns of export/import according to transit routes between the country of origin and the final destination. The prevalent pattern is **importing genuine brands from Eastern Europe**, warehousing them in the border areas with Poland and Slovakia and then distributing them further. The basic financial advantage of importing genuine brands from Eastern Europe to the Czech Republic lies in the price difference between licit and illicit cigarettes. The retail price of 1 package of licit cigarettes is approximately €3 which is twice the price of a smuggled legal; in the case of illicit whites the difference is more than three times (1 package = €0.90).

The common distribution model is **through the network of warehouses and retailers** (i.e. bars, restaurants, kiosks, etc.). The warehousing system is based on the distribution from the unloading yard to plenty of warehouses alongside both sides of the border. These warehouses can be small storage spaces (e.g. a garage) or larger storage facilities where the contraband merchandise can be easily hidden among other goods. Afterwards, it is sold to a network of retailers who buy the products directly from the warehouses or via taxi drivers or similar mobile services that deliver the products to them. In the case of unloading the cigarettes in Poland, Polish or Czech smugglers export them using cars or ant smuggling to the Czech Republic.

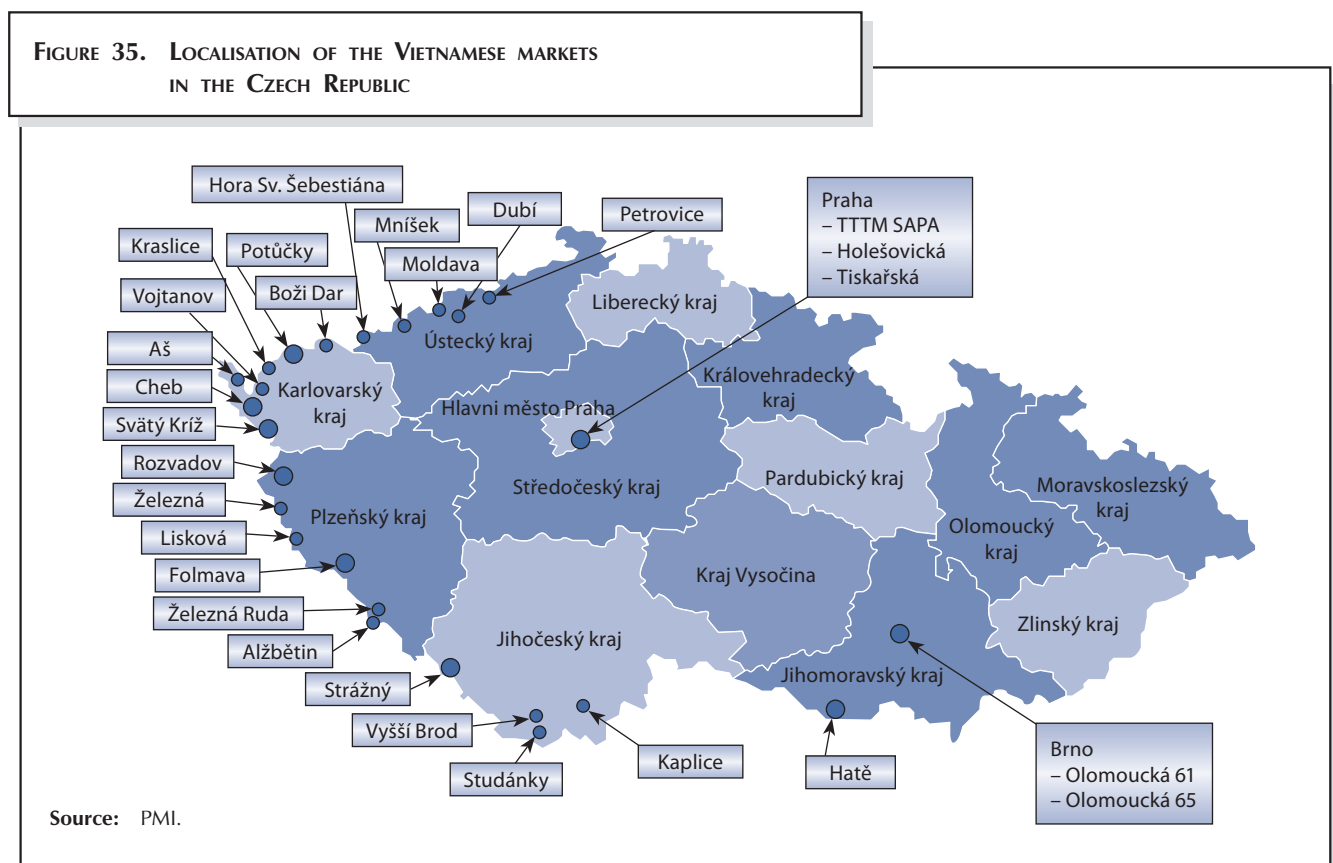
In terms of the consumption of illicitly imported cigarettes, the most affected regions are the Moravian-Silesian Region (with several distribution nodes – Český Těšín, Karviná, Bohumín, Ostrava), the West-Bohemian Region (Cheb, Pilsen and Vietnamese markets), the Karlovy Vary region (Karlovy Vary, Aš and Vietnamese markets), the Usti Region (especially the Vietnamese markets), the Central Bohemian region, the Liberec region (Czech-Polish borders) and Prague (especially the Vietnamese markets and the Russian-speaking community). While post-industrial regions (the Moravian-Silesian region, the Usti region) are characterised by economically marginalised consumers, Czech-German regions (the West-Bohemian region, the Karlovy Vary region) are focused on German-

speaking consumers (or distributors). The capital Prague includes all of these trends simply by being the biggest Czech city. Czech smugglers can also bypass the local market and transport the contraband to foreign countries:

„In one of the cases there were 16 Czech people sentenced who were specialised in exporting cigarettes to the UK, Germany and France. In the latter case they had been able to deliver special cigarettes directly to the Algerian community. Legal cigarettes were transported from Ukraine, smuggled through the Czech Republic and sold to clients on the border with Germany. Germans had been demanding them because of their quality which is much higher than hand-rolled cigarettes made by the Vietnamese” (CZ-E6).

Another modus operandi is subsequent or alternative to the already described one and remains largely undetected: the one-man distribution. Its main players are former cigarette smugglers or other individuals who buy the tobacco leaves in Poland, chop them, place the fine-cut tobacco into packages (150-500 grams) and sell it in the Czech Republic.

Additionally, **the smuggled cigarettes can also be transited from the warehouses alongside the borders to the Vietnamese markets** by Czech, Russian or Ukrainian distributors. The Vietnamese markets (Figure 35) are concentrated along the Czech-German border with the exception of two big markets in Prague and Brno, and one market



on the Czech-Austrian border. These markets are considered to be 16 autonomous units with a hierarchy existing on the basis of close family relations and a cell distribution system. Illegal tobacco products are usually placed in a kind of special central warehouse outside these markets to make the merchandise invisible. The retail in the Vietnamese markets is run by know-how and “know-who” principles: genuine customers are recognised according to formal markers (car plates, appearance, accent); the decision to sell or not is usually in the hands of an experienced local boss.

The centre of Vietnamese business is the Sapa bazaar in Prague, a place which involves untraceable movement of money, immigration fraud, drugs and warehouses full of counterfeit goods. Laundering of the money is easily achievable due to the huge amounts of fast selling merchandise. Since most of the payments are based on cash, the transgressions are difficult to monitor and identify. The situation is even more complex due to the existence of informal Vietnamese banking system called “chuyen tien” which is similar to the hawala.

During the last few years, one of the major shifts in the illegal tobacco business is the replacement of the production of counterfeit cigarettes by the trade in hand-rolling tobacco (HRT). The reason is that chopping tobacco and selling it in packages or bags is less challenging and detectable than the defective and risky production of counterfeit cigarettes. Apart from other players, research has identified a strong involvement of Polish organised criminal groups, especially in the Czech-Polish border areas. The presence of these groups in the Czech Republic is usually explained by the opportunity to exploit the differences in the taxation of fine-cut and whole tobacco leaves.

TABLE 47. MODEL OF THE ILLEGAL CIGARETTES MARKET IN THE CZECH REPUBLIC

Model	Type of operation	Merchandise	Country of origin	Destination country	Mode of transportation	Players	Distribution/Customers
Export-Import							
Post-Soviet territory – Poland route	Export/Import	Cigarettes	Ukraine, Russia, Moldova, Baltic states (via Hungary, Slovakia)	Poland	Car-trains, green way	Ukrainian, Russian, Moldovan groups	Wholesale to Polish players
Subsequent Poland-Czech Republic route	Export/Import	Cigarettes	Ukraine, Russia, Moldova, Baltic states (via Hungary, Slovakia)	Czech Republic	Car-trains	Polish, Czech groups	Wholesale to Polish or Czech players
Asia route	Export/Import	Tobacco	Asian countries (Vietnam)	Europe	Sea routes, long-vehicles, vans, cars	Vietnamese groups, legal companies	Logistics plan

TABLE 47. MODEL OF THE ILLEGAL CIGARETTES MARKET IN THE CZECH REPUBLIC (CONTINUED)

Model	Type of operation	Merchandise	Country of origin	Destination country	Mode of transportation	Players	Distribution/Customers
Distribution							
Cross-border warehouse model	Distribution	Cigarettes, HRT	Poland	Czech Republic	Cars (Schengen), ant smugglers	Polish, Czech groups	Warehouses, wide spectrum of customers who sell it further
One-man business model	Distribution	Cigarettes, HRT	Poland	Czech Republic	Cars	One-man business model	Selling to acquaintances
Inland warehouse model	Distribution	Cigarettes	Czech Republic	Czech Republic	-	Czech, Polish, Post-Soviet, Vietnamese groups	Warehouses, wide spectrum of customers, re-distribution to Vietnamese markets
Direct cross-border model	Distribution	Cigarettes	Ukraine, Russia, Moldova, Baltic states (via Hungary, Slovakia)	Czech Republic	Cars	Post-soviet groups	Russian-language community
Foreign players cross-border model	Distribution	Cigarettes	Ukraine, Russia, Moldova, Baltic states (via Hungary, Slovakia), counterfeited cigarettes	Czech Republic (Vietnamese markets)	-	Vietnamese	German cities close to the border
Production							
Production	HRT	Poland, Czech Republic	Czech Republic	Cars	Wide spectrum of players	Warehouses, direct sales	Wholesale

Source: Authors' elaboration.

Financing and financial management

Financing and financial management of the illegal tobacco trade in the Czech Republic is embedded in social relations far exceeding the particular business deals.

Sources of capital for criminal operations

Considering the fact the roots of the illegal tobacco trade that affects the Czech Republic are located in the post-Soviet territory, the tracing of the source of the capital for initiating the business is quite challenging. There was an agreement among interviewees that the organisers of the trade and the financiers/investors are different entities. The financiers provide the money for the organisers who are responsible for hiring people willing to be part of the business as drivers-smugglers. The organisers are also responsible for ensuring the vehicles required for the

smuggling, arranging customers, final destinations and also trans-border shipments to Central and Western Europe.

Generally speaking, the illegal tobacco trade in the territory of the Czech Republic is not linked to hierarchically organised criminal groups. Quite the opposite, the network of actors responsible for the distribution of illegal cigarettes is – apart from Vietnamese groups – fragmented, decentralised without any crucial key nodes. Hence it follows that the source of the capital for initiating the distribution business is not generally definable. However, there are several identifiable ways of sustaining the business. The most common way is investing money from a legal activity (e.g. trade in foodstuffs, gaming devices, restaurants) which makes the illegal tobacco trade not the main business activity but as a side business of mostly legal business transactions. The estimated ratio of legal to illegal capital is 70:30.

Another way to sustain an illegal cigarettes business is using the financiers or investors who are not directly active in the business, their role being limited to providing funding. However, the socioeconomic spectrum of those financiers/investors is so varied that it is not possible to provide any general characteristics. Their business involvement is usually anticipated rather than detected:

“There are some cases when guys start as petty tobacco smugglers, or they find someone who is willing to invest his money and finance their business. Usually, they are their acquaintances from a previous career. Whoever they can find...” (CZ-E4).

An illegal financing method is re-investing proceeds from VAT fraud. It is used sporadically due to the risky nature of the illegal tobacco trade and higher profits from illegal business other than cigarette fraud. The more frequently used model is reinvesting money from small scale smuggling in order to expand the trade. It is typical for the Vietnamese branch of the illicit networks: illegal tobacco products (cigarettes or HRT) are just one of the many commodities in a wide spectrum of traded merchandise.

As regards illegal HRT, there are two regular ways in which the actors can establish their own criminal operations. One of the common ways is using legal companies which buy raw tobacco leaves which are not subject of taxation in the Czech Republic. At the same time, these companies apply for a concession for setting up the operations to fine-cut the tobacco. Right after the purchase of the tobacco, the leaves are fermented, aromatised, chopped and packaged. The packaging – the final step of the process – makes the products subject to taxation. During the period of setting up the business these companies not only produce officially taxed tobacco but unofficially they continue to chop tobacco after hours and sell it untaxed to distributors.

Another traditional figure symbolising the permeability between legality and illegality is a person or a group of several people who run a

takeaway business offering a wide spectrum of goods including illegal cigarettes and illegal HRT. This figure can be illustrated in the short story related by one of the interviewees:

“We arrested Mr. X this January. Mr X. started his career as money changer before 1989. During the 1990s he was involved in numerous legal and illegal activities using several takeaway kiosks in the Moravian-Silesian region. Mr. X was officially homeless and registered in the municipality but in fact owned several luxury cars and had personal bodyguards at his disposal. In the course of time, he left the takeaway business and started to produce just fine-cut tobacco from leaves bought in Poland” (CZ-E7).

Settlement of payments

The transactions between the smugglers from the former Soviet countries, retailers and customers without exception are being done in cash. Bartering or its variations are not recognised. The same cash principle applies to distribution schemes because of not only the high-profile nature of business but primarily the direct hand-to-hand sale of illegal tobacco products which makes the business dynamic. There exists a wide spectrum of retailers – acquaintance networks, bar and restaurant owners, small warehouse operators etc.

The Vietnamese markets are known for their wide spectrum of goods (mobile phones, pre-paid cards, drugs, etc.) and services (massage, night clubs) where the profits from illegal tobacco products are mixed with the profits from other legal or illegal goods and services.

The payment for illegally produced HRT is without exception a cash payment. In the case of raw tobacco bought in foreign countries for the production of HRT the classical payment schemes are settled. These schemes involve officially registered companies and bank transactions.

Costs of doing business. Profits and profit sharing

The overall costs of organising the car-trains smuggling from the eastern neighbours of the Czech Republic are estimated to include petrol and other expenses for 3-7 cars (incl. caravans), wholesale cost of the traded cigarettes, remuneration for the drivers and brokers in the places of transshipments and in the final destinations, accidental expenditures. One fully loaded van can transit 2,500-3,000 cartons; however, the usual truckload is around 1,500 cartons.⁶⁰⁴ As regards manufacturing, apart from the costs which are inherently connected with the running of a half legal and half illegal business mentioned above, there is the cost of a tobacco cutting machine which is between €200 and €20,000 depending on the requested volume. The Vietnamese community has at their disposal tobacco cutting machines imported from Vietnam, the

⁶⁰⁴ The prevalent size of the smuggled goods can be illustrated with the claim of the speaker of the Customs Administration of the Czech Republic for the South Moravian Region Gabriela Kokrhelová on the occasion of the arrest of a Czech van driver who was consequently accused of smuggling 1,800 cartons of cigarettes. She claimed that the amount was quite huge compared with the other similar arrests (Česká televize Brno, “Úlovek celníků: Řidič dodávky pašoval skoro dva tisíce kرتونů cigarete [Customs’ Dragnet: Van Driver Smuggled Nearly 2 Thousands Cartons of Cigarettes]”, May 24, 2014).

original price of which is not known. In the case of the production of regular cigarettes from this tobacco, the expenses for papers, packages and filters need to be added (as mentioned, however, this kind of production has significantly decreased during the last years.

The package cost in the countries of origin is about €0.40, while in the destination country it is €1.5-€2, which means the profit can reach up to €25,000-€30,000 per van load. In the cases of cars (approximately 500-1,000 cartons) the profit is between €5,000 and €10,000. This profit is, however, shared between a number of stakeholders: financiers, organisers, smugglers, distributors and other actors in the business. This means, the financiers, organisers and smugglers never reach these amounts because of the need to sell the contraband to distributors for a bargain price (€0.60-€1.20). The same applies to the distribution process: costs and profits of distribution schemes are highly variable depending on the demand, the quantity discount arranged and transport expenditures.

Given the involvement of broad spectrum of actors in the tobacco trade networks consisting of a variety of legal and illegal activities, there is lack of information about profit sharing. There are no generally recognised rules but rather each group applies an informal system of rules and obligations which emerge from various aspects of the mutual relationships where the business aspect is just one among many. In the case of the smuggling from the post-soviet territories, the supposition is that the profit gained from illicit tobacco trade is partially re-invested in another cycle of the trade.

The Vietnamese community differs in the existence of a general financial system which also covers profit sharing. It is built around an informal network of underground bankers (the hawala) and money transfer services (Western Union) where high amounts of cash can be divided into smaller cash units undetectable by law enforcement. In their case the profit is usually reinvested in real estate expanding their commercial spaces in the city centres of the Czech Republic or is sent back to Vietnam.

Similarly, little is known about the system of sharing the profit from HRT and it is not even monitored by law enforcement agencies or the customs service. Attention is focused on concrete cases which are usually constructed around evidence referring to a concrete single transaction and thus usable in the prosecution of a predicate crime, not to the general process and mechanism of transactions.

Overall, the multitude of players involved in this illegal business dissipates the profit within the whole network:

“Cigarettes smuggling? It’s just for the greenhorns. The worst business you can do... It used to be like that, it is true even today and in the future it will be the same” (CZ-C2).

Access to capital at critical moments

As mentioned above, the profit from illegal tobacco products is mixed together with the profit gained from other legal and illegal activities. That is why access to capital at a critical moment is influenced by the overall business of the players. Short-term loans are provided by people included in network of acquaintances or, more often, by official, semi-official or unofficial companies lending the money at an interest rate. There are approximately 50,000 individuals registered as credit tradesmen in the Czech Republic and 33,651 non-bank credit subjects registered by the Financial Arbiter. According to the study *Secure Credit Navigator*⁶⁰⁵ the market share of non-bank loans is around 35% (€2.9 billion). The main reason for using non-bank institutions are credit conditions and higher interest rate imposed by banks on consumer lending. These institutions range from companies with brand credibility (e.g. Provident, Home Credit, Cetelem) to completely unknown and predatory entities charging high rates and unclear rights and obligations. Some of the latter are considered to be established for money laundering purposes.⁶⁰⁶ Although this kind of crediting is perceived as socially disrupting, it is not defined as organised crime in the official documents.

Accessing to capital at critical moments in the Vietnamese community is provided by the mechanisms for raising communitarian capital. This does not mean the whole Vietnamese community is involved in criminal activities but that mutually connected family and business channels cover also investments in illegal activities. The significant feature of the Vietnamese community is limited mobility between social classes, although there is no single hierarchical system. To put it differently, “there exist varying degrees of connectivity and seniority, meaning that although there is no single and united Vietnamese criminal organisation, common interests and family ties connects the units and hold them together.”⁶⁰⁷

Accessing capital at critical moments in HRT production does not differ from the other parts of the business, as sources include legal or other illegal activities, personal savings, short-term loans with unknown interest rates or the use of legal or semi-legal bank companies.

ITALY: THE TERRITORIALITY OF THE ILLICIT TOBACCO BUSINESS

Introduction

The illicit tobacco trade represents one of the oldest illegal activities of Italian OCGs. In particular, it is around the 1950s and 1960s that the high level of cigarettes consumption (estimated in 90,000 tonnes a year) and State taxation acted as facilitating factors for the growth of the

⁶⁰⁵ EEIP, *Navigátor bezpečného úvěru [Navigator of Secure Loan]* (Charles University, 2013).

⁶⁰⁶ High interest rates combined with high penalties for delay or default allow these lenders to forfeit real estate used as collateral which then becomes the subject of money laundering (People in Need – Rozhodně ně (2014): *Byznys s dluhy: Licha [Loan business: Loansharking]*).

⁶⁰⁷ P. Kupka and T. Šmíd, “The Outsiders: Vietnamese Crime Groups in the Czech Republic”, *Jane’s Intelligence Review*, 2011 23, no. 12 (2011): 40-43.

illegal cigarette market at the national level, thus creating a profitable opportunity exploited by Italian criminal entrepreneurs.⁶⁰⁸

In particular, the evolution of this illicit market is characterised by two distinct phases, with the police operation “Primavera”⁶⁰⁹ functioning as a key dividing event:

- In the first period (between the 1950s and the 2000s), the illicit tobacco market in Italy represented the initial and very profitable illegal activity of Italian OCGs (the Camorra, the ‘Ndrangheta, Cosa Nostra and Sacra Corona Unita) that, in this way, had been able to foster the recovery of economic growth employing different individuals, residing especially in deprived areas of the country. Due to the type of products smuggled and their low prices, the number of persons involved (estimated, for example, at 15% of the total population residing in the city of Brindisi, region of Apulia) the illicit tobacco market expanded rapidly, thus becoming accepted and, in some cases, supported at the social level (IT-E1, IT-E15, IT-E7, IT-E11). Tobacco products at this time consisted mainly in contraband cigarettes, with smugglers adopting a *modus operandi* aimed at avoiding police control at borders or officials control at customs, and tobacco manufactures in many cases as compliant suppliers (IT-E1, IT-E2).⁶¹⁰
- In the second period (2000s to nowadays), resulting from the counteraction attempts of Italian and European authorities (e.g. police operation “Primavera”, national laws, and agreements between EU institutions and major international tobacco companies), the scenario of the illicit tobacco market has consistently changed in the following features: 1. a renewed interest of traditional Italian OCGs (especially the Camorra and the Sacra Corona Unita); 2. the appearance of new criminal organisations from Eastern Europe (due to the opening of borders), the former Soviet Union and Asia; 3. the formation of new alliances and business joint ventures among criminal entrepreneurs used to introduce illicit tobacco products not previously traded on the national market (e.g. counterfeit brands and illicit whites), imported in huge quantities through container shipments or lorry trucks to hide the merchandise at customs (IT-E1, IT-E4, IT-E15).

Indeed, at present, the national illicit tobacco market appears to be undergoing a renewed expansion, also due to the contingent economic crisis, displaying vibrant and mutating dynamics, while involving the interplay of different actors (see section on market structure and actors).

⁶⁰⁸ G. Nanula “Il contrabbando come fonte di finanziamento della mafia” [Contraband as a Source of Mafias Financing] (Guardia di Finanza, Palermo, 18-19/11 2009).

⁶⁰⁹ The operation “Primavera” was carried out in 2000s by the Guardia di Finanza, National Police and Carabinieri in the region of Apulia, which has represented since the beginning a key area of tobacco smuggling carried out by the collaboration between the Sacra Corona Unita and Albanian/Montenegrin smugglers. This counteraction originated as a response to the heavy contraband phenomenon that was becoming more and more widespread and violent, having also caused the death of some officials. See La Repubblica, Duemila uomini in Puglia contro i contrabbandieri [Two Thousand Policemen in Apulia Against Smugglers], February 2000.

⁶¹⁰ See also F. Calderoni “A New Method for Estimating the Illicit Cigarettes Market at the Subnational Level and Its Application to Italy”, *Global Crime* 15 (2014): 51-76; L. Joossens, *PACTE. Industry and Market Response. Work Package 5. Illicit Tobacco Trade in Europe: Issues and Solutions*, 2011.

Market overview

Data on consumers of illicit tobacco products in Italy are limited. Available research estimate a slight decrease of smokers in the general population between 1990 and 2010 (from 26% to 23%), and, on the contrary, an increase of ITP smokers since 2010 (10% in the first months of 2013, 6.4% in 2012 and 3.3% in 2011.⁶¹¹ The latter present differences in regard to the areas of the national territory: people are more aware of possible health damages in the Northern regions and thus less likely to buy this type of products; less worried and more used to this illicit market are smokers in the Southern regions where individuals, also for the different socioeconomic conditions, turn to ITP more frequently (IT-E3).⁶¹² Furthermore, one expert (IT-E15) has suggested higher levels of use of contraband cigarettes among the juvenile population compared to other age groups, due to lower levels of affordability and awareness of eventual health risks.

As for the expenditure on tobacco products, according to Nomisma,⁶¹³ it amounted to €18.9 billion in 2011, with an increase in value of 3% compared to 2010 (€18.4 billion), and with a 74.5% out of the total corresponding to tax revenue in the same year (€10.9 billion for excise duty and €3.1 billion for VAT). Although prices of tobacco products are not the highest in Italy compared to other EU countries (e.g. the average price of a pack of 20 cigarettes is around €4.58), taxes on tobacco products have constantly and gradually increased during the last years, with repercussions on customers' affordability.⁶¹⁴ The latter has been also undermined by the present economic crisis, affecting mainly lower social classes in which smoking prevalence appears to be higher.

Indeed, the slight but constant decrease in the volume of cigarettes sold starting from 2010 (-1.8% in 2011; -5.3% in 2012 and -6.3 in 2013) can be interpreted as the choice of customers for other tobacco products: from low priced cigarettes (from 0.8% to 2.5% of the legal consumption in the period between January and October 2013), HRT (+47.3% in 2011 compared to 2010), to e-cigarettes.⁶¹⁵

Consistently, some experts (IT-E1, IT-E3, IT-E2, IT-E15) and authors⁶¹⁶ have argued that the increasing tax burden which results in higher prices of

⁶¹¹ Nomisma, *La filiera del tabacco in Italia. Impatto socioeconomico ed aspetti di politica fiscale. XVI Rapporto [The Tobacco Supply Chain. Socio-economic Impact and Fiscal Policy Issues. XVI Report]*, 2012.

⁶¹² See also Transcrime, *European Outlook on the Illicit Trade in Tobacco Products*, 2015.

⁶¹³ Nomisma, *La filiera del tabacco in Italia. Impatto socioeconomico ed aspetti di politica fiscale. XVI Rapporto [The Tobacco Supply Chain. Socio-economic Impact and Fiscal Policy Issues. XVI Report]*.

⁶¹⁴ KPMG, *Project Sun. A Study of the Illicit Cigarette Market in the European Union. 2013 Results*.

⁶¹⁵ Philip Morris Italia, *Audizione di Philip Morris Italia Srl su Accise e Tabacchi [Audition of Philip Morris Italy on Excise Duty and Tobacco Products]*, 2013.

⁶¹⁶ Nomisma, *La filiera del tabacco in Italia. Impatto socioeconomico ed aspetti di politica fiscale. XVI Rapporto [The Tobacco Supply Chain. Socio-economic Impact and Fiscal Policy Issues. XVI Report]*; F. Calderoni, M. Angelini, S. Favarin, *Italy: the Factbook on the Illicit Trade in Tobacco Products 2*; Commissione parlamentare, *Relazione sulla contraffazione nel settore del tabacco [Report on Counterfeiting in the Tobacco Sector]*, 2012; Philip Morris Italia, *Audizione di Philip Morris Italia Srl su Accise e Tabacchi [Audition of Philip Morris Italy on Excise Duty and Tobacco Products]*; Censis, *Nuove regolazioni del mercato dei tabacchi lavorati: le posizioni degli attori, il rilievo economico, l'atteggiamento dei cittadini [New Regulations on the Market of Tobacco Products: Actors Roles, Economic Importance, Citizens Attitudes]*, 2011.

tobacco products represents a significant factor for the presence of the illicit tobacco trade (ITT) in Italy. In this regard, different estimations are available at the national level, although not updated and regular, that underline how the ITT “passed from high levels until the 1990s to very low ones at the beginning of the 2000s”,⁶¹⁷ while starting to increase again in recent years.

In particular, Nomisma⁶¹⁸ has estimated the ITT in the years 2009 – 2010 at about 3.2% of the total legal consumption, corresponding to a volume of 2.8 billion cigarettes, among which 413 million pieces being counterfeited (Table 48). Furthermore, the illegal market value is estimated at €615 million, with €485 million representing the amount of loss in tax revenue by the State. As for the years 2011 and 2012, the incidence of the ITT on the total legal consumption was estimated respectively at 3.3% and 6.4%.⁶¹⁹

TABLE 48. ESTIMATIONS OF THE ILLICIT TOBACCO TRADE IN ITALY. YEARS 2009 – 2010 AND % VARIATION

	2009		2010		2009 – 2010 (average)	
	<i>Cigarettes (millions)</i>	<i>Incidence of legal consumption</i>	<i>Cigarettes (millions)</i>	<i>Incidence of legal consumption</i>	<i>Cigarettes (millions)</i>	<i>Incidence of legal consumption</i>
Counterfeit	305	0.3%	520	0.6%	413	0.5%
Contraband	2.438	2.7%	2.419	2.8%	2.429	2.7%
Illegal market*	2.741	3.1%	2.926	3.4%	2.833	3.2%

* The illegal market does not correspond to the sum of the counterfeit and contraband cigarettes since one pack can produce both law violations at the same time.

Source: Authors' elaboration on Nomisma (2011).

In most recent years, there has been a decline in counterfeit and contraband (C&C) tobacco products “as a share of the total consumption in 2013”⁶²⁰ at the European level, a trend which is in line with consumption at the national level: between 2012 and 2013, both the overall consumption of manufactured cigarettes and of C&C tobacco products decreased from €7.29 billion in 2012 to €3.68 billion in 2013 (-50% drop in consumption), (Table 49). In this regard, several factors have been contended: 1. Additional law enforcement activity in areas recognised of being at risk (streets and ports), and especially in the city of Naples where contraband of cigarettes accounts for the 30% of the national ITT; 2. The withdrawal of “Classic”, heavily counterfeited in Ukraine and becoming increasingly recognised as illicit brand; 3. The

⁶¹⁷ F. Calderoni, “A New Method for Estimating the Illicit Cigarettes Market at the Subnational Level and Its Application to Italy”, *Global Crime* 15 (2014): 51-76, 57.

⁶¹⁸ Nomisma, *La contraffazione delle sigarette in Italia. Presentazione del Primo Rapporto Nomisma [Cigarettes Counterfeiting in Italy. Presentation of the First Report Nomisma]* (Rome: June 2011).

⁶¹⁹ Nomisma, *La filiera del tabacco in Italia. Impatto socioeconomico ed aspetti di politica fiscale. XVI Rapporto [The Tobacco Supply Chain. Socio-economic Impact and Fiscal Policy Issues. XVI Report]*.

⁶²⁰ KPMG, *Project Sun. A Study of the Illicit Cigarette Market in the European Union. 2013 Results*, 10.

effect produced by the introduction of the “super-low” segment that maintaining stable prices have prevented customers to turn to the illicit market (4% of overall market share in 2013).⁶²¹

TABLE 49. TOTAL MANUFACTURED CIGARETTE CONSUMPTION.
YEARS 2009 – 2013 AND % VARIATION 2012 – 2013

Billion cigarettes	2009	2010	2011	2012	2013	2012 – 2013 %
Legal domestic sales (LDS)	89.16	87.05	85.47	78.74	74.04	6
Outflows	-0.92	-0.93	-1.01	-0.93	-0.78	16
Legal domestic consumption (LDC)	88.24	86.12	84.46	77.81	73.25	6
Non-domestic legal (ND(L))	1.46	1.09	1.12	0.84	0.84	1
Counterfeit and contraband (C&C)	3.04	4.55	4.81	7.29	3.68	50
Total non-domestic	4.50	5.64	5.93	8.13	4.52	44
Total consumption	92.74	91.76	90.39	85.94	77.77	10

Source: Authors' elaboration on KPMG (2013).

Besides the price of tobacco products and the role of the economic crisis that may be at the basis of ITT in Italy, other key factors have been underlined: 1. The presence of organised crime groups involved, in particular native ones (see section on market structure and actors), due to the high profits and the low risks of being detected and apprehended, while exploiting consolidated routes used for other criminal activities (e.g. cocaine trafficking); 2. Medium to high levels of corruption; 3. The lack of a national plan to counteract the ITT; 4. The geographical position of Italy as a key destination and transit country for the illicit tobacco trade, especially perpetrated by sea routes.⁶²²

Illegal tobacco products arrive to Italy through three main entry points: the Adriatic Sea, the Tyrrhenian Sea and the Eastern European border (Croatia) reaching the region of Friuli-Venezia Giulia, with Italian ports as the most vulnerable places for smuggling.⁶²³ As indicated by data on seizures provided by the Customs and Monopolies Agency, National Anti-Fraud and Control Directorate for 2012, gathered during the interview and in line with more recent data provided by experts (IT-E1, IT-E2, IT-E5, IT-E3, IT-E8), illicit tobacco products are imported from:⁶²⁴

⁶²¹ Ibidem, A. Greco, “Crolla in Italia il contrabbando di sigarette: -50% nel 2013” [Cigarettes Contraband Collapse in Italy: -50% in 2013], *La Repubblica*, June 2014.

⁶²² F. Calderoni, M. Angelini, S. Favarin, *Italy: the Factbook on the Illicit Trade in Tobacco Products 2*.

⁶²³ Transcrime, *European Outlook on the Illicit Trade in Tobacco Products*; Commissione parlamentare, *Relazione sulla contraffazione nel settore del tabacco [Report on Counterfeiting in the Tobacco Sector]*.

⁶²⁴ It is specified that: the port of Ancona is situated in the region of Marche (Central Italy) on the Adriatic coast; the port of Bari in the region of Apulia (South of Italy) on the Adriatic coast; the port of Gioia Tauro in the region of Calabria (South of Italy) on the Tyrrhenian coast; the port of Genoa and La Spezia in the region of Liguria (North West of Italy) on the Tyrrhenian coast; the port of Trieste in the region of Friuli-Venezia Giulia (North East of Italy) on the Adriatic coast; the port of Naples in the region of Campania (South of Italy) on the Adriatic coast.

- Eastern European countries such as Montenegro, Moldavia, Romania, Bulgaria, by land routes and reaching the city of Trieste;
- Eastern European countries such as Montenegro and Albania to the ports of Venice, Ancona, Bari;
- Greece to the ports of Venice, Ancona, Bari;
- United Arab Emirates to the port of Gioia Tauro and Saudi Arabia to the port of Genoa;
- Northern African countries such as Egypt reaching the ports of Trieste and La Spezia;
- China to the port of Genoa, Taranto, Naples.

In particular, contraband cigarettes seized by regional and provincial custom agencies amounted to a total of 12,357,031 packs in 2012, imported mainly from Greece (5,498,383 packs), United Arab Emirates (2,227,754 packs) and Egypt (1,944,709 packs), hidden in container shipments carrying other legitimate or counterfeit products. The highest quantity remains on the national territory (4,378,680 packs), while the higher volumes are further exported to Montenegro (1,960,000 packs), Greece (1,800,300 packs), Belgium (739,490 packs) and Germany (687,430 packs).⁶²⁵ Lesser quantities are also exported to the United Kingdom (IT-E7, IT-E8, IT-E2, IT-E1). Once ITP reach the national territory, the major destination areas are the regions of Lombardy, Apulia, and Campania, with the latter considered to be the place more frequently used to sort, storage and distribute the merchandise at the wholesale and retail level (IT-E10, IT-E9, IT-E19).

TABLE 50. MAIN CIGARETTES BRANDS CONFISCATED AT CUSTOMS IN 2012

Brands	No. of packs	% total
Gold Classic	2,099,732	17.0
Ronhill	1,978,480	16.0
Capital	922,915	7.5
Gold Mount	895,254	7.2
Raquel	877,100	7.1
Richman	828,330	6.7
Jin Ling	509,580	4.1
Brooks	500,00	4.0
Marlboro	439,653	3.6

Source: Authors' elaboration on Customs and Monopolies Agency, National Anti-Fraud and Control Directorate (2012).

Among the different types of ITP, Italy has been recording high growth of illicit whites, especially starting from the 2000s (IT-E14, IT-E15, IT-E1). In 2010, 106 tonnes out of a total of 280 contraband cigarettes seized; while in 2011, 141 tonnes out of 240 of contraband cigarettes seized.⁶²⁶ Furthermore, one expert (IT-E15), reported for the first semester of 2013, a 75.5% of illicit whites seized in the national territory. In 2012, main brands of illicit whites intercepted at customs have been Gold Mount, Raquel, Richman, Jin Ling, together with other legal brands (Table 50).

At the same time, as pointed out by some experts (IT-E1, IT-E15)

⁶²⁵ Data provided by the Customs and Monopolies Agency, National Anti-Fraud and Control Directorate during the interview with the appointed expert and referring to 2012.

⁶²⁶ Commissione parlamentare, *Relazione sulla contraffazione nel settore del tabacco [Report on Counterfeiting in the Tobacco Sector]*.

new type of tobacco products have entered the national market during the last years. These are produced by tobacco manufacturers to be sold online to companies, mainly located in Eastern Europe, that in turn supply duty free shops. This trend resembles to one of the 1990s and 2000s when Switzerland was used to sell cigarettes in virtue of legal licences to Montenegro, that once imported were further diverted to Italy through maritime transportation (via motorboats), (IT-E1, IT-E15). Indeed, in 2014, a major case involved an Italian tobacco manufacture, named Yesmoke (situated in the municipality of Settimo Torinese, region of Piedmont), that was seized because of suspected €70 million of evaded taxes for cigarette contraband through fictitious exportations carried out among EU and extra EU companies.⁶²⁷

Market structure and actors

The illicit tobacco market in Italy is particularly fragmented into the interplay of various actors: from native OCGs (the Camorra, the Sacra Corona Unita, and to a lesser extent the 'Ndrangheta and Cosa Nostra) and foreign OCGs, to more or less organised criminal organisations (mainly foreigners) and individuals, (IT-E10, IT-E9).⁶²⁸

As contended by one expert (IT-E2), at present the illicit tobacco trade seems to be characterised by the territory in which criminal organisations are settled within the country: 1. The regions such as Campania and Apulia, where the more traditional and historical Italian OCGs (respectively the Camorra and the Sacra Corona Unita) reside, structured more as oligarchic organisations with a clear definition of tasks and duties among members; 2. Criminal organisations, mainly of Eastern European origin, with members located in metropolitan areas (e.g. cities of Milan, Turin, Rome) acting as points of reference and controlling from 5 to 15 affiliates. These criminal entrepreneurs, characterised by different roles and *modus operandi* within the ITT, may either collaborate or act as solo criminal entrepreneurs.

In the first case, it is then possible for larger networks to be formed in virtue of business opportunities and type of relations among smugglers (i.e. stable vs. occasional), (IT-E1, IT-E5, IT-E3, IT-E7, IT-E19).

“In our investigation we started from a small Polish group, but soon we discovered different groups all connected and already knowing each other in virtue of previous joint ventures and/or mutual support (e.g. a group needs a courier/a mean of transport and ask to members of the other groups). A real network” (IT-E1). “The [same] investigation revealed the involvement of 301 individuals of the following nationalities: Italian,

⁶²⁷ M. Peggio, “Sequestrato per contrabbando lo stabilimento Yesmoke di sigarette a Settimo Torinese” [Seized Yesmoke Company in Settimo Torinese for Cigarettes Contraband], *La Stampa*, November 2014. It is underlined that the tobacco manufacture Yesmoke has been recently reopened by the owners. For further information on this case see also D. Turrini “Smokings, docufilm su azienda che sfidò i big del tabacco. Ma proprietari in cella [Smokings, Documentary on the Company that Challenged the Tobacco Big Manufacturers. Owners in Jail], *IlFattoQuotidiano*, December 2014.

⁶²⁸ See also F. Calderoni, “A New Method for Estimating the Illicit Cigarettes Market at the Subnational Level and Its Application to Italy”; F. Calderoni, M. Angelini, S. Favarin, *Italy: the Factbook on the Illicit Trade in Tobacco Products 2*; Commissione parlamentare, *Relazione sulla contraffazione nel settore del tabacco [Report on Counterfeiting in the Tobacco Sector]*.

Greek, German, Russian, Ukrainian, Polish, Moldavian, Kazakh, Bulgarian, Slovak, Romanian, Latvian and Argentinian".⁶²⁹

Loose and fluid networks of variable dimensions exist within the national illicit tobacco market, in order to share costs and risks of tobacco smuggling operations among groups, diversify routes of trafficking, and provide mutual support. Although participating in joint ventures, these groups tend to remain separated because they are in charge of and specialise in each distinct phase of the smuggling operations. Indeed, individuals operating within these networks carry out specific and distinct tasks: transportation (e.g. couriers, drivers), unloading (unloaders, dockers), storage (warehouse keepers), selling (wholesalers and retailers), payment (intermediaries, couriers). The aim is to avoid reciprocal knowledge as to guarantee the safety of groups involved (IT-E14, IT-E1, IT-E2, IT-E5, IT-E11). For this reason, some experts have underlined the key role of intermediaries (IT-E1, IT E-7), useful to connect potential buyers and suppliers, and guaranteeing for the deal. Furthermore, their strategic function is to ensure constant contact among the groups involved, as well as the arrival of the products, being usually located in the destination areas (both in Italy and other EU countries).

"Intermediaries are key persons, functioning as trusted linkages among groups. They are useful to keep contacts with couriers transporting ITP that in many cases do not know the Italian language. The Neapolitan buyer, for example, would have problems in being acknowledged about variations occurred (e.g. delays in delivery, change of routes due to police control), so there is the need of persons able to communicate with both sides of the operation. During the last years and in regard to cases of collaborations between Camorra clans and Ukrainian criminal entrepreneurs, we have detected Eastern European intermediaries residing in Naples representing the *trait d'union* between the two groups" (IT-E1).

In the second case, criminal organisations present a more 'centralised' structure and are based on familial, kinship or ethnic bonds. The bosses are usually the financiers and the organisers of the entire smuggling operations with direct contacts with suppliers. Roles and duties are extremely separated among members and are functional to carry out all the necessary phases of trafficking as well as to avoid the circulation of information, reducing in this way the risks of apprehension. At the same time, other external individuals are recruited to perform specific tasks (IT-E3, IT-E18, IT-E5).

"We detected a group presenting an oligarchic structure, capable to perform all the necessary steps to accomplish tobacco smuggling operations. At the top level there were three Ukrainian bosses investing equal capitals to purchase the ITP. Among them, one was in charge of logistics, one of transportation, and one of finding couriers for further distribution throughout the national territory. Individuals of the same

⁶²⁹ Trentino Corriere Alpi, *Traffico illecito di sigarette lungo il Brennero, maxi sequestro della Finanza Illicit Cigarettes Trade Through the Brennero Route, Huge Seizure of Guardia di Finanza*, January 2015.

nationality were also recruited in Italy in order to identify warehouses, recover vehicles for transportation and contact possible clients” (IT-E3).

High/middle and low segments are active within the national illicit tobacco market which are characterised by different scale of tobacco smuggling operations, nationalities of smugglers, countries of origin of ITP and *modus operandi*. In particular, high/middle segments include both native and foreign OCGs that organise large scale smuggling operations, manage production and/or importation of huge quantities of tobacco products and their further distribution throughout the national territory and to other EU countries. Low segments, involve small groups (more or less organised) or solo criminal entrepreneurs mainly of foreign origin, that arrange small importations of ITP to be further sold especially to compatriots.

Importation and wholesale levels

High/middle segment – large scale smuggling operations

At this level, both native and foreign OCGs are active within the national illicit tobacco market exercising different roles. As pointed out by the majority of experts (IT-E15, IT-E17, IT-E18), Camorra clans located in Naples are nowadays the criminal entrepreneurs that import huge quantities of ITP, while at the same time controlling strategic areas of arrival and transit, and the further distribution within the national territory. “34.3% (more than 115 tonnes) out of the total illicit tobacco seizures occurred in Italy in 2013 was registered in the region of Campania” (IT-E15). In particular, the Camorra imports illicit tobacco products collaborating with the Sacra Corona Unita and the ‘Ndrangheta (to a lesser extent), and with other groups of smugglers from China, the former Soviet Union (Russia, Georgia, Belarus), Eastern Europe and Greece. Collaborations with Maltese and Turkish criminal entrepreneurs, although in minor cases, are also present (IT-E7, IT-E8, IT-E1).

Support from Italian OCGs is obtained having at disposal strategic ports (such as Bari and Brindisi on the Adriatic coast and Gioia Tauro on the Tyrrhenian coast) where tobacco products arrive from Eastern European countries, China and Russia. The Sacra Corona Unita especially, controls the arrival of container shipments and cooperates with Camorra transporting the merchandise by land (e.g. vehicles, lorries) to warehouses located in the region of Campania (especially in the city of Naples); while at the same time being involved in national distribution as well (IT-E17, IT-E2).

Camorra clans are also in contact with groups of Neapolitan smugglers (made of 5 up to 15 members), named “paranze”, active in the areas of Naples and in the nearby provinces as well as in the region of Apulia (IT-E16, IT-E15). The latter manage tobacco smuggling operations independently, importing ITP from Eastern European countries, although submitted to the permission of Camorra clans for both operating and selling. While, on the one hand, Camorra families may also finance these

tobacco smuggling operations, on the other (and in more recent times), they have started to charge smugglers with payments per each master case entering these local illicit markets (IT-E15, IT-E2).⁶³⁰

Similarly, collaborations between the Camorra and foreign criminal entrepreneurs such as Chinese, Russian, and Eastern European (Romanian, Ukrainian, Moldavian, Polish, Bulgarian, Hungarian, Slovak), are fundamental in order to purchase and import ITP. Indeed, as underlined by some experts (IT-E1, IT-E7, IT-E10, IT-E14), in most cases the latter manage production, importation, storage and final delivery of contraband cigarettes to the former. For example, joint ventures with Chinese OCGs exist as to import to Italy huge quantities of counterfeit cigarettes. Indeed, these groups own and manage illegal factories (almost 80% located in the provinces of Guangdong and Fujian) producing counterfeit tobacco products directed to Italy via container shipments and further introduced into the illegal national market in virtue of the cooperation with Camorra clans (IT-E14, IT-E4, IT-E1, IT-E15). Nevertheless, counterfeit cigarettes are not intended for the Neapolitan illicit market, being instead subsequently diverted to the cities located in the Northern regions (e.g. Lombardy, city of Milan). As suggested by one expert (IT-E15), “Neapolitans smoke good quality cigarettes being able to discern among products. They do not smoke Chinese brands, which indeed are not present in their illegal local markets”.

Eastern European criminal organisations either collaborate with Camorra clans or act as autonomous groups of smugglers cooperating with each other. In particular, these groups produce illicit whites and, in many cases, import them to Italy together with contraband cigarettes. While in their countries are also in charge of storing ITP coming from Russia and China, in Italy they mainly supply Camorra families and other groups of similar origin. Furthermore, these groups act as importers, brokers (mediating between Italian buyers and Eastern Europe suppliers), warehouse keepers and transporters for the former.

“We have detected a group of Moldavians active in the area of the city of Pesaro [central Italy] with intermediaries settled in Greece. Tobacco products were transported by ships to the port of Ancona and from there by lorries to the city of Pesaro to be stored. The loads were intended for a Camorra clan, revealing strong links among these groups. The latter are always present, together with the Sacra Corona Unita. Furthermore, Camorra clans have also contacts with Ukrainian and Polish criminal groups that import ITP from Romania and Hungary” (IT-E7).

With regards to the role of Eastern Europe criminal entrepreneurs within the illicit tobacco national market, experts (IT-E1, IT-E2, IT-E7, IT-E17, IT-E18) agree that these entrepreneurs need, in the initial phase of smuggling (dated back to the beginning of 2000s), to establish alliances with Italian OCGs and in particular the Camorra as to operate within the

⁶³⁰ As suggested by one expert (IT-E15), this practice has a long history, being in use since the beginning of this type of illicit activity. Indeed, Raffaele Cutolo, one of the main bosses of the Nuova Camorra Organizzata involved in tobacco smuggling used to charge €2.50 per each master case.

national territory. Nevertheless, at present, it seems that these organisations have been able to open independent channels of importation and further distribution. For example, Ukrainian, Polish, Moldavian, Hungarian and Slovakian, that have been settled in Italy for a long time, have gradually acquired prominence, visibility and credibility as to establish themselves at the top levels of the smuggling chain. “Criminal groups from the Eastern Europe (Ukrainian, Polish, Moldavian) started to appear in the national illicit tobacco market around 2005/2006. From that time, they have developed and rooted rapidly” (IT-E1). Indeed, in the hinterlands of different Italian metropolitan cities, the ITT is now managed by the same ethnicities assisted by Arabs recruited for minor tasks (e.g. retail selling), (IT-E2).

In general, as explained by one expert (IT-E2), OCGs and more organised crime groups adopt a common step by step *modus operandi* in order to organise and carry out tobacco smuggling operations: 1. Arranging initial contacts with foreign suppliers to verify availability of the merchandise, quantity, quality and price; 2. Starting negotiations through coded messages or cryptic languages. “We have intercepted a Greek smuggler owning 50 mobiles and phone cards using them randomly, and another Italian smuggler from Apulia that used to discard his mobiles after every 7 calls. He would then communicate from a public telephone box changing alphanumeric codes to transmit his new numbers” (IT-E1); 3. Organising procedures for the illicit transportation; 4. Recovery and storing in temporary warehouses; 5. Distribution through retail markets.

Importation of ITP to Italy occurs through container shipments or lorries depending on whether suppliers are respectively Chinese, Russian or Eastern European used to deliver huge quantities of tobacco products. In both cases, the latter may be transported together with other commercial goods (e.g. pieces of furniture, animal food cans, engine tanks, vegetables) or counterfeit products (e.g. clothes, shoes, gabs, accessories) especially when Chinese groups are involved, or hidden in the interspaces of transports (IT-E2, IT-E7, IT-15, IT-E5). “I suppose that the use of vegetables, for example, reside in the similarity of weight compared to ITP, alternatively the use of cold storages depend on the impossibility for customs to control without products getting altered” (IT-E14).

“At some point of our investigation we detected a supplier working with criminal entrepreneurs in Naples. He was a Kazakh with a Greek passport supplying huge quantities of illicit tobacco to Italy recovered from Southern East Asia and Bulgaria. He used to take care of the consignment of the merchandise: illicit cigarettes were unloaded in the port of Brindisi, Bari, Ancona accompanied by fake dispatch notes declaring as final destination the North of Europe. In practice, once cigarettes were unloaded, dispatch notes were replaced by the intermediary of the Kazakh-Greek smuggler reporting the city of Naples as final destination.

The Kazakh-Greek smuggler has delivered many loads this way, organising the transportation of illicit cigarettes that were hidden in container shipments together with several and different commercial products. His

criminal organisation in Greece is rooted and wide, and linked to numerous compliant transportation companies” (IT-E1).

Thus, in order to transit through customs, dispatch notes are falsified in terms of products, quantity and destination. At the same time, container shipments for example, are more likely to cross several different transshipment spots (among countries and in a same country) as to hide the origin of the merchandise (IT-E7, IT-E1, IT-E8). In other cases, smuggling is facilitated by the direct control of OCGs of strategic delivery spots, as it is for Chinese groups in the port of Taranto (region of Apulia), and Camorra clans in the ports of Naples and Salerno (region of Campania), (IT-E1).

Companies that provide commercial products to hide ITP, as well as transportation services are owned by smugglers (usually registered to straw men), or compliant individuals. “We have discovered cigarette packs hidden in the structure of wooden doors, made for sure by a colluding factory since introduced during the production cycle” (IT-E1). In other cases, transportation can be managed either by unaware companies exploited by traffickers, or holdings acting as filters to hide the identity of criminal entrepreneurs which are the effective owners and organisers of the smuggling operations (IT-E14). As for transporters (e.g. truck drivers), some experts agree that unaware individuals are not the rule (IT-E2, IT-E1, IT-E14).

Eastern European criminal organisations (e.g. Ukrainians) also import ITP employing cars (with double-bottoms) and vans, transporting larger numbers but separate loads (around 40 kilos up to 5,000 kilos in total), decreasing this way the likelihood of interception of all the merchandise. “This Ukrainian group was used to import huge quantities of contraband tobacco through high-powered cars (Mercedes, BMW). Loads left from the city of Chernivtsi in Ukraine, crossing the Romanian customs thanks to complicit officers. Using outriders (in some cases couches transporting unsuspected Ukrainian citizens coming back to Italy for work), the loads of tobacco reached the hinterland of the city of Milan to be further stored in rented garages run by affiliates” (IT-E3).

Corruption of customs officials is considered by some experts (IT-E1, IT-E15, IT-E7) to represent a means used by smugglers to run tobacco smuggling operations smoothly. Cases of corruption have been identified pertaining both to Eastern European and Italian officials. The latter, indeed, may facilitate importation of contraband tobacco products either by avoiding controlling suspected loads, or approving irregular dispatch notes.

Once ITP reach the Italian territory, loads are then divided into smaller ones and transported by cars, vans, campers, lorries (carrying from 100 kilos [100 master cases] to 9,000 kilos [900 master cases]) by recruited couriers or lorries to be stored in huge quantities in warehouses located in the Northern and Central regions as to avoid the risks of police seizures. From these locations, the smuggled tobacco is subsequently delivered to the main distribution areas for retail selling (IT-E15).

Low segment – small scale smuggling operations

At this level of operation, the illicit tobacco trade appears more fragmented involving different smugglers either linked to small criminal groups or acting as solo criminal entrepreneurs. Again, a prominent role is exercised by Eastern European (Belarusians, Ukrainians) but also North Africans (Egyptians, Senegalese)⁶³¹ transporting ITP in lesser quantities (i.e. bootlegging), and selling them mainly to circumscribed circles of customers, that are usually compatriots, family members or friends.

“In the city of Bologna we detected an inside man working for an Ukrainian and Moldavian group. His clients were 99% Ukrainians living in the area. Cigarettes were sold to acquaintances, friends and relatives that were used to make orders. In some cases he would deliver the cigarettes, in other clients would come to pick them up” (IT-E1).

More generally, these actors purchase small quantities of tobacco products (exceeding the legal limits) in other countries exploiting differences in prices among countries. The merchandise can be transported by land, air or sea, hidden in travelling bags or suitcases. The following examples have been reported:

- East European (e.g. Ukrainian, Romanian) exploiting legitimate travels and means of transport (e.g. coaches and minibuses) to import ITP (hidden in bags) together with passengers, luggage containing personal belongings and other goods. An example is the importation by Ukrainians of contraband cigarettes/illicit whites through trips made by caregivers from their home country to Italy (IT-E4).
- Egyptian individuals travelling with many bags from Egypt to Italian airports importing cigarettes of foreign (produced in their country) and EU brands acquired at a very low price compared to Italy. The products are sold to country-fellow men. The same method is used by Eastern European importing cigarettes with EU brands (IT-E6).

Retail level

At the retail level, the illicit tobacco trade in Italy is characterised by the coexistence of different markets related to the type of actors involved (i.e. OCGs/criminal groups, solo entrepreneurs) and areas within the country (North, Centre and South). “Retail selling could be defined as South and North models, with a prominent role of Camorra in sorting loads and directing them to Southern and Northern markets on the basis of the quality of ITP” (IT-E1).

In the regions of Campania and Apulia, the presence of Italian OCGs (Camorra and Sacra Corona Unita) has brought to the creation of open

⁶³¹ It has been pointed out by one expert (IT-E10) that the *modus operandi* of North Africans (i.e. Senegalese) may also include the use of container shipments. Indeed, they import small quantities of cigarettes using luggage of couriers travelling by plane, or they introduce illicit tobacco in Italy through shipping the products via ship cargos. The latter may also transport other counterfeit products, foodstuffs, medicines, commercial goods and typical African products in the same loads.

markets where illicit tobacco products are sold in the streets. The city of Naples is an example of stalls selling contraband cigarettes and located in different neighbours where individuals are recruited for this purpose, performing work shifts. This illicit widespread market has become almost a “normal” commercial activity especially for inhabitants (IT-E15).

“Once the groups of Neapolitan smugglers (paranze) have introduced the illicit tobacco in the national territory, they get in contact with wholesalers (named ‘bozzatori’) that in turn supply stalls where the retail distribution occurs. In some cases, it is wholesalers (bozzatori) that manage stall networks. Clients are mainly Neapolitan aware and used to this market and able to recognise quality illicit tobacco products” (IT-E15).

At the same time, contraband cigarettes are sold in private apartments known by customers. A similar method of selling is carried out by Eastern European individuals (e.g. Ukrainian, Moldavian, Romanian, Polish) in the Northern parts of the country, although illicit cigarettes can be found hidden in cars/vans in daily/weekly ethnic markets where they sell other commercial products as well. Clients are either family members, friends, acquaintances, residing in the same areas, or North Africans (e.g. Egyptians). These covert markets are present mainly in the North of Italy, that is areas not controlled by Italian OCGs and corresponding to the ones where higher presence of Eastern European citizens is registered, functioning as networks of retail distribution. Examples are the markets of Cascina Gobba and Molino Dorino in the city of Milan or Porta Palazzo in the city of Turin (IT-E4, IT-E5).

Financing and financial management

Financing and financial management depend on the criminal entrepreneurs involved in tobacco smuggling and the scale of operations. Due to the interplay of very different actors within this market, start-up capital to initiate and sustain the trafficking may come from illegal and legal sources and from personal savings as well. At the same time, besides OCGs (as for example the Camorra), a common characteristic of smugglers structured in smaller and less organised crime groups is the involvement only in this type of illegal activity where they are able to consolidate their criminal career, while guaranteeing this way not only huge profits but also constant financing of smuggling operations.

Sources of capital for tobacco trafficking and profiles of financiers

Illegal sources of financing and criminal careers

Italian OCGs organising tobacco smuggling operations (the Camorra and the Sacra Corona Unita) are, due to their criminal background and profile, involved in other criminal activities. In the case of the Camorra some experts (IT-E1, IT-E15) have underlined the coexistence of different organised crimes being perpetrated that range from drug trafficking, extortions, loansharking, counterfeiting. All of them represent sources of financing of the illicit tobacco trade, which in turn provides capital to

be further reinvested. “It is more likely that the Greek smuggler would have €300,000 in cash to be reinvested in other tobacco smuggling operations” (IT-E1). Similarly, Chinese crime groups finance tobacco smuggling operations with profits gained from counterfeiting (IT-E15, IT-E2, IT-E3, IT-E1).

In general, these OCGs are able to finance and sustain the trafficking without turning to external financiers. Furthermore, capital acquired may also constitute a source of investment into other criminal activities. For example, Camorra clans lend money to persons or families in need through what is called ‘neighbourhood loansharking’: “This system exists only in the city of Naples where smugglers with availability of money lend small sums of money to individuals for their ordinary expenses (e.g. €500 to the lady that has to pay gas or phone bills). They are mainly acquaintances, paying back at high interest rates to affiliates in charge of collecting the loaned sums of money” (IT-E1).

Nevertheless, in most cases criminal entrepreneurs involved in the illicit tobacco market, whether more or less organised, invest capital exclusively in tobacco smuggling operations. As pointed out by one expert (IT-E1), only in very few cases smugglers may decide to join drug trafficking. The majority starts with tobacco and remains in this market where they develop their criminal careers. At the basis of this choice, there are both practical reasons as well as ethical and moral motivations. On one side, the nature and the dynamics of the two markets are different (e.g. origin and prices of the product, routes of smuggling, type of customers), (IT-E3). On the other, smugglers perceive drug trafficking as a real criminal activity, more risky and with a higher social impact. In their opinion, tobacco smuggling regards legal products sold by the State, thus consisting in committing a minor crime, tax evasion mainly. The “not to blame” perception of their role within this market is well explained by an Italian high profile ex smuggler as follows:

“I am a much respected person. Everyone loves me and is respectful since I am a brave man. Gifted with uncommon courtesy and elegance. I cannot say to be a saint, but in my feelings, I could say to be a saint criminal. Circumstances made me lead my life according to society rules, for which I am a criminal, but my spirit is more similar to the one of a benefactor”.⁶³²

Thus, when smugglers are at the beginning and in need of initial capital turn to external financiers either belonging to the criminal milieu or legal entrepreneurs.

“In different cases, we have detected the participation of external financiers, facilitated by acquaintances in contact with the criminal organisations or thanks to the action of intermediaries. These individuals are not involved in tobacco smuggling operations, although investing capital coming from other illegal activities (e.g. drug trafficking, frauds,

⁶³² F. Capececiatro, *Lo spallone. Io, Ciro Mazzearella, re del contrabbando [The Smuggler. Me, Ciro Mazzearella, King of Contraband]*, (Milan: Mursia, 2013), p. 51.

gambling, counterfeiting) and receiving the invested money back plus lump sums or alternatively agreed cents per each carton or pack sold" (IT-E15).

Italian OGCs, both the Camorra and the Sacra Corona Unita, employ a system called "puntate", dated back to the 1980s and 1990s, to gather the amount of money required among different external financiers (IT-E1, IT-E7, IT-E17, IT-E15). Indeed, during these years in the region of Campania and in particular in the city of Naples, before the arrival of the load from Montenegro, smugglers were used to visit different important and wealthy families and to collect the money on the basis of the quantity ordered to be further carried to Switzerland. Once cigarettes were recovered, they were distributed among families on the basis of the initial investment. The families would have then sold the products and kept the profits (IT-E7). Similarly, in the city of Brindisi (region of Apulia) a virtual bank was created by smugglers where different individuals external to the operations invested money that was subsequently used to buy contraband cigarettes. The invested capital was periodically returned with accrued interest (IT-E1). Nowadays, as explained by one expert (IT-E1) a similar method exists, since regarding customers anticipating the sums of money needed to purchase the loads of tobacco:

"At present in the city of Naples, there is a form of 'call-up' financing, consisting in previous agreements between wholesalers and customers on the quantity of master cases to be ordered. The latter would proceed with anticipated payments, while the former would contact suppliers. It is a sort of capital collecting" (IT-E1).

A similar specialisation has been pointed out by experts for Eastern European smugglers as well (IT-E9, IT-E1, IT-E3, IT-E6), that at present sustain tobacco smuggling operations mainly investing profits gained. Indeed, financiers are members of the criminal organisation, usually at the top levels, that in most cases are not involved in the operations, and may reside abroad in the countries of origin. Nevertheless, at the initial stage, source of financing may be acquired committing minor crimes such as thefts of vehicles, commercial products, thefts in apartments, robberies, credit card frauds. For example, Polish, Ukrainian, and Moldavian criminal entrepreneurs were used to perpetrate cars thefts to gather start-up capital, since implying low initial costs (e.g. number plates and documents) and allowing consistent earnings: "A stolen car in Ukraine can be sold at €20,000" (IT-E1). Once the business is thriving, sources of financing come exclusively from illicit tobacco trade. At the same time, some groups start with small tobacco smuggling operations, being able in short time to expand their illicit activity as to have no need of other sources of capitals besides the profits acquired.

"During our investigations we detected a group of Moldavians composed of seven members that have started to smuggle tobacco carried in bags and suitcases during coach trips on the route Romania-Italy. After a period of time, we intercepted the same group smuggling 1 tonne and 800 kilos of contraband cigarettes hidden in marble slabs and transported by lorry" (IT-E1).

Legal sources of financing

While during the first period of the tobacco illicit trade in Italy (1990s – 2000s) criminal entrepreneurs used to be involved solely in this market, at present the engagement in both legal and illegal activities characterises the *modus operandi* of smugglers, in particular belonging to high-middle segments. The latter are active mainly in running trading businesses (pubs, import-export/construction/food companies), that may either represent start-up capital to enter the illicit tobacco market or a continuous source of financing (IT-E1, IT-E3, IT-E7). Indeed, in the first case, one expert (IT-E3) described an Ukrainian criminal group financing tobacco smuggling operations in the initial phase with proceeds gained in running a construction company, dismissed once the trafficking have started to grow allowing for illegal capitals to be invested. In the second case, the strict co-existence of legal and illegal activities was mentioned (IT-E3) in regard to an Egyptian group, owning and managing a café in the city of Milan, where clients could smoke the smuggled tobacco using narghile.⁶³³ At the same time, if on one side legal activities are functional to hide tobacco smuggling operations and laundering profits, on the other they allow entrepreneurs to benefit from EU funds for the sustainment and implementation of the businesses, that in turn may be employed into the tobacco trade: “In one investigation we have detected a lorry truck coming from Ukraine transporting loads of illicit tobacco intended for an Italian company. It then resulted that, to acquire the illicit tobacco products, the owner had used funds received from the European Commission” (IT-E2).

Financial joint ventures

Besides the cooperation among groups of smugglers (Italian and foreign OCGs, more or less organised criminal organisations) in relation to each phase of the tobacco smuggling operations, joint ventures can be formed aimed at gathering capital to purchase products, sustains costs and increase profits. These alliances regard both high and low segments and are functional to enter the market at first as well as to sustain the illicit activity over time. Furthermore, they can be formed in virtue of previous and well-tested business relations, temporary agreements concerning single tobacco smuggling operations, or contacts provided by intermediaries (IT-E15).

Depending on cases financial partnerships can involve Italian OCGs, foreign criminal entrepreneurs of East European origin (e.g. Ukrainians, Polish and Moldavian), or Italians and Eastern Europeans (e.g. the Camorra and Ukrainians or Russians). For example, in the region of Campania, small groups of smugglers operate together with Camorra clans providing financial resources to acquire the tobacco products. The latter, although remaining external to the different phases of the smuggling operations, only purchase the merchandise that is indeed distributed by smugglers both at the wholesale and retail level. In the

⁶³³ Water-pipe.

end, Italian OCGs receive the revenues and smugglers are paid for the service provided with profit margins. Capital acquired, in line with this well-tested collaboration, is then invested for subsequent tobacco smuggling operations (IT-E2).

These financial joint ventures among criminal entrepreneurs based, in most cases, on reciprocal trust and knowledge, are not only functional to finance tobacco smuggling operations, but also to preserve smugglers from situations where capitals are lacking or from different unexpected episodes (see next section). Indeed, although the use of violence among partners does not emerge as a typical trait of this illicit market, retaliations can occur when agreements are not respected or trust is betrayed as to re-establish own control and reputation: "In 2000, we have assisted to a dispute settlement among smugglers in the city of Brindisi resulting in three homicides due to a failed tobacco smuggling operation involving all of them" (IT-E17). At the same time, since criminal organisations may, in some cases, operate in other criminal markets, financial joint ventures allow for capital compensation, that is the possibility to partly repay back financiers through other valuable illegal goods (e.g. counterfeit products, drug, arms) when, for example, occurs a delay in the selling of tobacco products.

Settlement of payments

Compared to other criminal markets (e.g. cocaine), the illicit tobacco trade is usually managed by smugglers active at all the levels of the operation (high/medium and low) through a common scheme of payment which is cash-up front (IT-E2, IT-E1, IT-E5, IT-E3, IT-E6, IT-E7, IT-E16, IT-E15, IT-E13). In this regard, some experts (IT-E1, IT-E3) have underlined two main reasons: a general lack of trust among smugglers characterising this illicit market and the necessity for suppliers to avoid the risk of remaining unpaid (i.e. critical moments, or the impossibility to sell all the merchandise).

In one case, for example, although cash up-front payment was agreed between two groups of smugglers (Italians from the Centre of Italy and Polish) operating through the intermediation of Neapolitan criminal entrepreneurs (residing in the region of Campania), a particular form of guarantee was requested by the Polish suppliers. Since tobacco products were imported through fictitious transactions of glasses, an export international credit was opened via bank services, thus assuring the payment of the products (i.e. tobacco) via legal bank transfer in case of problems. "Neapolitans were in charge of recovering the loads at customs, probably corrupting some officials, and of the consignment in a nearby area. Actually, at delivery tobacco was paid cash up-front with the guarantee remaining unused, but if, for example, Neapolitans were not able to recover the load, suppliers would have still been paid. The loss was Neapolitans' responsibility, not of Polish suppliers" (IT-E1).

Exceptions exist to this general scheme, which are revolving credit and part payment arrangements (IT-E7, IT-E15, IT-E1). Nevertheless, when

the tobacco is not paid cash up-front, smugglers may in some cases ask for the anticipated payment of the entire loads, especially at the initial phase of the business relationship where trust and credibility are yet to be built, thus functioning as a form of guarantee of the smuggling operations (IT-E2, IT-E19). Consistently, one expert (IT-E2) has underlined how this type of arrangement has appeared in more recent times due to the economic crisis, which in turn can impact on the possibility to sell all the tobacco products acquired, or to repay back suppliers rapidly.

Revolving credit and part payment arrangements

Revolving credit and part payment schemes are agreed among buyers and suppliers during the negotiation phase (definition of quantity, price, time and place of delivery) that precede tobacco smuggling operations. At this point, responsibilities in regard to the loads smuggled are also decided as to prevent retaliation in case of unexpected circumstances (IT-E15).

In particular, the first type of agreement consists in the possibility to receive the tobacco products and to pay suppliers after selling, while the second is based on multi-step payments usually carried out as follows: part during the negotiation phase to demonstrate the commitment and reliability of buyers, another part before sending tobacco products as to cover logistic expenses, and a final part when loads are delivered (IT-19, IT-17, IT-E5, IT-E6).

As underlined by some experts (IT-E1, IT-E15, IT-E7), these settlement of payments are used only when trust characterises the business relationships among criminal entrepreneurs or when groups detain solid credibility within the illicit tobacco market, as this is the case for example of Camorra clans (IT-E1, IT-E15).

“A Greek smuggler was used to come to Italy together with the loads of cigarettes. He then stayed in Naples two or three days waiting to collect the money after the selling by Neapolitan buyers. In other cases he would employ couriers for this purpose, while if difficulties occurred, the Greek would allow the purchase on credit also of huge quantities of cigarettes since these smugglers have been knowing each other for a long time. In two occasions Neapolitans faced problems in selling the merchandise quickly (2 or 3 days) to wholesalers and the Greek went back to Greece waiting for the payment to arrive later” (IT-E1).

Furthermore, revolving credit or part payment arrangements are also facilitated by the difference in prices of illicit tobacco products between countries of suppliers and buyers. Indeed the former can purchase the merchandise at a very low cost, without the need to make considerable investments (IT-E15).

Methods of payment

Illicit tobacco products are paid mainly in cash, and in few instances using other legal methods (when tobacco is transported with other commercial products in container shipment) or exchanging valuable goods (form of compensation between groups as for example the payment of a consignment of drugs in a subsequent moment with quantities of tobacco of equal value), (IT-E1). In both high and low segments, specific actors are in charge of facilitating the payment process.

Cash settlements of payments

The most used means of payments is cash, either at delivery or after having sold the tobacco products on an agreed time scale among smugglers. Cash is less detectable, transfers are harder to be reconstructed by law enforcement and in case of apprehension couriers do not encounter heavy consequences. Consistently, as it occurs within cocaine trafficking, one expert (IT-E14) has in particular underlined the facilitating role of large denomination notes (e.g. €500 banknote) allowing criminals to carry huge amounts of money through small means of transport (bags, suitcases).

Individuals (i.e. money couriers) in charge of consigning cash to suppliers are present both in OCGs and more or less organised criminal organisations, and can be either internal members or persons recruited for this purpose (IT-E7, IT-E5, IT-E3, IT-E17, IT-E19). In particular, in case of OCGs, bosses or trusted affiliates are in charge of delivering further payments to suppliers, after other individuals have collected the money derived from selling (i.e. money collectors), (IT-E14, IT-E1). “They use facilitators and transporters that are part of the organisation since employed every fifteen days” (IT-E5). In case of minor groups (e.g. foreign criminal entrepreneurs from Eastern Europe), payments can be also managed by tobacco transporters or couriers, especially when they occur at the same time of delivery or when groups have at their disposal means of transport that allow to hide cash (i.e. double-bottomed vehicles), (IT-E1, IT-E15, IT-E7).

“There have been cases in which specific individuals were in charge of collecting the money and transferring it to the suppliers. It depends on the type of organisation involved and quantities of tobacco smuggled. For example, we have detected a group of Ukrainians using a variety of means of transport from cars, vans, and in one occasion even an unused German ambulance. In some cases, cash is collected and transported by dispatch riders that accompany the vehicles transporting the loads of tobacco. The boss of the foreign organisation that recovers the money often travels in the cars of dispatch riders” (IT-E1).

On the contrary, solo entrepreneurs that contraband cigarettes travelling, for example, by plane exercise both roles; indeed they import the illicit tobacco products, transporting at the same time the money back as to purchase other quantities: “when smuggling is by air, actually no facilitators are needed. The quantity of tobacco is small and travelling with €1,000 cash is not liable to suspicion” (IT-E6).

Non-cash settlement of payments

Legitimate transactions are employed by criminal entrepreneurs, especially when dealing with large scale tobacco smuggling operations (IT-E14, IT-E15, IT-E8). In these cases, tobacco products are more often concealed in containers transporting other commercial products, thus the merchandise can be paid through the issue of regular invoices between import-export companies. The latter may be either compliant or owned by OCGs and registered to other family members.

Besides regular shipping or land transportation of commercial products, the use of bank accounts and shell companies has been reported, again registered to the same individuals, and located especially in off-shore jurisdictions. “The worrying aspect is the use of a legal supply chain which, in the context of marketing of legal goods, distributes or pays for contraband products. In other words, the buyer simulates a legal transaction but he is actually purchasing loads of illicit tobacco products” (IT-E14).

Costs of doing business

Costs of tobacco smuggling operations are variable depending on different factors: 1) Type of tobacco products (e.g. counterfeit, branded, illicit whites) and quality; 2) Country of origin; 3) Scale of the operations (i.e. logistics and number of individuals involved).

When organising large scale tobacco smuggling operations, both OCGs and less or more organised criminal organisations need consistent start-up capital (IT-E1). Nevertheless, the amount required depend at first on the type of tobacco products purchased. In the opinion of one expert (IT-E7) prices present in the illicit market for contraband cigarettes have in general increased, starting from the 1990s due to the appearance of new products (e.g. illicit whites). Indeed, if one master case of Marlboro cost around €300-€400 20 years ago, nowadays it costs around €700-€800, with illicit whites costing in comparison much less, around €200-€300 per master case, at the national level (Table 51). Consistently, it has been underlined an increase of 40% in the price of tobacco products between 2010 and 2012.⁶³⁴

“Small smuggling operations have limited costs, while larger ones from 200 kilos to 5 tonnes of tobacco imported require more financial and material resources. Indeed, costs vary consistently. Furthermore, it also depends on the type of product acquired: it is different if smugglers buy counterfeit or branded Marlboro (the former cost 50% less), or if they buy Jin Ling coming mainly from Belarus” (IT-E1).

“The price per pack of contraband cigarettes may range from €1.30-€1.50 to €2-€2.50. The latter price, which is higher, refer to cases in which branded and top quality cigarettes are smuggled (e.g. Red Marlboro, Marlboro Lights) or other brands produced by major tobacco companies such as Philip Morris, British American Tobacco” (IT-E3).

⁶³⁴ F. Calderoni, M. Angelini, S. Favarin, *Italy: the Factbook on the Illicit Trade in Tobacco Products 2*.

TABLE 51. EXAMPLES OF COSTS FOR PURCHASING ILLICIT TOBACCO PRODUCTS AT THE WHOLESALE LEVEL IN ITALY

Region/country of supply	Type of illicit tobacco product	Cost of purchase(€)
		Master case
Eastern Europe	Illicit whites	200-300
Bulgaria/Macedonia	Illicit whites	350
Italy	Illicit whites	700
Italy	Counterfeit Marlboro	600
Italy	Marlboro	1,200
Italy (Naples)	Chesterfield Red and Blue	625
United Arab Emirates	Richman	350
China	Jin Ling*	400-500
		Pack
North Africa	Local brands	1.50-2

* Counterfeit product.

Source: Authors' elaboration on collected data.

The costs of purchasing the loads of illicit tobacco products also depend on the place of supply, that is directly from producing tobacco companies, or from warehouses located in both transit or destination countries. Furthermore, agreements between smugglers on which players is taking the risk of transportation and method of payment can impact on the final price of the merchandise, as well as the quantity bought and the type of relationship among buyers and suppliers (e.g. occasional versus well-tested), (IT-E1, IT-E3, IT-E7, IT-E6, IT-E5). For example, in countries of Eastern Europe a master case of illicit whites acquired by producers costs around €70-€100, while in warehouses located in Greece or Montenegro the cost goes up to €350-€500. If acquired in Italy delivered by suppliers taking the risk of transportation, the price is around €800-€900 (IT-E2). At the same time, when payments are made through revolving credit, in most cases, the price of cigarettes is overcharged compared to cash payments (IT-E6).

While, on one side, importation of small quantities of cigarettes to the Italian territory imply very low costs, as contended by one expert (IT-E6), especially when couriers travel by plane (e.g. €500 for transportation plus the cost for the tobacco products), on the other, groups of smugglers involved in large scale smuggling operations sustain higher costs related in particular to logistics (means of transport, renting of warehouses and employees). For example, if tobacco is delivered by land or sea, the price of one carton of cigarettes may vary up to €2. "Ukrainians sell to Neapolitans at €18 per carton since transported by cars or vans, while the Greeks at €20 since transported by container shipments. But then it depends also on the quantity acquired" (IT-E1).

The actors employed are either members/affiliates or external recruited individuals. In particular, the former are remunerated through profit sharing, while the latter with monthly, weekly, daily payments or lump sums (IT-E1, IT-E3, IT-E14, IT15, IT-E6, IT-E16). Compared to other illegal markets (e.g. cocaine trafficking), some experts (IT-E3, IT-E7) have pointed out how external employees are more frequently paid in cash than in part of the smuggled tobacco loads (e.g. in-kind payments). “There are individuals receiving €50-€100 a day to unload or transport the merchandise; others, such as warehouse keepers, are paid with monthly salaries varying from €1,000 to €2,000” (IT-E15). At the same time, in the case of OCGs, other actors that remain completely external to the tobacco smuggling operations are employed to perform specific tasks and paid lump sums as well. Examples refer to foreign individuals in charge of buying and registering telephone cards or storehouses, paid €500 for this service (IT-E1).

The existence of a price list has been underlined by some experts (IT-E1, IT-E14) in regard to high-middle segments operating within the illicit tobacco trade, with remunerations fixed on the basis either of the role and tasks accomplished, or the skills, importance and reliability of employees (Table 52). “Italian professional lorry drivers, for example, may take from €35,000 up to €50,000 per trip. Indeed, they organise not only the trip, recovering the merchandise and the goods to hide it, but also the transit in more safe routes together with dispatch riders” (IT-E1). Furthermore, the country of origin of the employees is another

TABLE 52. EXAMPLES OF COSTS RELATED TO RUN TOBACCO SMUGGLING OPERATIONS IN ITALY

Role of individuals	Remunerations
Intermediary	€50-€250 per master case
East European car driver	€200 per trip
East European lorry driver	€600 per trip
Italian professional lorry driver	€35,000-€50,000 per trip
Unloader (warehouses)	€50.00-€100.00 per day
Unloader (transferring containers at ports)	€50,000
Warehouse keeper	€500 per service (storage)
Stable driver/warehouse keeper	€1,000-€2,000 (monthly salary)
Air courier	€200 per trip
Other individuals (registering phone cards, transferring money)	€500 per service
Official at Eastern EU customs	€500 per service
Official at Italian customs	€10,000

Source: Authors' elaboration on collected data.

discriminating variable for the amount of payments since compared to life standards of the different areas. Some experts (IT-E14, IT-E1, IT-E6) have indeed argued that North Africans and Eastern European are paid less than Italian counterparts.

“There are groups of smugglers preferring to use individuals that appear completely external to the organisation, such as more or less unaware transporters of vegetables to whom the illicit tobacco loads are consigned without revealing the content and paid €400 for 18 hours of work. On the contrary, larger loads are entrusted to members that are paid with higher remunerations since transporting an entire illegal load facing more risks” (IT-E14).

Major costs are then sustained for importation since at the retail level and in street markets they consist mainly in acquiring bags to transport cigarettes and in organising very basic stalls. Furthermore, smaller quantities of tobacco are kept in apartments or garages of retailers, friends or acquaintances (IT-E1).

Besides individuals employed, other expenses may be also faced by smugglers at all the levels of operation, i.e. costs related to unforeseen circumstances (e.g. arrestee of members, theft of loads by competitors, police seizures) and corruption. The former are usually charged in the total price of the tobacco loads, being this way difficult to identify precisely, while the latter were indicated to be lower in East European countries and non-EU countries compared to Italy (IT-E1). As for the costs related to promotion techniques, one expert (IT-E15) has contended that due to the economic crisis, the illicit tobacco market has flourished again, pushing consumer trends to levels similar to the phase previous to the operation “Primavera”. Thus, smugglers are not in need of promoting cigarettes.

At the same time, as underlined by one expert (IT-E14), it is possible for criminal entrepreneurs, especially OCGs, to cut costs mainly in two ways: 1. Owning import-export companies trading in licit goods, used also to carry out tobacco smuggling operations. Indeed, the latter are perpetrated through the solely payments of commercial products, and supported by logistics already available; 2. Acquiring, through loansharking, legal companies with a well-established reputation within the legal market but facing economic difficulties. Thus, in a first moment, the debts of the owners secure collaboration and allow them to exploit logistic services and warehouses; while in a second moment the impossibility to repay back lenders facilitates the acquisition of the companies, in some cases accomplished through the introduction of OCGs members into the advisory boards. In general, criminal entrepreneurs prefer this second option since decreasing the possibility to be intercepted (IT-EX1).

Profits and profits sharing

According to experts (IT-E15, IT-E1, IT-E16, IT-E18) and in line with previous research⁶³⁵ proceeds from the illicit tobacco trade are consistent: “Profits gained through tobacco smuggling allow the sustenance of an entire family involved in retail selling as well as the accumulation of thousands of euros by high level criminal entrepreneurs” (IT-E15).

Nevertheless, the actual amount gained by criminal entrepreneurs operating in this illicit market depend on different factors: the level of the operation (high/medium and low segments), the type of tobacco products smuggled, the location of the illicit tobacco markets at the national level (i.e. Northern, Central, Southern areas of the country) and the number of groups/actors in the supply chain. Indeed, higher profits are gained when buyers and suppliers are able to arrange importation directly, using own already available resources (i.e. import-export companies, means of transportation, drivers, warehouses) and at least one intermediary (IT-E1). More generally, some experts (IT-E1, IT-E15, IT-E17, IT-E6) have pointed out that profit margins gained by smugglers are almost double the initial investment, while reporting the following examples:

- at the wholesale level a pack of cigarettes costs around €1.7-€2.5, while at the retail level around €3.5-€5, allowing to earn around €2 per pack;
- a master case of contraband cigarettes is purchased at around €100 in countries of suppliers, and introduced into the wholesale market at around €500-€1,000 depending on the type of products;
- a master case of good quality branded cigarettes (e.g. Marlboro, Philip Morris) is sold at €700 by suppliers and at €1,000 by wholesalers so that profits are around €200-€300 per master case;
- Ukrainians sell to wholesalers at €1.60 per pack, while retailers in markets/streets at €2.80-€3, with a profit of €1.50-€2;
- A pack of cigarettes from North Africa costs 0.70 cents-€1.00, which is sold at the retail level at €3.

Profit margins decrease during the tobacco smuggling chain with individuals at the higher levels receiving the larger amounts. Within OCGs and more or less organised criminal organisations (both Italian and foreign) financiers and organisers are the individuals receiving the larger amounts of profits, in accordance with the risk taken in the smuggling operations and the amount of the initial investments. Whereas employees and retailers mainly gain revenues from respectively fixed salaries and the selling of tobacco products. For these reasons, investment schemes are strictly related to the level of the operation within the illicit tobacco market (IT-E1, IT-E7, IT-E13, IT-14, IT-15).

Investment schemes

At lower levels (medium-low segments), the better part of the profits is used for personal expenses and to raise the life standards of

⁶³⁵ See F. Calderoni, “A New Method for Estimating the Illicit Cigarettes Market at the Subnational Level and Its Application to Italy”; F. Calderoni, M. Angelini, S. Favarin, *Italy: the Factbook on the Illicit Trade in Tobacco Products 2*.

criminal entrepreneurs. Especially in regard to foreign smugglers, some experts have underlined the acquisition of luxury items or goods (high-powered cars, yachts, etc.), the latter registered more often to straw men, relatives or family members (IT-E15, IT-E7, IT-E17): “in the city of Naples, we intercepted elderly women to whom motorcycles were registered” (IT-E1).

Profits are also invested in continuing the illicit tobacco trade, both in high/medium and low segments. A characteristic of this illicit activity, as underlined previously, is its almost exclusive involvement of actors, thus money is mainly used to finance subsequent tobacco smuggling operations and to expand this illicit activity. Many groups of smugglers save part of the profits as “rainy day” funds, useful to sustain critical moments (i.e. payment of legal assistance to arrested members and support to their families, investing in subsequent operations after eventual seizures or stealing of loads by police or competitors), (IT-E7, IT-E18).

Foreign smugglers operating at medium-low levels, and especially from Eastern Europe, send back profits to the countries of origin, via money transfer services or through cash transportation, while maintaining a low profile in Italy (IT-E7, IT-E2, IT-E5). Criminal entrepreneurs active at the high level (Italian and foreign OCGs such as for example Chinese and Russian) invest into the legitimate economy, preferring the acquisition of business companies, real estates, restaurants, general stores, and tourist facilities, especially in the Northern part of Italy. Indeed, cash is laundered and further reinvested into the legal economy through complex money-laundering processes that may involve the use of banks (in some cases with the support of complicit officers) and bank accounts (especially in off-shore zones), business companies registered to family members or straw men, allowing criminal entrepreneurs to perform fictitious transactions of goods (IT-E1, IT-E14, IT-E). As stated by one expert (IT-E1), the deposit of revenues into accounts in Swiss banks by Camorra clans was widespread during the “golden times” of cigarettes contraband in Italy, and this method is still in use.

“There have been smugglers linked to Camorra clans offering their know-how and bank accounts to families of Cosa Nostra for both running other criminal activities (e.g. cocaine trafficking) and favouring the flows and laundering of proceeds coming from tobacco smuggling (e.g. deposits in Camorra clans bank accounts)” (IT-E1).

At the same time, the economic crisis, in the opinion of some experts (IT-E1, IT-E14, IT-E17), is at present a facilitating factor for the laundering of profits, as well as the acquisition of legal companies, mainly through loansharking, to be further employed for this purpose and for arranging tobacco smuggling operations. “Huge amounts of illegal money previously deposited into bank accounts had indeed been introduced into the legal economy due to the financial crisis. Although criminal entrepreneurs may lose part of their capital in this process, the remaining part becomes a source for investments into different legal businesses. Many smugglers, indeed, interrupt their criminal career at some point in life: owning and managing trading companies (e.g. olive oil production) or restaurants,

hotels, represent assets also to recycle themselves as ‘unsuspected’ individuals, while securing own retirement” (IT-E14).

Access to capital in critical moments

In general, all smugglers (OCGs, more or less organised criminal organisations, solo criminal entrepreneurs) active within the illicit tobacco market are able to continue operating although facing critical moments (e.g. arrestee of members, stealing of loads by competitors, police seizures). Sources of capitals to re-enter the business correspond to the finances used to initiate illicit tobacco smuggling operations, i.e. money coming from other type of criminal activities, legal businesses, external financiers, personal savings or small loans borrowed by friends or acquaintances. Nevertheless, the capacity to maintain the illicit tobacco activity varies in terms of profile and criminal career of smugglers.

In case of high/middle segments (native and foreign), the part of capital that have being saved and not intercepted by the authorities represents the main source for continuing the smuggling, also thanks to trusted individuals acting as reliable substitutes in cases of arrest of other members of the organisation. When capitals are not readily available, individuals at the top levels are able to re-establish contacts with both financiers and suppliers quickly due to maintained trust and reputation; while players at the lower levels are often assisted by the group and then reintegrated into the business once out of prison. Furthermore, the latter receive legal assistance together with other forms of aid for their family members (e.g. a monthly salary to arrestee families in the case of Camorra clans), (IT-E1, IT-E15, IT-E3, IT-E7, IT-E16).

“More often they go back to the tobacco business. Although vehicles used for smuggling are detected and couriers arrested, after a period of detention it happened to find the same individuals, using different and bigger means of transport” (IT-E1).

“There is real specialisation. Once out of prison, members re-enter the illicit tobacco trade. Usually, financiers do not experience judicial problems so they can continue lending capital. Indeed, in most cases individuals arrested belong to the lower levels (couriers, lorry drivers, wholesalers, unloaders)” (IT-E15).

“Smugglers remain smugglers for their entire lives. In some cases we recognise the same voices during interceptions. They are specialised and exploit channels and contacts previously detained” (IT-E7).

Mutual assistance exists among members which favours the reintegration into the tobacco business (IT-E1). At the same time, some experts have pointed out other ways allowing to continue to operate (IT-E1, IT-E7, IT-E15, IT-E16). First, the practice of preserving rainy day funds: “A real fund is present within groups, and usually foreseen, as to sustain critical moments. It is used to compensate losses of loads, seizures, but also to assist arrestees and their families, to rent means of transport, assure the silence of individuals or to corrupt officials when needed” (IT-E1). Second, the possibility to receive tobacco on credit as to restart and

acquire capitals as well as repay back eventual previous debts, in virtue of trusted and well-tested relations with suppliers or intermediaries.

On the contrary, there are cases in which criminal entrepreneurs are not capable to re-enter the illicit tobacco business, especially small groups of smugglers that have not at their disposal saved capitals or trusted contacts with suppliers. As a result, responses may range from dismissal of the illicit tobacco trade to the involvement in other illegal activities (e.g. counterfeiting, organised VAT frauds).

“In some instances they are not able to restart once apprehended and their capital and material resources seized. This can happen with small groups lacking financial support. Nevertheless, some members may ‘recycle’ themselves in other illicit activities, for example the alternative energy sector. We have detected ex-smugglers being managing directors of companies dealing with wind turbines or solar panels, maintaining a criminal profile since perpetrating frauds” (IT-E1).

6. NATIONAL CRIMINAL MARKETS AND FINANCES: VAT FRAUD

This section contains the results of four country studies of VAT fraud as an organised crime activity. Large-scale, organised VAT fraud has a number of commonalities and differences with illicit cigarettes and drugs: unlike the latter, VAT fraud does not deal in a particular substance and is thus not a market in the same sense; like cigarettes but unlike drugs it causes serious revenue leakage; similar to both illegal tobacco trade and drug trafficking VAT fraud is aggravated when performed on an international scale; VAT fraud has a somewhat higher entry threshold than the other two criminal fields of operation; it is a much more white-collar type of crime than the other two. Most importantly from the point of view of analysing its financial implications, VAT fraud – similar to illegal cigarettes but unlike the drug trade – has numerous points of interface with the legal economy and especially with legal financial institutions.

Most of the criminal schemes described in the following chapters are common to EU countries. Thus, particular attention is paid to the intra-community variety of VAT fraud in the country reports.

The country studies draw on existing research and policy analyses, as well as on original research carried out with the assistance of both experts from the public and private sectors, and criminal entrepreneur who have operated in this criminal field. The sources have been coded in order to preserve their anonymity. The first two letters of the code indicate the country (e.g. CZ – the Czech Republic), “E” indicates an expert, while “C” means criminal entrepreneur. The description of the background of the individual sources referenced can be found in the “List of interviewees in the section on organised VAT Fraud” in the Annex.

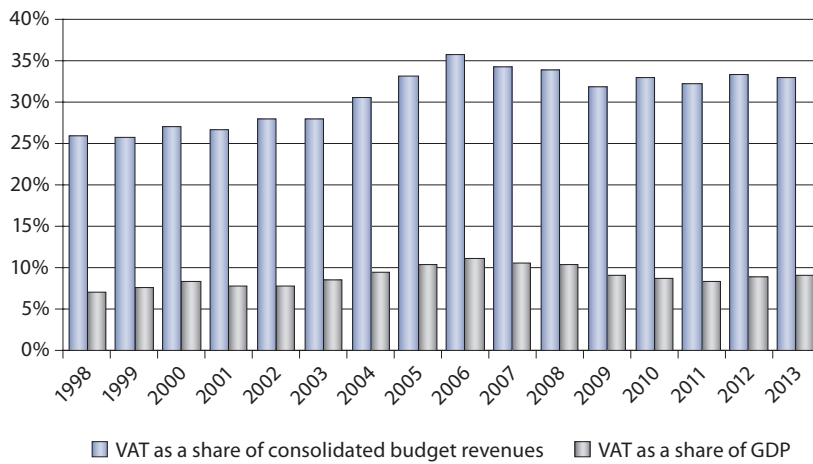
6.1. BULGARIA: INSIDE A VAT FRAUD-RIDDEN ECONOMY

Introduction

Organised VAT fraud has been one of the major organised crime threats for Bulgaria in recent years. After human trafficking, this is the second biggest source of revenues for organised crime, surpassing lucrative criminal activities such as drugs and illicit tobacco.⁶³⁶ What makes organised VAT fraud such a big threat are the direct fiscal damage and the distortion of the competition in entire economic sectors. The heavy dependence of the public budget on VAT tax revenues makes it specifically vulnerable to this kind of crime. The scale of these criminal activities in

⁶³⁶ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

FIGURE 36. VAT REVENUE IN BULGARIA (1998 – 2013)



Source: Ministry of Finance and National Statistics Institute.

certain economic sectors such as construction, manufacturing and trade in electronics, oil, vegetables, meat, sugar, and grain has distorted competition and forced legitimate companies either to get involved in some kind of fraud or leave the market. As a result, organised VAT fraud proves very resilient and hard to tackle, since the abrupt suppressing may lead to various undesired economic and social costs such as steep rise of prices for socially sensitive goods⁶³⁷ or bringing companies in affected sectors to insolvency.

The VAT tax was introduced in Bulgaria in 1994, when it

replaced the turnover tax.⁶³⁸ Currently it is the most important source of revenues for the country: it contributes up to 33% of the total central government revenue and amounted to 9% of the country GDP in 2013 (Figure 36). In comparison, the corresponding share in the EU-27 for the period 2000 – 2011 was 21% or 7.5% of GDP.⁶³⁹ For the EU-15, the share of VAT in their general government revenue is even below 19%.⁶⁴⁰ This simple comparison shows that currently Bulgaria is the EU country most heavily dependent on its VAT revenues and therefore most vulnerable to organised VAT fraud.

Until 1997, organised VAT fraud was not a big issue for the tax authorities in Bulgaria. The galloping inflation and the long statutory time limits for credit refunds rendered such schemes unprofitable in the first years following the introduction of the VAT taxation in the country. The establishment of the currency board in Bulgaria in 1997, which resulted in rapid reduction of inflation rates, changed gravely the situation with fraudulent tax refund schemes. Thus, the second half of the nineties saw the first high-profile organised VAT fraud schemes and it took a couple of years for the government to respond with the first countermeasures such as closing existing legal loopholes, establishing a large taxpayers

⁶³⁷ For example, VAT evasion schemes in Bulgaria often concern goods such as vegetables or bread. Countering VAT evasion may lead to a steep rise in prices of such commonly purchased food products, thus affecting the purchasing power of many households and especially the low income ones.

⁶³⁸ Initially the tax was introduced with a rate of 18% in 1994, only to be raised to 22% in 1996 and finally was set at 20% in 2000, and has not been subject to further changes since. The general VAT rate of 20% is applicable to all goods and services traded in Bulgaria, except the services of tour operators and tourist agencies, which are taxed at a reduced VAT rate of 9%.

⁶³⁹ CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report* (The Hague: CPB Netherlands Bureau for Economic Policy Analysis, 2013).

⁶⁴⁰ Eurostat, *Taxation Trends in the European Union. Data for the EU Member States, Iceland and Norway*. (Luxembourg: Publications Office of the European Union, 2014).

unit and anti-fraud unit, restructuring the tax audit area and monitoring for VAT losses.⁶⁴¹

Before the accession of Bulgaria to the European Union in 2007, the VAT evasion schemes were related both to conventional tax evasion and unlawful tax refunds. Conventional tax evasion schemes were related either to underreporting of taxable sales or to overstating of taxable costs to claim larger tax credit. Unlawful tax refund schemes, which are also known as organised VAT fraud and were based on fictitious transactions and fictitious traders, also proliferated. Most common were fictitious export schemes, missing trader schemes, X-type fraud schemes.⁶⁴²

The accession of Bulgaria to the European Union in 2007 created new opportunities for VAT fraud for which the tax administration was not fully prepared. Becoming part of the single EU market, Bulgaria was obliged to introduce the EU legislation on VAT, as well as to adopt the common EU regime for VAT taxation of intra-community supplies. Within the internal market goods are traded freely and without exercise of customs control at the borders. The common VAT regime on intra-community supplies is based on the so called destination principle, whereby the taxation occurs in the country where the goods are consumed and in line with the rate and conditions of that country. Following this principle, zero rate of VAT tax is applied to exports of goods to another member state. The zero-rating principle means that VAT tax on exports is levied at zero rate, while at the same time the supplier keeps the right for tax credit (and eventually for tax deduction or tax refund) on his domestic purchases. In order to be eligible for such zero rate of VAT, both the supplier and his trading partner must possess valid VAT-registration in their own countries.⁶⁴³

This regime has proved vulnerable to fraudulent abuse of its credit mechanism long before Bulgaria joined the single market, despite the many anti-fraud measures introduced on national and EU level in the last two decades.⁶⁴⁴ Thus, along with the already existing VAT fraud schemes, new and modified types of schemes emerged in Bulgaria – i.e. missing trader intra-community frauds (MTIC) and carousel frauds.⁶⁴⁵

Market overview

The exact scope of the organised VAT fraud problem is hard to estimate. Most often the so called tax gap is used as proxy indicator. The VAT tax gap is top-down estimate of tax non-compliance, which is measured

⁶⁴¹ K. Pashev, "Countering Cross-Border VAT Fraud: The Bulgarian Experience", *Journal of Financial Crime* 14, no. 4 (2007): 490-501.

⁶⁴² Ibid. X-type fraud schemes are modified version of the missing trader scheme, which emerged after the introduction of a specific VAT account for all VAT registered enterprises in 2002. The VAT account was intended only for incoming and outgoing VAT payments and was introduced as a measure to counter missing trader fraud. The emergence of X-type fraud schemes soon proved it inefficient, so the VAT accounts were abolished in 2007.

⁶⁴³ M. Keen and S. Smith, "VAT Fraud and Evasion: What Do We Know and What Can Be Done?", *National Tax Journal* LIX, no. 4 (2006): 861-87.

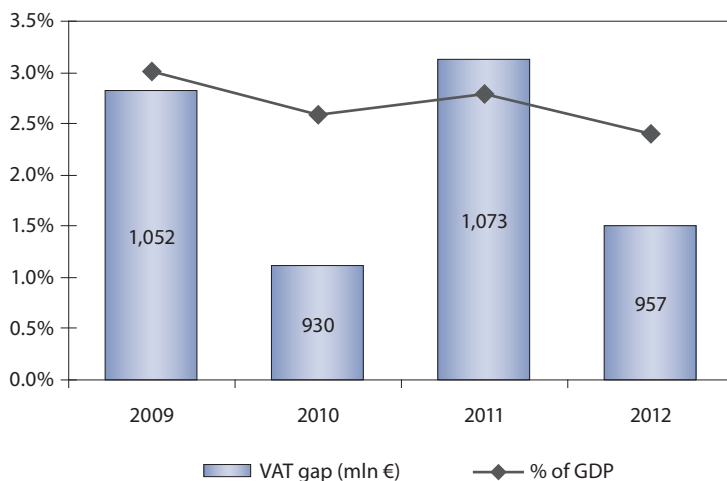
⁶⁴⁴ A. Aronowitz, D. Laagland, and G. Paulides., *Value Added Tax Fraud in the European Union* (WODC, Amsterdam: Kugler Publications, 1996); National Audit Office (UK), *HM Customs and Excise: Tackling VAT Fraud* (London, 2004).

⁶⁴⁵ CSD, *Serious and Organised Crime Threat Assessment 2010 – 2011*.

as the difference between the theoretical tax liability according to the tax law and the actual revenue collected. It is not a mere indicator of organised VAT fraud, insofar as it also captures legitimate tax avoidance, tax noncompliance due to insolvency or delayed payments, as well as statistical errors.⁶⁴⁶ Still it is the best indicator available for measuring the scale of the problem, as well as for drawing comparisons across countries and capturing trends in tax non-compliance over given periods of time.

The most recent estimates of the VAT gap for Bulgaria were provided in two studies on the VAT gap in the European Union, which were assigned by the European Commission.⁶⁴⁷ According to these studies the VAT gap in 2012 was 20% of the VAT total tax liability or 2.4% of GDP, whereas the average VAT gap for EU amounted to 16%. Generally, Bulgaria falls in the group of countries with VAT gap higher than the average for EU along with the countries from Central and Eastern Europe (Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia and Romania) and Southern Europe (Greece, Italy, Malta, Spain). The two estimations of CASE draw on two different databases, which have been a product of different statistic methodologies and therefore are not really comparable. Generally the trend for the period 2009 – 2012 is more or less stable (Figure 37).

FIGURE 37. TRENDS IN VAT GAP, TOP-DOWN ESTIMATE FOR BULGARIA (2009 – 2012)



Source: CASE, 2012 Update Report to the Study to Quantify and Analyse the VAT Gap in the EU-27 Member States.

Bottom-up estimates based on extrapolating data on individual companies and detected frauds provide a more precise picture of unlawful VAT refunds and deductions or the criminal VAT evasion.⁶⁴⁸ This kind of data is generally not publicly available, so such estimations could be carried out only by the tax authorities, which have access to operational data. Such assessments were carried out in Bulgaria in 2010 and 2013 by the National Revenue Agency (NRA) for the period 2005 – 2009 and 2010 – 2012.⁶⁴⁹ The estimates of NRA for 2005 – 2008 indicate steady upward trend coinciding with the accession to the EU and the economic boom just before the economic crisis, which re-

⁶⁴⁶ Reckon LLP, *Study to Quantify and Analyse the VAT Gap in the EU-25 Member States* (London, 2009).

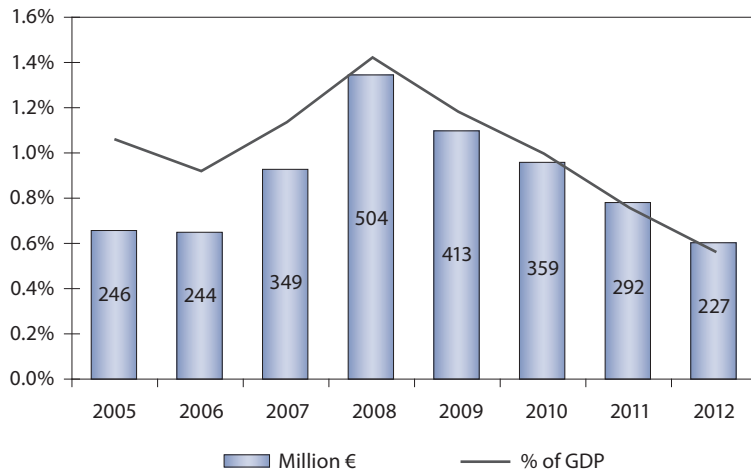
⁶⁴⁷ CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report*; CASE, *2012 Update Report to the Study to Quantify and Analyse the VAT Gap in the EU-27 Member States*.

⁶⁴⁸ Reckon LLP, *Study to Quantify and Analyse the VAT Gap in the EU-25 Member States*.

⁶⁴⁹ National Revenue Agency (Bulgaria), *Tax Gap Analysis* (Restricted report, Sofia, 2010); National Revenue Agency (Bulgaria), *Tax Gap Analysis of Organised VAT Fraud* (Restricted report, Sofia, 2013).

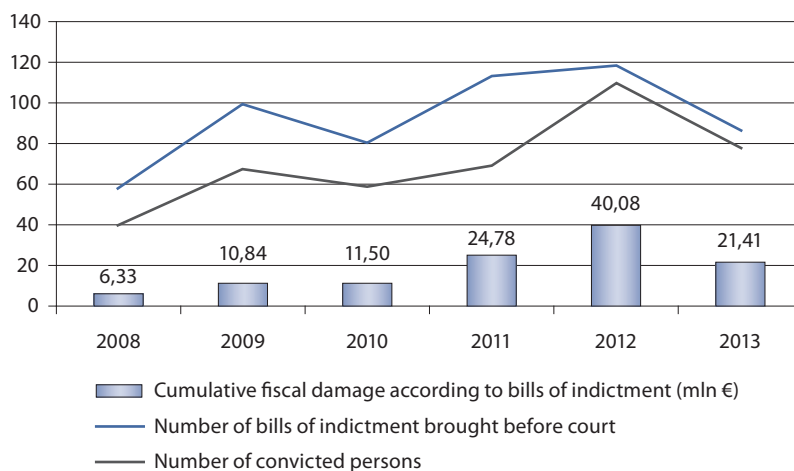
versed in 2009 (Figure 38). However, it should be noted that the NRA assessment covers only the missing trader fraud, whereas the CASE estimate also includes the legal VAT avoidance, conventional VAT evasion, insolvencies and delayed payments.

FIGURE 38. TRENDS IN VAT GAP, BOTTOM-UP ESTIMATE FOR BULGARIA (2005 – 2012)



Source: NRA (2010, 2013).

FIGURE 39. PROSECUTION STATISTICS ON VAT FRAUD CASES IN BULGARIA



Source: Annual reports of the Prosecution’s Office and investigation authorities for the years 2008 – 2013.

In contrast with the top-down approach, the bottom-up approach for assessment of the VAT gap also provides more detailed picture in terms of breaking the gap to components such as type of taxable supplies, vulnerable sectors and domicile of missing traders detected. The analysis of NRA has identified the most vulnerable sectors by type of goods and services misused for VAT fraud schemes. The bulk of the fraudulent schemes concern goods such as grain, meat, fuels and sugar, which take the lion’s share with over 40% of all unlawful VAT fraud refunds. The services which are most often misused in fraudulent schemes are related to construction and advertising. In an attempt to arrest the growing number of unlawful VAT refunds related to grain exports, the Bulgarian government adopted reverse charge VAT taxation⁶⁵⁰ for these goods in the middle of 2014.

The analysis of NRA also reveals that more than sixty percent of all missing traders are registered in the Sofia region, which is the region with the most vibrant economy in the country. The tax authorities report that the average number of detected missing traders for the period 2007 – 2012 is 2,453 companies, while the average number of “clients” of such companies is fourteen.

⁶⁵⁰ Reverse charge VAT taxation differs from the regular VAT taxation as the VAT tax is paid by the supplier instead of the client.

The overall shrinking of the VAT gap in the period 2008 – 2012 can be partially explained by the increased attention and efforts of the Bulgarian authorities to this type of crime. An example in support of this is the increasing number of bills of indictment and convictions for the period 2008 – 2012 (Figure 39), which suggests for increased efforts by the law enforcement agencies and the Prosecution's Office to tackle this type of crimes. Until 2008, the Prosecutor's Office also did not follow closely crimes related to VAT fraud and they were reported within the broader category of tax crimes. Since then VAT fraud crimes are specifically highlighted in all annual activity reports among the crimes of significant public interest. The prosecution statistics show steady increase of the number of cases brought before court and persons convicted in the period 2008 – 2012, although it was followed by a rapid decline of almost 70% in comparison with 2012.

Market structure and actors

Unlike the traditional criminal markets such as drugs markets and illicit tobacco, organised VAT fraud appears to have far more complex, multifaceted and multilayer nature. First of all the profile of the actors involved in the VAT fraud networks is very diverse – some of them have a clear criminal background, whereas others come from the legitimate business or are part of the public administration. The fraudulent networks actually mimic legitimate business activities, so although they function as organised crime group, in practice the authorities face legitimately established business entities conducting from entirely legal to purely fictitious business transactions. The business models of these fraudulent networks or the embezzling schemes are also very diverse: while some aim at evasion of tax liabilities, others aim at unlawful deduction of VAT liabilities or unlawful VAT refunds from the state budget. Furthermore, focusing solely on VAT fraud appears to be quite short-sighted, insofar as VAT fraud is often part of or linked to other kinds of tax fraud such as customs and excise duty fraud or corporate tax evasion (BG-E5, BG-E10). VAT fraud could also be linked to some other organised crime activities such as money laundering (BG-E20), illicit alcohol production (BG-E11), and smuggling of fast moving consumer goods (BG-E10).

Key actors

The fraudulent networks are usually described as a circuit of legal entities performing chains of fictitious transactions in order to embezzle the VAT refund mechanism. However, the network of individuals behind these schemes who actually benefit from the fraud should also be a matter of consideration. Thus, the description of the key actors should refer not only to the legal entities involved, but also to the perpetrators abusing these legal entities as vehicles for the fraud.

The role of corporate entities in VAT fraud schemes

The various types of corporations used as vehicles for fraudulent VAT chains are usually categorised according to their specific roles in the criminal schemes. Some of them are classic fictitious traders registered

with the only purpose to enable the fraud, while others are compliant companies that benefit from these schemes. Furthermore, some of these actors can be identified in all schemes, whereas others are specific only for certain schemes.

The “**missing traders**” are key actors in most of the schemes and in Bulgaria they are widely known as “a fuse.” They are limited liability companies formally registered in the name of **straw persons**. The role of the missing traders is to document fictitious sales and purchases and abscond or go insolvent without remitting the VAT to the budget. These companies have neither personnel, nor assets or any capacity for commercial activities. Usually, when tax authorities attempt to inspect or audit such companies they find only a post box at the official address declared at the time of the registration. In contrast to other EU countries, in Bulgaria missing traders are only rarely registered by foreign citizens or by offshore owners with undisclosed identity (BG-E1, BG-E16). Bulgarian criminal networks also register missing traders abroad for perpetration of schemes involving intra-community deliveries to other member states. Their role is to document the fictitious importation of the goods (BG-E10, BG-E13, BG-E19).

The “**buffers**” are the other common actor in most of the fraud schemes. The role of the buffers might be performed either by real companies or shell companies registered in the name of straw persons much like the missing traders. The buffers are introduced as compliant intermediaries in the fraudulent schemes to document fictitious purchases from the missing trader and sell the goods to the final recipient of the goods. In most cases the goods flow through more than one buffer in order to provide higher credibility to the fictitious transactions and conceal the link between the missing trader and the actual recipient of the goods. Thus, criminal networks hamper the detection of the fraudulent chain. Usually both missing traders and buffers receive the goods only on paper, whereas in practice the goods are directly delivered to the actual recipient.

“**Crossed invoice**” companies are also often used as part of most types of fraudulent schemes. Their role is to additionally complicate the detection of the fraudulent schemes. To certain extent their role is similar to the role of the buffers. **Crossed invoicers** declare purchases and sales of real goods and services from and to real traders. At the same time they also register fictitious sales to missing traders, thereby nullifying their VAT liabilities to the budget (BG-E1).

The schemes involving intra-community deliveries or exports to third countries also involve the so called “**brokers**.” The broker may be a bogus company registered in the name of a straw person, which purchases on paper goods from real traders and declares intra-community delivery to a missing trader in another member state or export to third country. Upon the declared supplies abroad the bogus company claims a VAT refund to the budget. However, use of such “dummy companies” without any commercial capacities is quite risky, insofar as the normal practice of NRA is to perform audits upon any claim for VAT refund. Therefore,

such scenarios are rarely perpetrated, being vulnerable to easy detection and practically impossible without direct involvement of NRA officials. Usually the role of the broker is performed by real traders that perform intra-community deliveries or exports to third countries on a regular basis as part of their normal business. Accepting the role of brokers in such fraudulent chains they use the opportunity to obtain deduction of their VAT liabilities on inputs, while at the same time receive a certain fee for their complicity from the ring leaders of the fraudulent network. They might also benefit from purchasing goods below market value, thus receiving the opportunity to legally increase their profits (BG-E1).

“Final recipients” are the actors that generally benefit from the opportunity to purchase goods or services at prices below market value. Usually these are retail companies or manufacturers, but may be companies from any business sector (e.g. construction, tourism, etc.). They are registered in the country and are fully tax compliant. Final recipients may or may not be aware of their involvement in the fraudulent scheme (BG-E4).

“Conduit companies” or exporters are actors that appear in schemes involving intra-community acquisitions and imports from third countries. These are companies registered abroad and are usually fully compliant. Conduit companies are either manufacturers or wholesalers performing intra-community deliveries or exports, which do not profit from the frauds as such, but receive the normal profit as in any other business transaction. They may or may not be fully aware of the perpetrated schemes, but generally benefit from being able to find market for their goods which under other circumstances might not be as competitive.

The fraudulent chains are also aided by various **facilitators**, which are not directly involved in the frauds, but play significant role in their realisation. Usually these are real companies that are fully tax compliant, which provide certain services for a pre-agreed fee to the fraudulent networks, while being or not being fully aware of the fraudulent schemes taking place. Among the important facilitators are the accounting service providers, also known in Bulgaria as **“accounting houses.”** They not only bring specific expertise in tax law and procedures, but in many cases facilitate the registration of the bogus companies that act as missing traders, crossed invoicers, buffers or brokers. The accounting houses actually take over the accounting, settlement of payments and communication with tax authorities of the shell companies. Usually this is done through issuing of a power of attorney to an accountant from such accounting houses along with an electronic signature. Thus, the accountant has the right to represent the company to the NRA, as well as to authorise bank transactions. However, the accountant usually has partial knowledge on the real activities of the shell companies, their volume or the actual destinations of the financial flows.

Equally important is the facilitating role of the **transportation and logistics companies**. The fraudulent networks turn to transportation companies, since besides the documentation for the origin of the goods (contracts, invoices) and the financial documentation (payment orders, bank statements, receipts), they are also required by law in case of tax

audit to present to tax authorities documentation that proves the actual movement of the goods. This is where transportation companies step in. It is possible for the transportation company not to be aware of the fraudulent scheme it is facilitating, but interviewees report that in most cases VAT fraud networks collaborate with the same transportation companies (BG-E1).

In order to provide the VAT network with the necessary documentation, the company usually transports the goods abroad only to return them back or performs a shipment within the country but forges documentation for international shipment. Thus, in case of a tax audit, the transportation company can justify that the international shipment has really taken place and present documents for accompanying costs. Issuance of transportation documentation without performing any shipment is rarely practiced, as it is perceived as risky and vulnerable to easy detection from tax authorities (BG-E1).

Criminal network actors

The criminal networks that perpetrate organised VAT frauds should not be mistaken with the corporate vehicles they employ for their fraudulent activities. Behind any fraudulent chain of legal entities are the individuals that actually commit the crime. They can best be described as a criminal network or a ring with three levels of participation – the inner circle players, the outer circle players and the facilitators.⁶⁵¹

The **inner circle players** are the ring leaders or the actual organisers and financiers that directly profit from the fraudulent schemes. In most cases their names would not appear on any document or in the companies directly involved in the fraudulent operations. The ring leader and the financier might be one and the same person, although this is not always the case. However, the ring leader not only provides the money for the fraudulent scheme, but they also act as a guarantee to the tax compliant companies that appear either as final recipients of the goods (big retailers, manufacturers or exporters) or are involved as transportation companies. They might also secure protection against investigations and tax audits through corrupting public officials and trading in influence.

The profile and social background of the ring leaders is diverse and depends on the nature and scale of the fraud perpetrated. Some of them are owners of well-established legitimate companies (BG-E1, BG-E3, BG-E4, BG-E19), whereas others are professional fraudsters with experience in smuggling of excise goods or various fast-moving consumer goods during the nineties in Bulgaria or other tax crimes (BG-E10, BG-E13). Along with that, many career criminals that have participated as actors in organised VAT fraud schemes have at some point started their own rings (BG-E3).

Ring leaders who own well-established legitimate businesses can be among the so called “oligarchs” – powerful businessmen well positioned on local or national level who accumulated their capital in the nineties

⁶⁵¹ Aronowitz, Laagland, and Paulides., *Value Added Tax Fraud in the European Union*.

through various shady or criminal practices such as siphoning state-owned companies, rigging privatisation deals, insolvency frauds, excise and custom duty frauds or corrupting public procurement tenders. Their social background is usually from the old communist party nomenklatura, former high-ranking executives of state companies or high-ranking officers from the security services. They have capitalised on their political links to profit from the large scale property re-distribution in the nineties.⁶⁵²

Unlike them, small scale fraudsters are rather high-risk entrepreneurs, who have been involved in one way or another in previous excise and organised VAT frauds or other tax crimes. In most cases, they neither possess the economic capacities, nor the political links of the oligarchs. Thereby they are more vulnerable to become targets of police investigations and tax inspections (BG-E4).

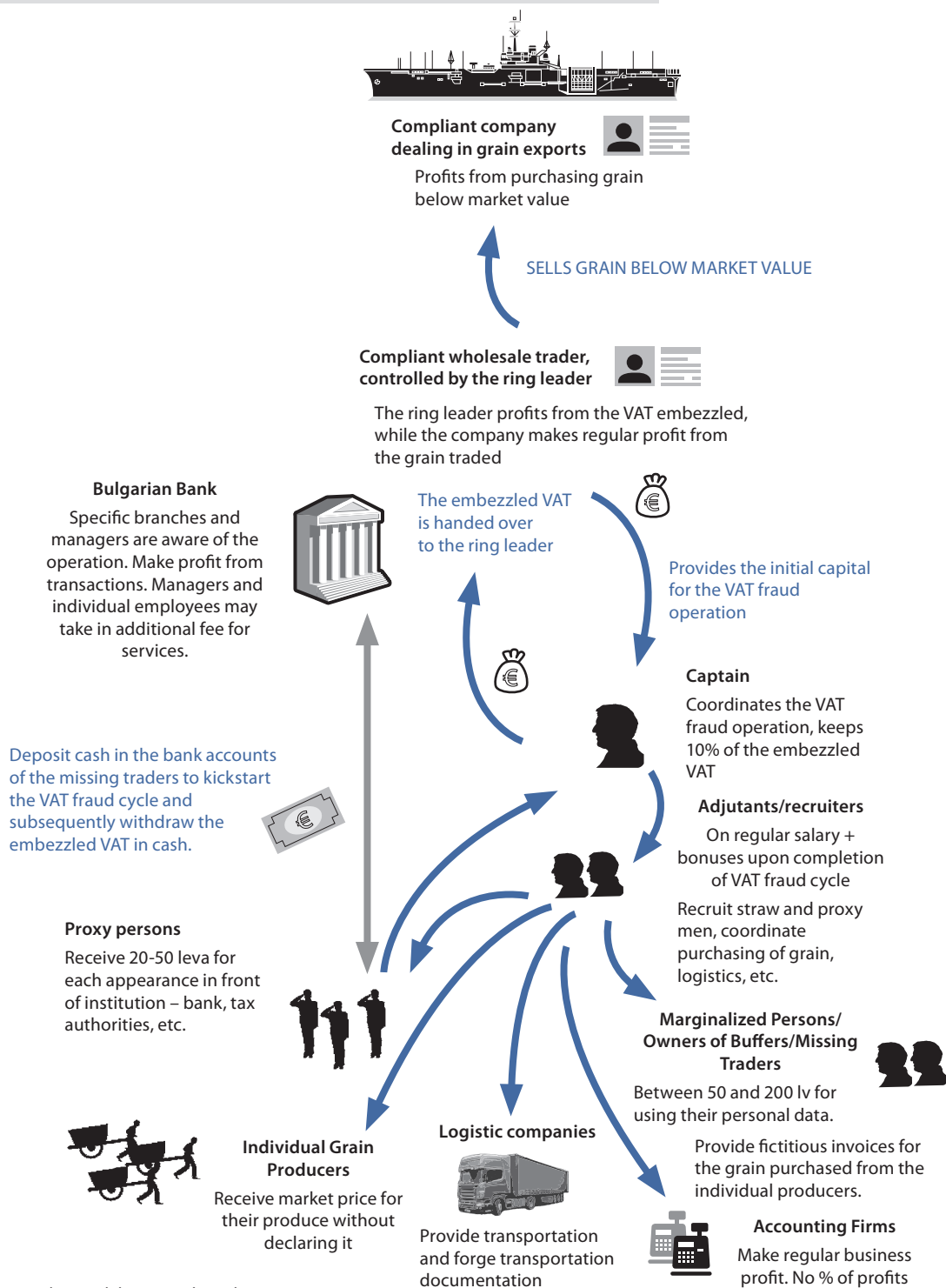
The practical implementation of the fraudulent schemes is entirely designated to the **outer circle players**. The outer circle players include actors with various roles – straw men, proxy persons, recruiters, supervisors, accountants. **Straw men** are usually illiterate persons from disadvantaged backgrounds who are lured to provide their identity for the registration of missing trader or buffer companies. They are remunerated with small amounts of money in advance and promised to receive some small monthly salary. Many of them are from the Roma community, but they could also be foreign citizens (e.g. Macedonian, Romanian), immigrants, terminally ill or disabled persons or simply people in need and are regularly replaced (BG-E1, BG-E22). Somewhat similar is the role of the **proxy persons**, who receive power of attorney on behalf of the missing trader companies and agree to represent them to banks or other institutions. Proxy persons are used to deposit or withdraw vast amounts of cash in favour of or on behalf of the missing-traders and receive a small fee for each of these missions. Both straw person and proxy persons are not aware or are aware to a limited extent about the fraudulent nature of their activities (BG-E22). **Buffer** persons are usually exposed to less risk and are not replaced so often as straw persons that act as missing traders. Therefore they receive monthly remuneration and a small percentage of the invoices issues (BG-C2).

Straw men and proxy persons are quickly replaceable and are the ones who usually face administrative sanctions or criminal charges in case the tax authorities or law-enforcement detect the fraudulent scheme. Therefore, fraudulent VAT networks are constantly seeking and recruiting new ones, as they need to change them every six or so months. This is usually the task of the **recruiters**, also known as **lieutenants**, who are also part of most criminal networks (BG-E13, BG-E22). Other important outer circle actors are the **accountants**. They provide not only bookkeeping services, but also manage the bank transactions and provide tax expertise. The criminal network and all the other outer circle actors are usually coordinated by a **supervisor** (also “captain”) who is usually a person trusted by the ring leader. The supervisor is responsible for the day-to-day management, the payment to all other actors involved in the scheme,

⁶⁵² CSD, *Organised Crime in Bulgaria: Markets and Trends*.

as well as accounts the profits to the ring leaders. The lieutenants, the accountants and the supervisors do not appear in any of the companies involved in the fraudulent chain and receive fixed remuneration along with bonuses for each successful cycle of the scheme.

FIGURE 40. EXAMPLE OF ROLE DISTRIBUTION IN A MISSING TRADER SCHEME FOR THE EXPORT OF GRAIN



Source: Authors' elaboration based on interviews.

Corrupt tax, customs and law enforcement officers can also be categorised as part of the outer circle actors. Their role is indispensable, insofar as no fraudulent scheme would last long time without their complicity. They could assist the fraudster on a fee-for-service basis or in some occasions by getting directly involved in the criminal networks. In the latter case the corrupt public officials act in favour of companies which are involved in fraudulent activities over a long period of time (BG-E1). Equally important is the role of the **corrupt bank officials**, as they are the ones that actually witness the fraudulent money transactions and have the discretion to decide whether to report the suspicious financial transactions to the authorities as they are prescribed to do by anti-money laundering legislation (BG-E22).

The third and outmost level in the fraudulent network is the level of the so called **facilitators**. These are legitimate businessmen that generally are not aware (or at least it is very hard to prove that they are aware) of the fraudulent activities. Their companies might appear in the VAT fraud chains as conduits, buffers, final recipients, exporters or transportation companies. While some of them would receive a fixed fee for their services and turning a blind eye to the fraudulent activities, others would benefit from finding a market for their goods or services or from purchasing goods below market value.

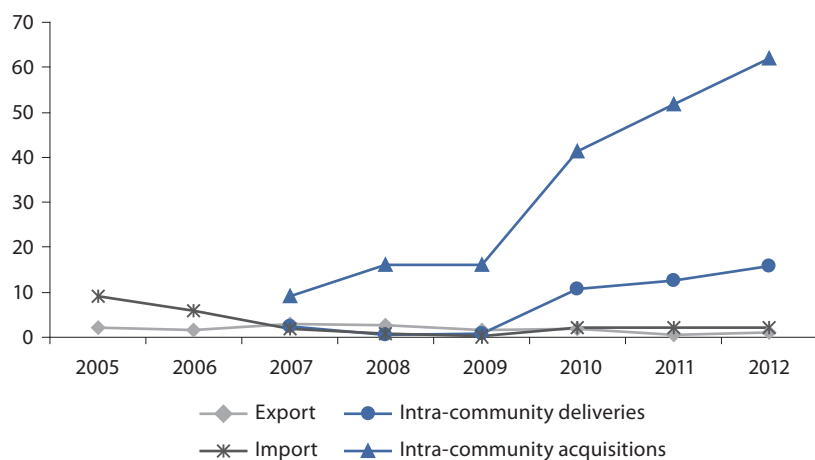
Taxonomy of VAT fraud schemes

Proper categorisation of existing fraudulent schemes related to VAT evasion first of all requires clear distinction between conventional tax avoidance and organised VAT fraud. As it was already mentioned, VAT tax avoidance is related to undervaluing of sales receipts or overvaluing of inputs with the objective of hiding tax liabilities. It is carried out on individual level by otherwise legitimate entrepreneurs. Conversely, organised VAT fraud abuses the tax refund mechanism and is pursued through a network of real and fictitious suppliers with accomplices within the tax and law enforcement authorities. Unlike tax avoidance, criminal VAT evasion schemes often involve inflating the value added in order to claim larger tax refunds. Fictitious transactions and missing traders are indispensable for organised VAT fraud.⁶⁵³ On the other hand, certain organised VAT fraud schemes facilitate individual tax fraud through providing fictitious invoices to legitimate companies that are trying to lower their tax liabilities (BG-E2, BG-E4).

The types of organised VAT fraud are pretty much the same across all countries that have adopted the VAT tax. The differences between the countries are largely related to the proliferation of certain schemes over others. The fraudulent schemes are usually classified based on the type of taxable supplies. In its analysis of the tax gap in Bulgaria (2013), the NRA identifies 5 basic types of organised VAT fraud schemes: fraudulent schemes related to domestic supplies, fraudulent schemes related to export to third countries, fraudulent schemes related to import from third countries, fraudulent intra-community acquisitions, and fraudulent intra-community deliveries.

⁶⁵³ Pashev, "Countering Cross-Border VAT Fraud: The Bulgarian Experience".

FIGURE 41. TRENDS IN VAT GAP COMPOSITION IN BULGARIA BY TYPE OF SUPPLIES



Source: NRA (2013, 2014).

The NRA reports that until 2007 organised VAT frauds were predominantly related to domestic supplies, whereas only a small share of the frauds (less than 10%) was related to imports or exports. Fraud related to intra-community acquisitions and intra-community deliveries spurred for the first time in 2007 with the accession of the country in EU. Five years later, frauds related to intra-community acquisitions had become the predominant type of VAT fraud in the country with 62% of all refunds related to such fraudulent schemes – a six-fold increase over the period 2007 – 2012. The frauds

related to intra-community deliveries also steadily increased and reached almost 16% of the unlawful VAT refunds (Figure 41).

Fraudulent schemes related to domestic supplies

The **fraudulent schemes related to domestic supplies** involve fictitious transactions or transactions with fictitious traders that take place within the jurisdiction of the country. These fraudulent schemes are usually related to provision of advertisement or construction services, as well as sale of agricultural products. Three modalities of such fraudulent schemes were reported – the “**invoice mills**”,⁶⁵⁴ the “**invoice bazaars**” and **domestic missing trader fraud**.

The **invoice mills** seem to be a particularly widespread form of organised VAT fraud and involve criminal networks that provide fictitious invoices to legitimate companies willing to diminish their VAT tax liabilities. Most of these invoice mills are built around the accounting houses, some of which provide services for hiding tax liabilities in addition to the entirely legitimate accounting services. There are also entirely criminal “mills”, which exist for the sole purpose of forging and selling fictitious invoices to legitimate companies willing to evade VAT taxes. These services are also known as “clearing of VAT duties” and are provided on a fee-for-service basis. The fictitious invoices are issued by specifically established shell companies which are registered by straw men with no income. The shell companies act as typical missing traders and provide receipts for fake sales or fake purchases and eventually fail to remit the collected VAT to the state budget (BG-E1, BG-E2, BG-E4, BG-E20).

There is a peculiar sub-type of these invoice mills that largely functions as an open market, where anyone can buy a fictitious invoice right on

⁶⁵⁴ Keen and Smith, “VAT Fraud and Evasion: What Do We Know and What Can Be Done?”

the street for 10-30% of the VAT value indicated on the invoice. The best term that describes this modus operandi of the fraudulent VAT networks is “**invoice bazaar**.” Such bazaars currently operate around the Iliyantsi marketplace in Sofia and the so called “Sunday market” in Dimitrovgrad, which are the two biggest and most prominent marketplaces for smuggled and counterfeit goods in Bulgaria.⁶⁵⁵ The provision of fictitious invoices at these marketplaces emerged as a supplementary service for the traders that were purchasing wholesale merchandise from these marketplaces and therefore needed documents for the tax authorities.⁶⁵⁶

Unlike invoice mills that usually provide their services both to small and medium businesses, the invoice bazaars serve mainly small traders who want to evade VAT or corporate tax duties. In contrast with the regular invoice mills, in many cases the fictitious invoices sold at these bazaars are entirely fake (i.e. use VAT numbers of non-existing or already bankrupt companies). Sometimes the invoice dealers also sell falsified invoices, which are filled in using hijacked identities of existing companies (BG-E1). Registering of missing trader companies on behalf of straw men is also practiced. The organised criminal groups that perpetrate this crime are mostly of Roma ethnicity, but they also collaborate with accounting houses. The groups usually have three-level structure, which includes street dealers, supervisors and ring leaders, as well as facilitators such as accountants and corrupt law enforcement officers (BG-E4).

The **domestic missing trader fraud schemes** usually involve medium and big businesses. They were quite popular in the construction sector during the boom in construction in the period 2004 – 2008. Such schemes were set up by many construction companies and commercial property investors in order to unlawfully deduct the VAT due. The schemes involved introduction of phantom companies that are commissioned as subcontractors to perform the construction and installation works, as well as using shell companies as suppliers of construction materials. These phantom and shell companies are registered in the name of straw men and act as missing traders or cross-invoicers.

In many cases, the same bogus companies that are introduced as subcontractors of construction and installation works are also used as an instrument to use undeclared labour and evade payments for income taxes, social security and health insurance contributions. Similar schemes are perpetrated in the agricultural and food processing sector through contracting bogus companies as fictitious suppliers of agricultural products or labour providers (BG-E4).

Fraudulent schemes related to intra-community deliveries or export

A popular kind of fraudulent scheme related to intra-community deliveries or export to third countries is **fictitious export**. In fictitious export schemes the exporter carries out the transaction on paper applying

⁶⁵⁵ These marketplaces emerged in the 1990s, when the contraband was thriving in the country, but gradually lost their importance with the accession of the country to the EU and the rise of the standard of living.

⁶⁵⁶ CSD, *Transportation, Smuggling, and Organized Crime* (Sofia, 2004).

zero VAT rates, while in reality sells the goods domestically on the grey market without invoices and subsequently claims tax credit refund on the inputs. Some of these schemes involve real exports of goods, but with overstated value. These types of fraudulent schemes are particularly widespread for products such as grain, cigarettes and fuels (BG-E11, BG-E20). Fictitious intra-community deliveries gained momentum after 2007, following the accession of Bulgaria to the European Union and largely replaced fictitious exports to third countries. The reasons were similar as in the case with the MTIC fraud on acquisitions – the relaxed physical control over the flows of goods within the single market turned these schemes into less risky and easier to perpetuate in comparison with exports to third countries.⁶⁵⁷

Another widespread type of fraudulent schemes related to intra-community deliveries or export is **missing trader fraud on exports**. In contrast to the fictitious export schemes, this scheme involves real cross-border transactions and is usually related to agricultural produce. The fraud is perpetrated through introduction of a missing trader between the farmers and the exporting company. The missing trader purchases agricultural produce (grain, sunflower seeds, etc.) from small farmers who are not VAT registered and sells it up the chain to the exporter with the VAT included. Another similar scenario is to register missing trader companies as agricultural producers. Under this scenario the products are purchased from real farmers without any documentation and the missing traders provide invoices with VAT included. In both cases the missing traders accumulate VAT liabilities, but go insolvent or abscond without remitting the tax to the budget (BG-E15, BG-E22).

Acquisition fraud

Fraudulent schemes related to intra-community acquisitions and import from third countries can generally be categorised as acquisition fraud. These schemes are typically commodity based and involve a bogus company that acts as a missing trader and supplies real goods from abroad for consumption at the domestic market. The missing trader embezzles the VAT debited and sells the goods on price equal or below market value. Missing trader fraud related to import from third countries was more common before the accession of the country to the European Union, after which it was largely replaced with missing trader intra-community acquisition fraud. The reason was the alleviation of the customs controls on the flow of goods from other Member States, when Bulgaria became part of the single market. This effectively removed the necessity for complicity of corrupt customs officers in order to run such fraudulent schemes and ultimately turned intra-community frauds to more attractive for organised crime.⁶⁵⁸ The fraudulent networks constantly adapt the schemes as a response to the efforts of the authorities to effectively counter them. Therefore, criminal networks often change the countries of origin for the goods in order to evade detection.

⁶⁵⁷ Pashev, "Countering Cross-Border VAT Fraud: The Bulgarian Experience".

⁶⁵⁸ Ibid.

MTIC fraud on acquisitions affects all kinds of fast moving consumer goods such as meat, sugar, dairy products, fruits and vegetables (BG-E4). The most basic form of this fraud is to purchase goods at zero VAT rate from a trader based in another member state and then sell them at the grey market domestically without receipts or invoices, thus evading the remittance of the VAT due to the state budget. Generally, this scenario repeats the well-known schemes for smuggling of goods with the only difference that the movement of goods across EU is not subject to customs control, so there is no need to evade it (BG-E4). Similar widespread scenario for this kind of fraud is to purchase goods from abroad through a missing trader company and sell them to legitimate retailer or manufacturer. Under this scenario the missing trader accumulates the VAT paid by the legitimate traders up the supply chain, but does not remit it to the budget. The VAT embezzled is paid by the final recipient of the goods – i.e. some manufacturer or retailer (BG-E3, BG-E4). A third scenario is to couple the acquisition fraud scheme with subsequent fictitious export, thus embezzling the VAT through a refund from the state budget. In this case the goods are usually sold on the grey market without any receipts or invoices (BG-E10, BG-E13, BG-E19).

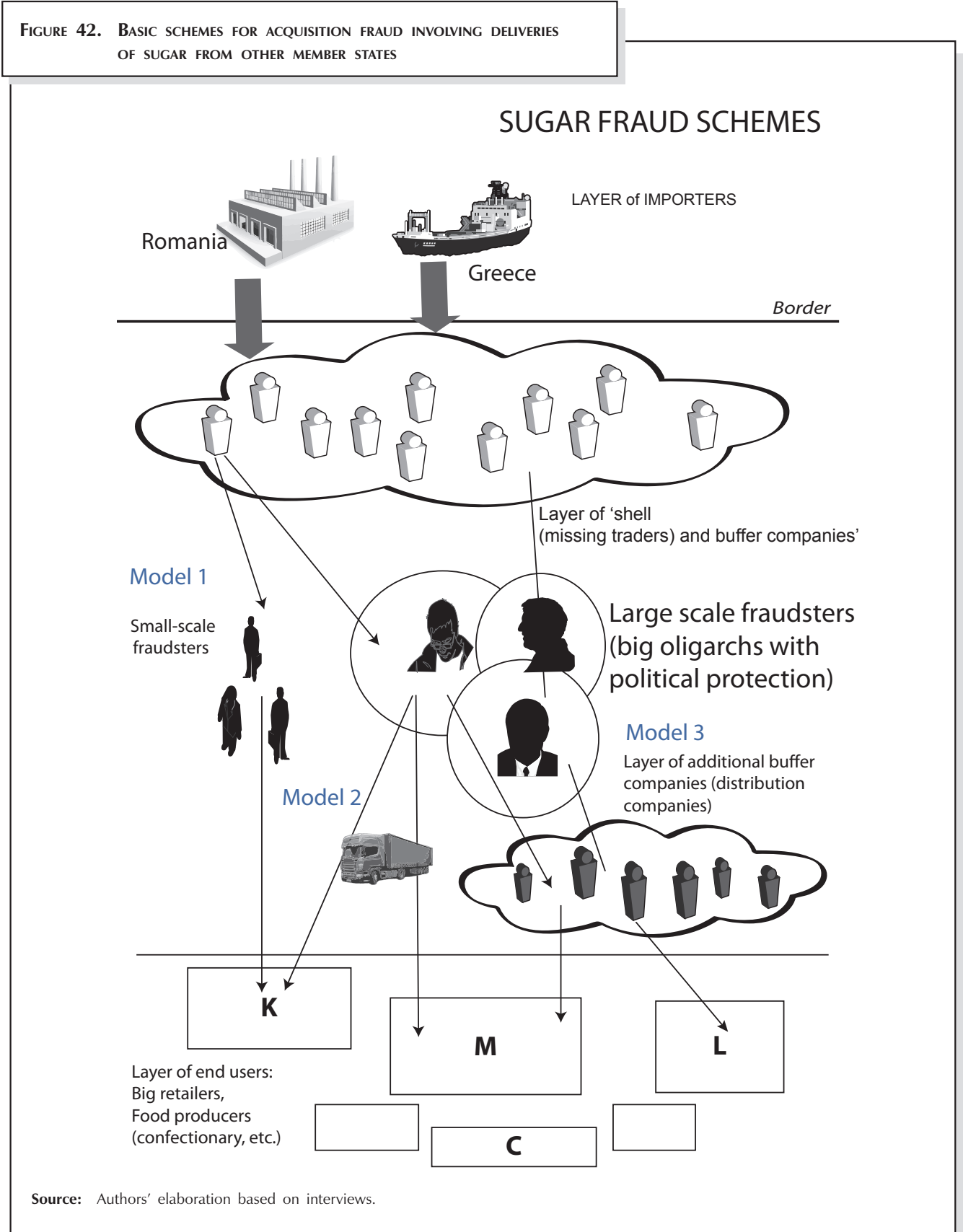
Missing trader fraud related to import from third countries is still perpetrated, although on a lesser scale. It is related mostly to import of goods from China and Turkey, which are two of the biggest trade partners of Bulgaria outside EU. These schemes along with embezzling of the VAT tax, also involve evasion of customs duties through various techniques such as understating the value of imported goods, misrepresentation of the origin or misclassification of the goods of imported, incorrect declaring of quantity of goods. Missing trader fraud related to import from third countries concern goods such as vegetables, apparel, toys, home appliances, construction and building materials (BG-E7, BG-E10).

Carousel schemes are a more sophisticated type of criminal VAT fraud, which involves repeated rounds of cross-border transactions, whereby the traded goods move in a circular pattern (in a “carousel”). The fraudulent chain starts with a missing trader that imports goods at a zero VAT rate. Unlike in the acquisition fraud schemes, the goods are not destined for the domestic market but are sold through a chain of business-to-business transaction chains within the country only to be re-exported again at zero VAT rate, thus providing the last trader in the supply chain (the “broker”) with the right to claim VAT refund on the inputs. The chain of transactions is repeated over and over again, stealing the VAT on each occasion.⁶⁵⁹ The imports and the exports could be either to other member states or to third countries. Usually the chain involves series of fictitious transactions, the role of which is largely to conceal the link to the zero-rate trader at the end of the chain, as well as to inflate the value of the traded goods and thus provide for a larger VAT tax credit to be claimed.⁶⁶⁰ According to the NRA (2013) carousel fraud is not a

⁶⁵⁹ F. Borselli, *Organised VAT Fraud: Features, Magnitude, Policy Perspectives* (Rome: Banca d'Italia, 2011).

⁶⁶⁰ K. Pashev, *Corruption and Tax Compliance. Challenges to Tax Policy and Tax Administration* (Sofia: Center for the Study of Democracy, 2005).

big threat for the Bulgarian budget and currently does not contribute to more than 2-4% of the organised VAT fraud gap.



Abuse of customs procedure for transit of goods

Apart from the fraudulent schemes described above, another kind of VAT fraud is related to abusing the customs regimes related to goods imported from third countries. This kind of fraud has not been so widespread after the accession of the country to the EU, as it was replaced by frauds related to intra-community supplies, but remains persistent nevertheless.

According to the Community Customs Code which is applicable in all member states, goods travelling between two points of a customs territory, via another customs territory, or between two or more different customs territories, are allowed temporary suspension of VAT, customs and excise duties. The tax and duties are levied at the destination point of the imported goods. The movement of goods between the 28 EU member states, the EFTA countries (Iceland, Norway, Liechtenstein and Switzerland) and Turkey are subject to the common transit regime (also known as customs procedure 4200). The transit regime should not be confused with the TIR⁶⁶¹ regime regulating the movement of goods which begins or ends outside the Community, or is effected between two points in the Community through the territory of a third country.

The fraudulent networks abuse the transit regime by placing the imported goods under the customs transit procedure and declaring them as delivery for another member state or third country. The usual countries of origin for the goods are China, Turkey and to a lesser extent – the Western Balkan countries. The goods are leaving the country only on paper, whereas at the same time they are sold at the domestic market (BG-E14). In order to enable such schemes, shell companies are registered in other member states that act as importers. Many of these fraudulent schemes rely on the complicity of customs officers and involve unlawful unloading and reloading of the goods on other vehicles, manipulation of the documentation on origin, quantity or value of the goods with the aim to evade customs duties, replacement of the goods and accompanying documentation before customs clearance (BG-E13).

Financing and financial management

Many of the interviewees shared the opinion that to set up a VAT fraud scheme criminals do not need initial capital or that only a minimal initial investment is needed, since once operating the schemes become self-sustaining (BG-E3). This might be true for conventional VAT evasion schemes, where it comes to “cooking” accounting books or utilising tax optimisation techniques, or to low profile schemes such as the invoice bazaars and the invoice mills. However, organised VAT fraud schemes involving trade in real goods or services require substantial initial investment in order to cover the value of the commodities or services that are purchased. Furthermore, in order to start importing large quantities of certain goods, apart from possessing the actual resources to make the purchase, companies usually also must demonstrate to their suppliers abroad financial capacity and reliability through presenting bank guarantees or letters of credit.

⁶⁶¹ Transports Internationaux Routiers.

Many of the interviewed experts stated that along with the financial capacity, far more important for entering and surviving in a given VAT fraud niche appears to be the social capital and reputation of the persons involved. Securing political or administrative protection would not only provide for establishing and surviving in this business, but can also aid in securing the needed financing.

What distinguishes organised VAT frauds from the typical criminal markets such as the drug market is that fraudulent chains mimic legitimate business transactions and therefore the flows of illicit and licit money are inter-mixed. This makes it very hard to distinguish between legitimate, grey and entirely criminal sources of money which are used to set up the crime.

Sources of capital for criminal operations. Profile of financiers in criminal operations

The ring leader as a financier (self-financing)

Many of the experts interviewed contended that in most cases the big players in organised VAT fraud schemes are actually well-established legitimate traders or manufacturers in certain economic sectors. Therefore they finance the organised VAT fraud schemes with **revenues from their legitimate business** or sometimes with **personal savings**. Examples were provided for the sugar and confectionery industry (BG-E3, BG-E4, BG-E11, BG-E18), the alcohol industry (BG-E17), the meat industry (BG-E4, BG-E22).

As mentioned earlier, most of these well-established businessmen involved in VAT frauds can best be described as oligarchs with political and economic influence either on local or national level. Therefore they utilise this influence when perpetrating organised VAT fraud schemes. Examples were provided for the sugar and meat industry, where all big VAT fraud actors were actually the owners of the biggest manufacturing and wholesale companies (BG-E4).

The funds may originate from the legitimate revenues of the companies they own, but actually very often much of these funds result from unaccounted **grey revenues**. The size of shadow economy in Bulgaria reaches 31% of the GDP or about €12 million in 2013 and is one of the highest in EU, whereas the average share for EU-28 is only 18%.⁶⁶² The big players in the organised VAT frauds actively employ various grey practices in their otherwise legitimate businesses and according to some of the experts interviewed at least half of their business is practically in the grey sector (BG-E17, BG-E20). It is this **vast shadow economy that creates the nurturing environment for the emerging and sustaining of the fraudulent VAT schemes** and a number of other criminal activities such as excise goods frauds, corruption to name a few.

Among the grey practices mentioned were various tax optimisation and conventional tax evasion techniques such as use of undeclared labour,

⁶⁶² F. Schneider, *The Shadow Economy in Europe* (VIZA Europe, 2013).

sale of excise goods without excise stamp (e.g. liquors), overstating the losses due to normal spoilage (e.g. with sugar processing or sugar packaging), declaring loss due to depreciation or decay (e.g. with perishable goods – fruits, vegetables), understating quantities of goods sold or overstating value of inputs. A typical example was provided with the sugar manufacturing industry, where the producers usually incur 2-3% losses due to normal spoilage. However, they declare 9-10% losses due to normal spoilage and subsequently sell the written-off amounts of sugar without invoices (BG-E13). Somewhat similar scheme was described in relation of import of fruits – company imports bananas, sells them without invoice and after 30 days writes them off the books, accounting for loss due to decay (BG-E5).

Thus the owners of these companies accumulate unaccounted grey revenues stemming from avoidance of payment of VAT tax, corporate tax, income tax, social and health security contributions. Part of the grey revenues are invested to grow their licit business or to buy political and administrative protection through corrupting politicians or public officials. However, part of it is subsequently invested in entirely criminal VAT fraud schemes.

Certainly, ring leaders also invest own revenues from criminal sources. Mostly **revenues from previous VAT fraud cycles** are re-invested in new operations, as well as money from other kinds of tax frauds such as excise or customs duty frauds (BG-E1, BG-E3). Somewhat similar is the case with former tax or customs officers that invest funds accumulated through **corruption** in initiating VAT fraud schemes (BG-E20). However, fraudsters that are involved in low-profile schemes such as invoice mills or are operating on a smaller scale might also invest money from **other criminal businesses**. An example was provided of a ring leader of fraudulent VAT scheme who was also notorious for his extortion racketeering, loansharking and money laundering activities (BG-E15). Apparently, some criminal entrepreneurs act opportunistically and easily switch from VAT frauds to excise frauds or loansharking.

External source of financing

Big players in organised VAT fraud rarely turn to external sources of financing, since they already possess substantial financial and economic capacity. However, being well-established economic players, it is not difficult for them to obtain a **bank loan** for example (BG-E17). An example was provided with a notorious ring leader of VAT schemes related to intra-community supplies of sugar and meat. In 2010, he received €23 million in the form of bank guarantees and loans from a Bulgarian bank institution through two companies under his control. Allegedly the funds were invested in VAT fraud schemes (BG-E3). The case subsequently became public, when the ring leader was charged by the Prosecution's Office for criminal evasion of VAT taxes and the two companies failed to repay the credits to the bank.⁶⁶³

⁶⁶³ Mediapool, "Прокуратурата разследва кредити за 46 млн. евро, отпуснати от ПИБ без 'елементарна проверка' [The Prosecutor's Office Investigating Credits for €46 million Granted by FIBANK without a 'Basic Examination']", *Mediapool.bg*, February 27, 2014.

In contrast with the big players in organised VAT frauds that rely primarily on self-financing, small and middle scale players in most cases do not possess the economic capacity needed to secure financing from their own sources, neither the financial credibility to apply for a loan. Thus, they often have to turn to alternative sources of financing to complete a VAT fraud cycle. Such external sources of financing might be illegal lenders, trade credit from manufacturers or exporters, and advanced payments from customers.

Several of the respondents provided examples in which the money for the VAT fraud scheme had been provided by an **illegal lender** ("black financier"). The criminal entrepreneur that was interviewed shared that he has started his fraudulent scheme involving import of mobile phones by obtaining a loan from a typical loan shark. The loan was for €25,000 with a monthly interest of 1%, whereas the collateral was his personal apartment and a promissory note for the sum. He managed to repay the loan in two years, but as the scale of the scheme grew up the loan shark decided to step in the business as a partner and investor. He extended his credit line but lowered the interest to 0.5 per cents monthly (BG-C1).

Other respondents reported similar cases, where such illegal lending was used to set up VAT fraud schemes. The illegal lender was a notorious fraudster from the Black Sea city of Varna, also known for various property crimes, smuggling of goods, organised VAT frauds, excise and customs duty frauds (BG-E22). **Legitimate businessmen** were also reported to provide initial financing of VAT fraud schemes (BG-E20).

Alternative source for securing initial financing for a given VAT fraud cycle appears to be setting agreements with manufacturers or exporters to provide the **goods on credit**. An example was provided for a criminal player that used to work for one of the big VAT fraud ring leaders in the sugar industry sector. He managed to secure delivery of several tonnes of sugar on a trade credit from a Greek manufacturer and thus initiated his own VAT fraud ring (BG-E4).

A similar approach is to secure the funding through **advanced payments** of the customer that would be the final recipient of the goods (BG-E1, BG-E3). An example was given of a complex acquisition fraud scheme involving importation of fast-moving consumer goods and their subsequent fictitious re-export to Kosovo, where the financing of each cycle was secured by advanced payments from the retail traders in Bulgaria that were final recipients of the goods (BG-E13).

In any case, **trusted relations and sound reputation** are indispensable for acquiring external financing. Therefore, usually actors that have already been part of such VAT fraud networks and have gained certain credibility can receive financing through such means.

Settlement of payments

A closer examination of the VAT fraud chains reveals that two separate and yet linked flows of money can be distinguished in all fraudulent schemes. The first flow is pertinent to the settlement of payments between the fictitious and legitimate companies which are part of the fraudulent chain. This flow mimics legitimate trade transactions and therefore all payments between these companies are settled through regular bank transfers and declared officially to tax authorities. Therefore this flow could be labelled as the “clean money flow.” This flow initiates with the purchase of the goods by the missing trader and their subsequent sale to the buffer companies up the chain to the customers that are the final recipients.

The second flow of money relates to the settlement of payments between the individuals behind the fraudulent chain of companies such as captains, lieutenants, accountants, straw men, proxy persons and corrupt public officials. Some of the actors (straw men and proxy persons) are paid on fee-for service basis, whereas others (captains, lieutenants and accountants) receive a fixed monthly remuneration. In contrast with the first money flow, the payments are usually settled in cash (BG-E22); thus, this flow could be labelled as the “dirty money flow.”

The two money flows intersect in the bank accounts of the missing trader (or sometimes the buffer), which is the in-out point and most vulnerable part of the scheme. The missing trader is a shell company per se and therefore does not have any assets or financial capacity. In order to purchase goods or services, the missing trader bank accounts need to be provided with income by the ring leader. This is the moment when the dirty money flow feeds into the clean money flow. Subsequently, the VAT embezzled within the fraudulent transactions is accumulated in the missing trader bank accounts and is eventually withdrawn or transferred in favour of the ring leader. At this point the clean money is converted back to dirty money, which can be invested in a new fraud cycle or laundered for the benefit of the ring leader.

As missing trader bank accounts are the most common target of tax and law-enforcement authorities, VAT fraud networks employ a variety of risk mitigation strategies to evade potential freezing or seizing of the money. In order to conceal the suspicious nature of the transactions, as well as the origin of the funds, fraudsters usually declare false premises for the transactions. For example the initial income to the missing traders account is disguised as advanced payment, intercompany loan, instalment for raise of capital or capital increase, unspecified payment through offshore accounts. Similarly the VAT embezzled might be declared as payments for consultancy services and transferred to an offshore bank account abroad (BG-E5). However, it seems that in most cases fraudsters usually resort to not very complicated strategies for concealment of the origin of the funds such as depositing the sums in cash with the assistance of proxy persons that act as agents with power of attorney. Less common is the introduction of offshore companies in such schemes as an instrument to conceal the origin of funds and hinder the detection and tracing of the chain of transactions (BG-E3).

Another common strategy to mitigate the risks of detection and freezing is to keep the accounts of all actors involved in the scheme in the same bank and thus speed up the transfers. As a rule, all bank transactions are ordered in a single day at the end of the working week. Thus fraudsters minimise the risks of the accounts being frozen before all payments are completed and the defrauded VAT is withdrawn in cash or transferred to a safe offshore account (BG-E2).

The practices described above are possible, insofar as most VAT fraud networks operate with the aid of complicit bank clerks. Apparently, fraudsters are highly dependent on the acquiescence of the banks and bank officers. The assistance of a bank clerk is crucial not only for speeding up the transactions, but also for evading the anti-money laundering rules regarding suspicious transactions. Complicit bank clerks sometimes also act as informers in case there is inquiry about the accounts of the fictitious companies from the authorities. The clerks may act with or without the knowledge of the branch manager. However, many of the experts interviewed shared that it is a widespread and regular practice to feed the accounts of the missing traders with depositing large sums in cash. Similarly, in most cases the VAT embezzled is also regularly withdrawn in large sums in cash. This highlights flagrant violations of the anti-money laundering rules, insofar as such transactions should not be possible to remain unnoticed for a long period of time. However, apparently banks often fail to report such suspicious transactions, as senior management in many banks does not want to lose valuable customers and turns blind eye to such practices (BG-E3, BG-E4, BG-E22).

Costs of doing business

The size of the costs for initiating and perpetuating a VAT fraud scheme is a good indicator for the amount of initial capital needed to enter this criminal business. The analysis of the criminal financing related to organised VAT fraud shows that regardless of the type of schemes, the costs encountered by the fraudulent networks differ mainly in scale. However the structure of the costs is more or less similar. Since most of the schemes are based on trade in real goods or services, the lion's share of the costs relate to the purchase of the goods or services. The only exception from this rule are the low profile schemes such as the invoice bazaars and the invoice mills, which are not trade-based but rather provide fictitious documents on a fee-for-services basis. Apart from the costs for purchase of real goods or services, the rest of the costs such as costs for registering bogus companies, fees for straw men and facilitators, corruption fees for public officials and remuneration to the actors from the outer circle of the fraud ring, are common for all schemes.

Costs related to purchase of real goods or services

Purchase of real goods usually requires substantial initial investments, especially when it comes to intra-community supplies or imports/exports. Most manufacturers, commodity markets, big wholesalers or exporters trade only in large quantities. They usually set a minimum order quantity, which may reach up to several hundred or even a thousand tonnes for products such as sugar, grain or fuel. Similarly, final recipients such as big

retailers or manufacturers also have requirements for minimal quantities and regularity of supplies. Thus, in order to set up a VAT fraud scheme based on import/export or intra-community supplies of real goods, a criminal network would need to invest a substantial amount of money. The investment would be justified as dealing in larger quantities is more profitable, insofar as it allows for economies of scale through cutting on the other expenses such as transportation, storage, bribery.

Several examples were provided in the interviews that reveal the size of these kinds costs. In a case related to VAT fraud with intra-community-acquisition, the scheme started with a purchase of 200 tonnes of sugar worth of over €100,000 (BG-E4). On a second case related to VAT fraud with sugar, there were 5,000 tonnes imported from Moldova, so the investment only for the purchase of the product was about €2.5 million. Another expert reported a VAT fraud case related to export of grain, where the criminal network invests €250,000 for the purchase of the grain (BG-E22). However, the size of the costs depends on the type of VAT scheme implemented. Acquisition frauds, where the goods are delivered only to be directly sold on the grey market would be possible even with low investment. Conversely, acquisition schemes aiming at selling the goods to big retailers apparently require much substantial investment that only criminal players with substantial financial capacity and established reputation could secure.

Furthermore, in most cases the goods or services, which are supplied to the final recipients of the fraudulent networks, are sold at prices below market value. This is the instrument of the fraudulent networks to secure market for their goods or services, whereby they lure legitimate companies through offering them discounted prices. However, such discounts can also be categorised as costs for the fraudulent network.

Costs related to logistics and transportation

Since many of the VAT fraud schemes are trade-based, costs related to transportation, storage and other logistics are indispensable part of all expenditures. In order to prove that the declared trade transactions are real, the fictitious traders need to provide not only documents for the origin of the goods (invoice) and payment documents (bank orders, receipts), but also transportation documents (bill of lading, CMR or consignment notes). Usually the transportation is by road, although big schemes may include maritime transportation as well. In order to keep these costs as low as possible, the bulk of the schemes related to intra-community supplies or imports/exports are usually set up to include legitimate or fictitious traders in the neighbouring countries such as Greece, Romania, Turkey, Serbia, Macedonia, Ukraine. For example, to have a truckload of sugar (about 22 tonnes) from Greece costs about €180,⁶⁶⁴ so the costs to ship 2,000-2,200 tonnes of sugar would amount to €18,000.

Sometimes other logistic costs are also incurred. These could be related to storing of the goods or packaging. Packaging companies are a common

⁶⁶⁴ Administrative Court Plovdiv, Case 3227/2012, Decision 359/11.02.2014.

actor in many of the MTIC frauds, where they may appear as buffer or broker companies (BG-E16). They are included as many of the goods are imported in bulk and are required to be packaged and labelled before being sold in the retail outlets. The costs for packaging of 1 tonne of sugar are about €60,⁶⁶⁵ so for 2,000 tonnes, this amounts to €12,000. In schemes related to export of grains, storage costs are also an important expenditure. For excise goods frauds, storage costs are even higher, as only licenced warehouses can be used. Perishable goods such as meats, vegetables and fruits also may require specialised transportation and storage and more expensive packaging.

Costs related to remuneration of outer circle actors

Outer circle actors such as straw men, proxy persons, lieutenants, captains, accountants are usually paid on a fee-for-service basis. Straw men usually receive €25-€50 for allowing their identity to be used for registering a missing trader company; in addition to that they may receive €200-€250 per month as a salary to act as an official representative of the fictitious company. Proxy persons are paid a fixed fee for each occasion they deal with bank institutions or tax authorities as agents with power of attorney from the fictitious company – one of the respondents mentioned a fee of €10-€25 per occasion (BG-E22). Buffer persons are also paid on a monthly basis along with certain percentage of each invoice issued. According to one of the respondents who was acting as an owner of a buffer company in a VAT fraud scheme, he was receiving a monthly salary of €500-€1,000 and 0.5% of the value of each invoiced issued by his company (BG-C2).

Lieutenants and captains usually receive a fixed monthly remuneration, as well as certain bonuses with the completion of each fraudulent cycle. A captain supervising a fraudulent ring may receive from €1,000-€2,000 up to €5,000-€7,500 monthly depending on the scale of the activities (BG-E20). Lieutenants were reported to receive about €500 per month (BG-E21). Accountants are also paid a pre-agreed sum as a monthly salary, except if the group works with an accounting house which charges a percentage per each invoice. One of the offenders interviewed reported that they were paying to the accounting house 1% of the value of each invoice issued (BG-C2), while another respondent reported about 20% of the embezzled VAT (BG-E21).

Costs related to establishing or acquiring a company

Registering a company in Bulgaria is relatively easy and an inexpensive process. Following the latest amendments of the Bulgarian Commerce Act in 2009, the initial capital required for establishing a limited liability company is only €1. Given that registration fees are about €150, these costs should not be an important barrier to the fraudsters. However, in order to demonstrate and prove capacity of a given fictitious company to the tax authorities, they might need to rent an office, warehouse

⁶⁶⁵ L. Lekova, "Хипермаркети подбиват цената на захарта [Hypermarkets Undercut the Price of Sugar]", *Pressadaily.bg*, August 06, 2012.

or other commercial venues. They would also need to hire personnel. However, most missing trader companies would rather rent an office and hire workers for a week and only in case they have information about an upcoming tax audit (BG-E3).

Costs related to corruption

Corruption fees are an inherent part of the costs for initiating and perpetrating VAT fraud schemes. All respondents have discussed about the role of complicit officers from tax, customs and law enforcement institutions. The corrupt practices mentioned included selling of information (BG-C2), securing administrative protection against tax audits (BG-E20), securing administrative protection against customs control on goods imported or exported to third countries (BG-E10), admitting selected vehicles to enter through external border without exerting proper customs control (BG-C1), not exerting inland control by the customs mobile units (BG-C1, BG-E10), manipulation of the electronic system for registration of vehicles entering or leaving the country (BG-E11, BG-E17), forging of false or fictitious documents for import, export or transit of goods (BG-E13).

The analysis of the data suggests that the size of the corruption fees depends on the level of involvement of the respective public official, as well as on the level of risk he undertakes. However few of the respondents reported specific sums for the bribes paid. Table 48 summarises several examples for corruption fees that were reported by the respondents.

TABLE 53. REPORTED SIZE OF BRIBES FOR VARIOUS CORRUPT PRACTICES IN BULGARIA

Corrupt practice	Perpetrators	Fees as reported (€)	Source
Selling information about upcoming tax audits.	Tax officer	150-200 per signal	BG-C2
Allowing selected vehicles to enter the country without exerting proper customs control.	Customs officer	300-500 per van (Turkish cargo – apparel, perfumery)	BG-E10
Allowing selected vehicles to enter the country without exerting proper customs control.	Customs officer	1,750 per truck (mobile phones)	BG-C1
Not exerting inland customs control by a specialised customs mobile unit.	Customs mobile unit	250 per truck (mobile phones)	BG-C1
Not exerting control by a customs mobile unit.	Customs mobile unit	1,750-2,500 per truck (Chinese cargo)	BG-E10
Falsifying documents for import, export or transit of goods.	Customs officer	250 per truck	BG-C1

TABLE 53. REPORTED SIZE OF BRIBES FOR VARIOUS CORRUPT PRACTICES IN BULGARIA (CONTINUED)

Corrupt practice	Perpetrators	Fees as reported (€)	Source
Manipulation of the electronic system for registration of vehicles entering or leaving the country.	Border guard officer	400-600 per week	BG-E11
Securing administrative protection against customs control on goods imported or exported to third countries.	Senior official at the Customs Agency	25,000 per month/300,000 per year	BG-E10

Source: Authors' elaboration based on the interviews.

Profits and profit sharing

Many of the experts interviewed provided examples for size of damage to the state budget established within investigations on specific cases. The damage established in one of the cases was €2 million (BG-E15), whereas in another was up to €13 million (BG-E13). However it should be noted that damage to the budget is neither equal to the actual revenues of the fraudulent networks, nor to their profits. First, the business models of the VAT schemes differ, so revenues may derive from different sources. Furthermore, part of these revenues is used to cover the costs of the fraudulent operation, so the profit margins also differ. Various opinions were shared regarding exactly how much of these revenues remain as a profit for the ring leaders.

Invoice bazaars and mills are fee-for-service based, so the revenues derive from the fees collected from the companies paying for fictitious invoices. Usually the fee is determined as a percentage of the VAT "cleared" on behalf of the customer. Experts reported that the fees are usually 10-15% of the VAT cleared, so if a VAT fraud ring clears €100,000 of VAT tax, the fraudsters will receive €10,000-€15,000. However, fraudsters have to cover various operational costs – accounting services, establishing missing trader companies, corruption fees, etc.

Acquisition fraud schemes and fictitious export schemes, which aim at selling goods domestically on the grey market without invoices or receipts profit from the mark-ups on the goods traded. As the goods are traded without VAT included, which is 20%, the fraudsters can afford to trade them below market value on the licit market and achieve mark-ups of 10-15% at the expense of the VAT taxes evaded. However part of these revenues are supposed to cover transportation and storage costs, costs for establishing missing trader companies, as well as bribes.

Far more complex is the business model of MTIC schemes, which aim to accumulate VAT through purchases and sales to tax compliant companies and thus target the VAT credit mechanism instead of directly profiting

through grey sales. Within these schemes, the size of the revenues from a given VAT fraud cycle is equal to the VAT tax embezzled by the missing trader(s), which amounts to 20% of missing trader's purchases. Certainly, if the fraud ring manages to sell the imported or delivered goods with a mark-up on the price, this also contributes to the overall profit from the fraud activities. However, some of the experts claimed that in many cases the fraudsters sell the goods at the price they have purchased them abroad (BG-E4). Selling the goods with a minimal or without any mark-up would be possible only if the fraudulent network operates on a really large scale. The turnovers of the fraudulent networks should allow the embezzled VAT to cover all operational costs (e.g. transportation, fees for actors involved, corruption fees, etc.) and provide for substantial profit of the ring leaders. The analysis of the data shows that this could be achieved only with fraudulent turnovers exceeding one million euro for a given fraud cycle.

Table 49 attempts to reconstruct the costs and profit of an intra-community delivery fraud cycle, building on the information of one particular case concerning trade in wheat grain (BG-E22). However, as the information on all expenses was not known to the expert interviewed, data from several other interviews was also incorporated. The example is just for illustrative purposes, as much of the important details about costs and profits are based on assumptions. In this example the fraudulent scheme is put up by an owner of a big grain wholesale company. The wholesaler, who is the ring leader, provides the initial capital for purchase of 600-660 tonnes of wheat grain from framers without invoices. Subsequently, through a fraudulent network of missing trader companies, the ring leader forges invoices to the wholesale company in order that the latter can prove VAT taxable purchases to the tax authorities. After selling the wheat grain with 43% mark-up to a big exporter, the missing traders accumulate the VAT and abscond without remitting it to the budget. The costs for the VAT fraud cycle are calculated for a one-month fraud cycle and account for the involvement of 6 missing traders and 2 buffers.

Few details were given in the interviews as to how the profits are shared between the inner circle actors in the VAT fraud networks. Some experts reported that the supervisor keeps 10% of the embezzled VAT tax and the rest remains for the ring leader (the owner of the wholesale company), as was in the case provided as an illustration in Table 49 (BG-E22). Other respondents reported that the ring leader keeps 20-30% of the embezzled VAT tax (BG-E3). Most likely, profits depend on a number of factors such as number of actors involved, scale and complexity of the fraud scheme, levels of risk.

The profits from the VAT fraud operations are invested in various ways. Apparently investing in new fraudulent schemes or expanding existing ones is most widespread (BG-E3, BG-E20). Common strategy is to invest in real estate (BG-C2, BG-E1, BG-E3, BG-E20), as well as to keep some money in safety deposit boxes or in bank accounts abroad as a "rainy day fund" (BG-C2, BG-E1, BG-E3). There was also a report from one of the experts interviewed about investing money from VAT frauds in loansharking (BG-E7).

TABLE 54. COSTS AND PROFITS FOR A VAT FRAUD SCHEME RELATED TO EXPORT OF WHEAT GRAIN

Type of cost	Item costs (€)	Overall costs (€)
Establishing shell companies (6 missing traders and 2 buffers)	200-300 per company	2,500
Straw men's remuneration (6 straw men)	200 per person/month	1,200
Buffer's remuneration (2 buffers)	2,500 per person/month + 0.5% of the value of each invoice	2,050
Lieutenant/recruiter (2 lieutenants)	500 per month	1,000
Captain/supervisor	1,000 per month	1,000
Accounting company	1-1.5% of the value of each prepared invoice	2,100
Purchase cost of grain (600-660 tonnes)	320-350 per tonne	210,000
Transport (30 trucks, 1 truck ->20-22 tonnes)	50 per truck	1,500
Corruption fees	per month	5,000
	Total investment per one month cycle	226,350
	Sell price (500 per MT without VAT)	300,000
	Net revenue	73,650
	VAT refund expected	60,000
	Profit (VAT + net revenue)	133,650

Source: Authors' elaboration based on the interviews.

Access to capital in critical moments

VAT fraudsters like any other criminal entrepreneurs face the risk of being investigated and prosecuted, as well as their money or assets being seized. Therefore they have to meet incidental expenses (such as loss of money or litigation expenses) or secure capital to restore business. Various scenarios for access to financing on such occasions were commented by the experts. First of all, the big players among ring leaders were believed to be able to manage in such cases by their own resources, since most of them also have large legitimate businesses, personal savings and various investments both in the country and abroad (BG-E3).

Small scale players rather rely on their social capital, as in many cases they anyway operate with advanced payments from customers or trade credit from their contractors abroad. One of the experts interviewed provided a notable example in support of this – notorious

VAT fraudster from Plovdiv received a trade credit of 200 tonnes of sugar from his former Greek counterpart in order to get back into business (BG-E4).

The problem with securing capital to get back into business concerns mostly trade-based schemes. However, fraudsters running fee-for service based schemes can easily resume their business at any time, since all they need is their reputation and contacts.

6.2. BELGIUM: THE ADDED DAMAGE OF CARBON EMISSIONS

Introduction

The value-added tax was introduced in Belgium in 1971 and replaced a number of consumption taxes such as the transfer tax (1921) and the tax on invoices (1923) which were originally meant to defray the costs of World War I.⁶⁶⁶ It was a European tax system that was turned into national legislation in order to achieve the objectives of the Treaty of Rome to create a common European market.⁶⁶⁷ The VAT is an important source of tax income of governments. In the EU, the VAT income amounts to more than €700 billion annually.⁶⁶⁸ In Belgium, the VAT accounted for 26.5% of total revenues of the Belgian state in 2012.⁶⁶⁹ But each year the Belgian National Treasury loses around 15% to 16% of all potential VAT income. In 2011, on a total of €30.9 billion VAT revenue, €4.9 billion in VAT collected by businesses never made it to the National Treasury.⁶⁷⁰ This difference between the theoretical tax liability and the actual revenue collected is called the VAT gap. In Belgium, the VAT gap was around 13% between 2005 and 2007, but increased significantly in the period between 2008 and 2011 to 16% due to the financial crisis. Although this loss of tax revenue has several causes,⁶⁷¹ it is partially the result of (organised) VAT fraud.

Because of its broad taxable base and high rates, the VAT system is an attractive target for organised criminals.⁶⁷² In Belgium the regular tariff for goods and services (new cars, cosmetics, home appliances) is 21%.⁶⁷³ In

⁶⁶⁶ K. Vyncke, "De impact van BTW op ondernemingsgroepen: BTW-eenheid naar Belgisch, Buitenlands en supranationaal recht. [The Impact of VAT on Business Groups: VAT Unit according to Belgian, Foreign and Supra National Law]" (Leuven: KULeuven, 2009).

⁶⁶⁷ A. Claes, *BTW-Carrousel: De fiscaal- en strafrechtelijke aanpak en de gevolgen voor de organisatoren, medeplichtigen en hun afnemers. [VAT Carousel: The Fiscal and Criminal Approach and the Consequences for the Organisers, Accomplices and Their Customers]* (Gent, 2005).

⁶⁶⁸ European Commission, *Clamping down on cross-border VAT fraud*, Press release, 13 February 2014.

⁶⁶⁹ Belgische Kamer van Volksvertegenwoordigers, *Begrotingen van ontvangsten en uitgaven voor het begrotingsjaar 2013 – Algemene toelichting [Budget of Receipts and Expenses for the Budget Year 2013 – General Explanation]* (Brussel, 2012).

⁶⁷⁰ CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report*.

⁶⁷¹ Such as bankruptcy, statistical errors, late payments, evasion, miscalculations and the performance of tax administrations (Ibid.).

⁶⁷² J. Swinkels, "Carousel Fraud in the European Union", *International VAT Monitor*, no. March/April (2008): 103-13.

⁶⁷³ There are two other tariffs: 6% for socially significant products and services (food, transportation, agricultural services) and 12% for certain goods and services that have an important economic or social objective (coal, margarine, subscription television).

the early 1980s, however, the VAT amounted to 25% with a luxury tax of 8% (for televisions and videos, for example).⁶⁷⁴

As early as 1974, three years after the introduction of the VAT, a Belgian VAT inspector fled to Spain after he had embezzled €3 million of VAT revenues through a classic VAT carousel.⁶⁷⁵ As a criminal phenomenon, organised VAT fraud has been known to the Belgian police since the end of the 1970s. It was not, however, until 2002 that the police could rely on accurate and reliable information with regard to the scale of the fraud and the different methods being used by fraudsters.⁶⁷⁶ The reason for this delay is that for a long time there was no specific regulation on the cooperation between fiscal and judicial authorities. While as of 1980 the public prosecutor could summon the assistance of fiscal investigators, the cooperation between fiscal and judicial authorities gained momentum when fiscal experts were being seconded to the public prosecutor's office in the beginning of the 1990s, and at the turn of the century a VAT fraud section was established within the Federal Police⁶⁷⁷ and a liaison cell between the judicial and fiscal authorities was created.⁶⁷⁸ The Support Cell Carousel Fraud⁶⁷⁹ was operational in 2001 and provided a coordinated and comprehensive view on VAT fraud. Fiscal fraud, including organised VAT fraud, now is high on the Belgian political agenda. Tackling fiscal fraud is a priority for the police and is denoted as such in the subsequent National Security Plans of 2004-2007, 2008-2011 and 2012-2015.

Based on data gathered by the Belgian Federal Police, the Support Cell Carousel Fraud and the Special Internal Revenues Service⁶⁸⁰ trends in organised VAT fraud can be identified. Organised VAT fraud in the 1980s concerned sales of cars, televisions, videos and computers, followed by mobile phones and electronics in the 1990s. Fraud involving informatics and computers took the lion's share of VAT fraud cases between 2000 and 2003. Fraud involving petrol, either through fictitious export, undeclared import or misusing lower tariffs by purchasing abroad and selling domestically was minimal around the year 2003.⁶⁸¹ Around the turn of

⁶⁷⁴ B. Staes and A. Buedts, *BTW carousel fraude [VAT Carousel Fraud]* (Brussels, 2011).

⁶⁷⁵ M. Van den Abeele, "Fraude carousel [Carousel Fraud]", in *Face à la criminalité organisée en matière fiscale. [Confronted with Organised Crime in Fiscal Domains]*, ed. A. Zenner (Liège: Luc Piré Electronique, 2001).

⁶⁷⁶ M. Holsteyn, *Vademecum georganiseerde BTW-fraude [Manual on Organised VAT Fraud]* (Brussels, Belgian Federal Police, CDGEFID, 2004).

⁶⁷⁷ The VAT fraud section of the Central Office for Combating Organised Economic and Financial Delinquency (CDGEFID). This office is part of the Directorate for Combating Economic and Financial Crime (DJF) of the Belgian Federal Police.

⁶⁷⁸ Staes and Buedts, *BTW carousel fraude [VAT Carousel Fraud]*.

⁶⁷⁹ The Support Cell Carousel Fraud (Ondersteuningscel Carrouselfraude, OCS) of the Special Internal Revenue Service is a multidisciplinary organisation composed of experts from the police, the treasury, and the public prosecutor's office. Its aim is to collect and share information on organised VAT fraud (E. Pearson, *Maatregelen Op Europees En Nationaal Vlak Om B.T.W.-Fraude Aan Banden Te Leggen. [European and National Measures to Counter VAT Fraud]* (Brussels, 2010). Through data mining, it seeks to proactively counter VAT fraud (Federale Gerechtelijke Politie, *Jaarverslag 2009 [Annual Report]* (Brussels, 2010).

⁶⁸⁰ The Special Internal Revenue Service is a department of the Treasury (Federal Public Service). Its objective is to combat large-scale, organised fiscal fraud, including organised VAT fraud.

⁶⁸¹ OCS, *Un état des lieux sur la fraude organisée à la T.V.A. Années 2000 à 2003 [Inventory of Organised VAT Fraud. 2000 to 2003]* (Brussels: Cellule de Soutien (O.C.S.) à la lutte contre les carrousels T.V.A., n.d.).

the century, organised VAT fraud shifted towards immaterial assets and services in the gas and electricity market.⁶⁸² With the enlargement of the EU in 2004 and 2007 organised VAT fraud flourished due to the expanded market sizes (BE-E1). More recently, criminal organisations discovered **a gap in the carbon emissions market that allowed them to commit fraud through the carbon emissions trade**. The first time Belgium was confronted with carbon emission fraud was in 2009 with a loss of €79 million.⁶⁸³ A recent phenomenon in organised VAT fraud is fraud on the silver market. While VAT is not levied on gold, it is levied on silver. A British firm bought jewels in other member states, but the goods never arrived; instead they were being sold under the counter in Belgium.⁶⁸⁴ Although access to the internet enables a globalisation of organised VAT fraud, according to the coordinator of the Support Cell Carousel Fraud the number of organised VAT fraud cases today is lower than ever before.⁶⁸⁵ Despite the optimism, more recent figures show a rise in serious organised VAT fraud cases.⁶⁸⁶ According to the Belgian Federal Police (CDGEFID), insufficiently strict inspections by the Treasury and technical adjustment in processing VAT data which has caused delays might explain the increase.⁶⁸⁷ This suggests that the police do assume that there is a real rise and more inspections are needed to prevent organised VAT fraud.

Market overview

The market of organised VAT fraud permeates different segments of the economy. News and media coverage from the last five years report organised VAT fraud in economic sectors such as restaurants, food and beverage distributors, the wholesale of machines, lorries, computers and cars. In the annual reports of the Belgian Financial Intelligence Processing Unit (CTIF-CFI),⁶⁸⁸ a breakdown is made of the types of goods that were used in organised VAT fraud (Figure 43). Cars, car parts, IT, hi-fi and video players appear to be among the most frequent goods in organised VAT fraud.

The CTIF-CFI receives information from informants⁶⁸⁹ on suspicious financial transactions and, after processing the information, passes it on to the authorities. The number of cases referred to the Belgian authorities has declined steadily over the years. Whereas in 2003 140 cases of

⁶⁸² Conseil Interparlementaire Consultatif de Benelux, *Visite de travail à l'administration belge de l'inspection spéciale des impôts. Thème de la visite: "Fraude carousel"* [Work Visit to the Belgian Special Internal Revenue Service. Theme of the Visit: Carousel Fraud] (Brussels, 2013).

⁶⁸³ Ibid.

⁶⁸⁴ Federale Gerechtelijke Politie, *Jaarverslag 2012* [Annual Report].

⁶⁸⁵ Conseil Interparlementaire Consultatif de Benelux, *Visite de Travail...*

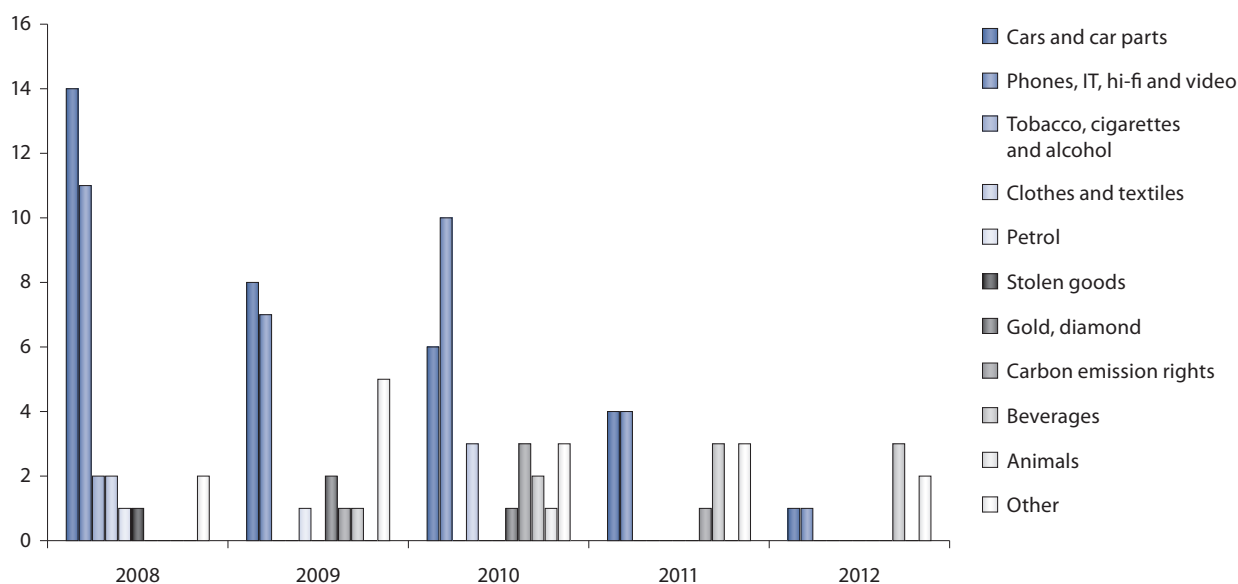
⁶⁸⁶ Bové, "Criminelen verdienen miljoenen dankzij lakse BTW-controle [Criminals Earn Millions Thanks to Lax VAT Audits]".

⁶⁸⁷ Ibid.

⁶⁸⁸ The Belgian Financial Intelligence Processing Unit (CTIF-CFI), established in 1993, is an independent administrative authority with legal personality supervised by the ministers of justice and finance. CTIF-CFI is in charge of processing suspicious financial facts and transactions linked to money laundering and terrorism financing reported by institutions and individuals specified in the law of 11 January 1993.

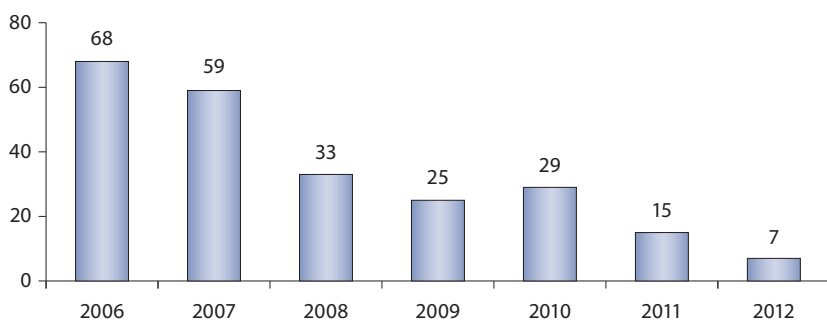
⁶⁸⁹ Certain financial institutions and individuals have a legal obligation to report suspicious financial transactions to the CFIT-CFI. Those are, among others, the National Bank, credit institutions, the Postal Services for its financial services, payment institutions, insurance companies, management companies, etc.

FIGURE 43. NUMBER OF VAT FRAUD CASES BY TYPES OF GOODS IN BELGIUM



Source: Annual reports of the CTIF-CFI, 2009 – 2013.

FIGURE 44. NUMBER OF ORGANISED VAT FRAUD CASES REFERRED TO THE AUTHORITIES BY THE CFIT-CFI IN BELGIUM



Source: Annual reports of the CTIF-CFI, 2009 – 2013.

organised VAT fraud were referred, this number dropped significantly to seven in 2012. According to the CTIF-CFI this is the result of the preventive approach by the judicial and fiscal authorities.⁶⁹⁰

Of course, the number of cases passed on by the CFIT-CFI is merely a fraction of the total number of organised VAT fraud cases. According to statistics gathered by the VAT fraud section of the Federal Police, there were 111 cases of organised VAT fraud in 2011.⁶⁹¹

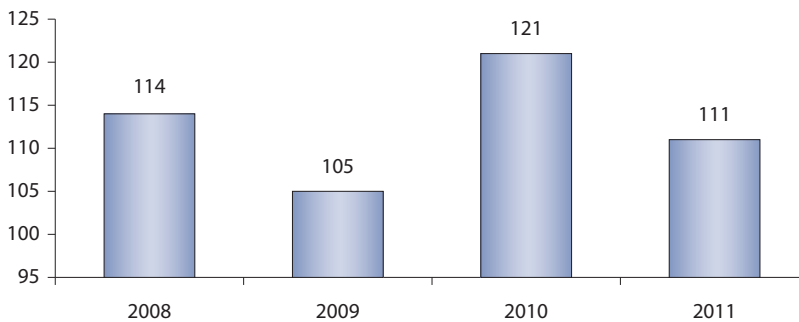
A study by the Belgian State Audit Office in 2009 collected information from the Support Cell Carousel Fraud and the Special Internal Revenues Service which gave an indication on the evolution of organised VAT fraud in Belgium.⁶⁹² Table 50 provides an overview of the number of cases the Special Internal Revenues Service has finalised and the

⁶⁹⁰ CTIF-CFI, *19e Activiteitenverslag 2012 [Activity Report]*.

⁶⁹¹ Federale Gerechtelijke Politie, *Jaarverslag 2011 [Annual Report]*.

⁶⁹² Rekenhof, "Intracommunautaire BTW-fraude [Intra Community VAT Fraud]".

FIGURE 45. NUMBER OF ORGANISED VAT FRAUD REPORTS – BELGIAN FEDERAL POLICE



Source: Federale Gerechtelijke Politie, *Jaarverslag 2011 [Annual Report]* (Brussels, 2012).

amount of VAT fraudsters have to redeem.

Not all organised fraud cases involve large sums of VAT. Of the total amount of VAT that has been embezzled in 2005, 2006 and 2007, fifteen cases take the lion's share: respectively 55%, 75% and 72%. Recovering VAT proves to be an arduous task. Concerning the fifteen biggest cases, the Special Internal Revenues Service has been able to recover merely a fraction of the VAT still due.

TABLE 55. VAT CLAIMED BY THE BELGIAN SPECIAL INTERNAL REVENUES SERVICE FROM CAROUSEL FRAUD

Year	Claimed VAT (€)	Number of finalised VAT cases
2007	75,773,882	127
2006	115,577,751	125
2005	99,201,895	146
2004	127,256,181	163
2003	230,019,465	205
2002	338,498,739	167
2001	413,020,064	471
2000	448,549,423	329

Source: Rekenhof, "Intracommunautaire BTW-fraude [Intra Community VAT Fraud]" (Report of the Belgian Court of Auditors to the Parliament, Brussels, 2009), 43.

Because of the difficulties in recovering embezzled VAT, Belgian judicial and fiscal authorities invest in data mining by the Support Cell on monthly or quarterly VAT declarations.⁶⁹³ As the authorities are not able to investigate every VAT declaration due to limited resources, cases are being selected based on pre-defined parameters. Since 2004, data mining enabled the authorities to better detect companies that pose an increased fraud risk. Various mathematical models are being used on combined transactional data focused on different types of fraud: buffers, conduit companies, and cross invoices. Besides these models,

data mining models from Eurocanet (the European Carousel Network) are being used as well.⁶⁹⁴

Recently, the Belgian State Secretary for Combating Social and Fiscal Fraud presented the Social Network Analysis project – a project that has successfully been tested in the Benelux – to the European Commission. Through this instrument, all fraud analyses are being brought together in one method which enables the visualisation of fraud mechanisms in real time.⁶⁹⁵

⁶⁹³ Federale Gerechtelijke Politie, *Jaarverslag 2009 [Annual Report]*.

⁶⁹⁴ Rekenhof, "Intracommunautaire BTW-fraude [Intra Community VAT Fraud]."

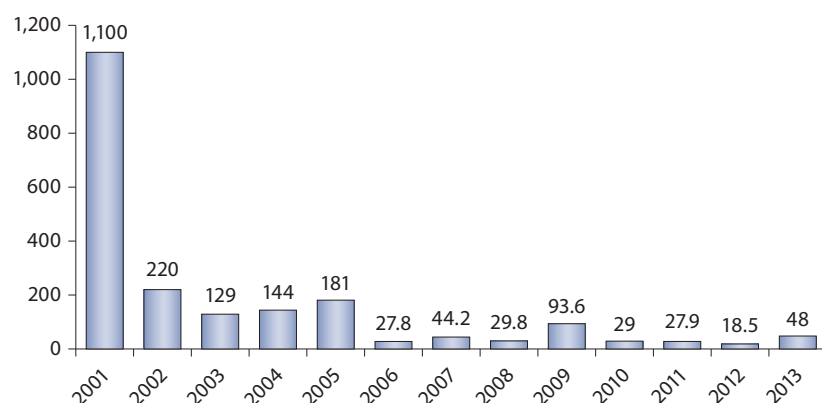
⁶⁹⁵ Benelux, "Benelux presenteert aan Europa oplossing om BTW-fraude sneller op te sporen [Benelux Presents Europe a Solution to Faster Track VAT Fraud]", *Benelux Press Release*, May 07, 2014.

TABLE 56. SHARE OF RECOVERED VAT IN THE 15 BIGGEST FRAUD CASES IN BELGIUM

Year	Share of embezzled amount that was recovered
2007	0.0001%
2006	0.032%
2005	0.004%

Source: Rekenhof, "Intracommunautaire BTW-fraude [Intra Community VAT Fraud]", 44.

FIGURE 46. DAMAGE BY ORGANISED VAT FRAUD IN BELGIUM, MILLION €



Source: L. Bové, "Criminelen verdienen miljoenen dankzij lakse BTW-Controle [Criminals Earn Millions Thanks to Lax VAT Audits]", *De Tijd*, June 26, 2014; Federale Gerechtelijke Politie, *Jaarverslag 2012 [Annual Report]* (Brussels, 2013), 45.

As a result, the financial damages to the Belgian National Treasury gradually declined, with the exception of the year 2009 due to carbon emission fraud. In 2012, a historical low was reached which was attributed by the State Secretary to the speed of detection of the fraud.⁶⁹⁶

This steady decline seems to have lulled the tax administration into thinking that organised VAT fraud was under control because in 2013 there was a sharp rise of damages to €48 million. According to the Federal Police, this sharp rise is partially due to an internal decision within the tax administration. In 2010, the administration had decided to decrease the burden they put on companies by immediately sending an inspector each time a company claimed a large VAT refund. Consequently, some companies – even when they were requesting millions of euros of VAT returns – were no longer troubled by a visit by the VAT inspector for up to two years. Moreover, technical adjustments caused

several months delay in processing VAT data, slowing down fraud detection.⁶⁹⁷

Market structure and actors

Based on an analysis of 320 large VAT fraud cases, eight modus operandi were identified by the Support Cell Carousel Fraud in 2004:⁶⁹⁸

- i. In 37.3% of the cases a **missing trader** was involved. A missing trader is a company that does not meet its VAT obligations either by not returning a VAT declaration, returning a declaration of zero activities or returning a declaration but not paying the VAT that is

⁶⁹⁶ J. Crombez, "Nieuw laagterecord voor BTW-fraude [New All-Time Low for VAT Fraud]", 2013, <http://www.s-p-a.be/artikel/nieuw-laagterecord-voor-btw-fraude/>

⁶⁹⁷ Bové, "Criminelen verdienen miljoenen dankzij lakse BTW-controle [Criminals Earn Millions Thanks to Lax VAT Audits]".

⁶⁹⁸ OCS, *Un état des lieux sur la fraude organisée à la T.V.A. années 2000 à 2003 [Inventory of Organised VAT Fraud. 2000 to 2003]*.

due. Companies that are used as missing trader can be recently established or being re-activated. The manager of the missing trader is often a low-ranking person recruited by the organiser who is promised to earn a lot of money in a short period of time. Fake identities are being used when no straw man is found. The company's headquarters is often merely a post office box. Usually after a few months, the straw man disappears and the company's administrative seat is abandoned. Missing trader intra-community fraud (MTIC) remains one of the most important forms of organised VAT fraud in Europe and is reported to generate €100 billion losses to EU member states.⁶⁹⁹

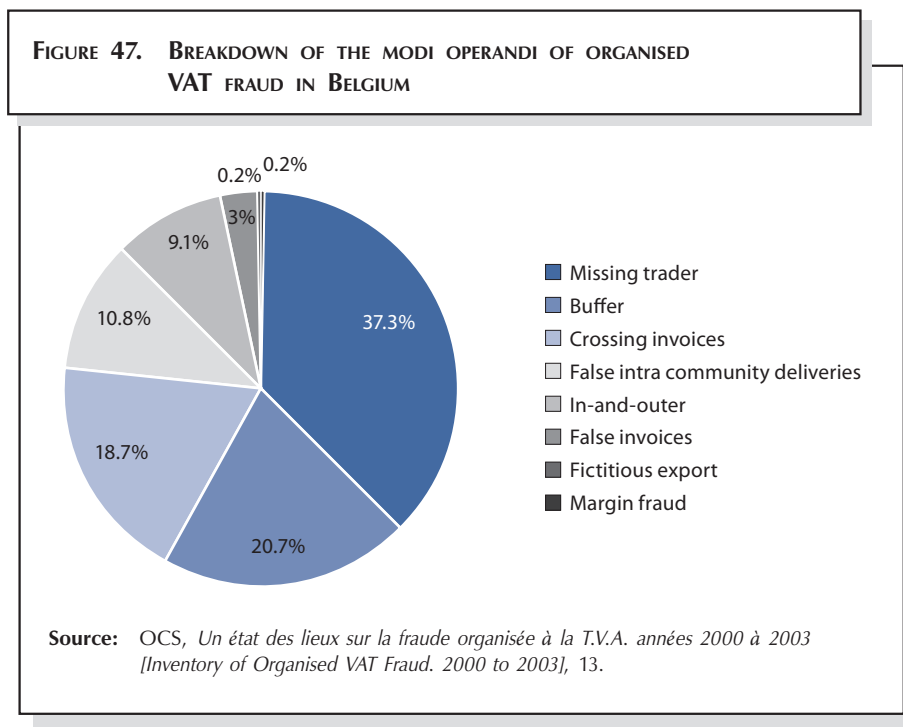
- ii. In 20.7% of the cases organised VAT fraudsters used a **buffer company**. In the flow of invoices, this company comes after the missing trader and shields the organizer from the missing trader. Generally, the buffer company complies with the VAT regulations. In that way, a buffer company serves two purposes: making it more difficult for investigators to uncover the VAT fraud on the one hand and provide credibility to the invoices directed to the customer. The study revealed a geographical distinction in Belgium: whereas missing traders are primarily found in Brussels and the Walloon region, buffers are mainly found in Flanders.⁷⁰⁰
- iii. An increasingly popular method used in organised VAT fraud, is **crossing invoices** which accounts for 18.7% of total cases. The missing trader is harder to detect and it enables the organiser to maximise the profits. A company that does not return a VAT declaration will be quickly detected by the authorities. By crossing invoices, partially based on fictitious figures, the VAT declaration will show a small amount of VAT due and the fraud will not immediately draw the attention of the authorities. Crossing invoices is the trademark of small groups or groups of specialised organisers. Some schemes were active for over three years.
- iv. **False intra-community deliveries** make up 10.8% of the cases. Goods are reported as being supplied to another EU member state (and thus exempt from VAT), but are sold on the domestic black market instead. This method is closely related to the fictitious export and takes advantage of the slow and often lacking cooperation between the member states.
- v. The **in-and-outers** are found in 9.1% of total cases. The in-and-outer is used to evade taxes in other member states. For example, goods are obtained by Company A in Belgium from a member state (company B in the UK, for example) and immediately redirected, usually to the country of origin (in this case, company C in the UK). The customers are always the missing traders based in the member state of destination. In most cases goods are actually being

⁶⁹⁹ Europol, *SOCTA 2013. EU Serious and Organized Crime Threat Assessment*.

⁷⁰⁰ OCS, *Un état des lieux sur la fraude organisée à la T.V.A. années 2000 à 2003 [Inventory of Organised VAT Fraud. 2000 to 2003]*.

delivered, even when these goods return to the country of origin. Organisers of this kind of VAT fraud are, according to the Support Cell, often well-known VAT fraudsters.

- vi. **False invoices** were being used in 3% of the cases. False invoices are found in different markets, but are not an often used method in organised VAT fraud. The profits are limited compared to more traditional *modus operandi*. False invoices are often issued by isolated fraudsters with a large number of consumers.
- vii. The roots of false intra-community deliveries can be found in the **fictitious export** of goods which occurred in 0.2% of the cases. Although these methods share a common objective, the difference is that while false intra-community deliveries occur within the EU, fictitious export is directed towards third countries. False transport documents and/or false customs stamps are needed to mislead border controls.
- viii. The last method identified in the Support Cell analysis, is **fraud with the margins of the sale of second hand cars**. The taxation on the sales of second hand cars is subject to a special regulation that avoids VAT being paid on the price in total, but only on the profit margin. This system is being used by fraudsters on cars that are subject to the normal VAT regulation. In most cases second hand cars, such as short-term leasing cars are bought in another member state (often Germany) using the intra-community delivery and sold with a low profit margin on both the domestic, but also the South-European market.



A review of recent news coverage of organised VAT fraud not only corroborates the findings of the Support Cell, but also sheds light on the goods and services involved and the amount of VAT revenues collected by the organisers. A first economic sector that is often mentioned in news coverage of organised VAT fraud is the truck, trailer and cars trade. Investigating a case of meat fraud in 2009, the police discovered a VAT carousel involving trucks. The organiser and two straw men bought a transportation company that was used as a cover for a parallel circuit in the trade of trucks. Police investigators discovered

that money from the meat fraud was being laundered through truck companies. Through numerous buffer companies they managed to em-

bezzle millions of euros in VAT revenue.⁷⁰¹ Another VAT fraud scheme involving trucks and trailers was unearthed two years later. 35 suspects and 12 Belgian and Dutch companies stood trial in 2012.⁷⁰² In 2014, the Federal Police arrested two car dealers on charges of large scale VAT fraud the sales of cars. The fraud was organised through a limited liability company with false VAT declarations. The Belgian treasury missed out on €3 million.⁷⁰³

Another economic sector vulnerable to organised VAT fraud is the catering industry. In 2002, a large fiscal fraud was detected with two beverage stores that were taken over by brewery Alken-Maes. Beer was being sold under the counter to around 300 barkeepers.⁷⁰⁴ A similar case was uncovered in Ghent where a beverage store sold beverages and liquor under the counter to thousands of cafés. Around 50% of the beverages were being sold under the counter. False invoices were drafted to obscure the fraud.⁷⁰⁵ In 2013, the managers of eight restaurants settled with the tax administration for an amount of €10 million. The method the restaurant owners used was quite simple: when a customer did not ask for a receipt and paid in cash, the money went to a “black cash register.” When customers paid with a credit card or did ask for a receipt, the money went into the legitimate cash register. This allowed the managers to skim off some €150,000 per month.⁷⁰⁶ In 2013, Belgian and Dutch inland revenue services discovered a large-scale VAT-fraud with mussels that amounted to several hundred thousand euros. It all centred around a Dutch mussel trader. In the Dutch accountancy, the inland revenue services discovered false identities and managed to find the real addressees of the traded mussels. 20 companies and 80 individuals bought fresh mussels on a large scale from the trader, but failed to declare VAT in their declaration.⁷⁰⁷ In another case, in 2014 the VAT section of the Belgian Federal Police interrogated two business managers of a wholesale company specialised in supplying food for pitta shops. Months of investigation brought to light that the managers used different fraud schemes to embezzle VAT revenues. They used fictitious traders that were established abroad in order to camouflage fictitious sales. This enabled them to sell products without VAT on the Belgian market and create a black money circuit. They also purchased non-declared goods from suppliers and used Belgian commercial structured with inflated turnover to sell goods on the black market. The different circuits used by the two suspects had an estimated value of €20

⁷⁰¹ VILT, “Zaakvoerders tagex gel vrijgesproken voor BTW-Fraude [Business Managers of Tagex Gel Acquitted for VAT Fraud]”, 2009, http://www.vilt.be/Zaakvoerders_TrageX_Gel_vrijgesproken_voor_btw-fraude

⁷⁰² MTY, “Alfred Hoet veroordeeld voor BTW-fraude. [Alfred Hoet Sentenced for VAT Fraud]”, *Het Nieuwsblad*, December 19, 2012.

⁷⁰³ Federal Police, “Twee verdachten van fiscale fraude en heling opgepakt te Luik [Two suspects arrested for fiscal fraud and fencing in Liège]”, Press release, June 27, 2014.

⁷⁰⁴ Mceulemans, “Opschorting in plaats van celstraffen voor bierfraude [Suspension instead of Prison Sentence for Beer Fraud]”, *Gazet van Antwerpen*, March 01, 2013.

⁷⁰⁵ X, “Creve Drinks in de etalage na bierfraude [Creve Drinks for Sale after Beer Fraud]”, *De Tijd*, August 19, 2013.

⁷⁰⁶ X, “Gentse broers van Amadeus kopen fraudeproces af voor € 10 miljoen. [Ghent Brothers of the Amadeus Settle for € 10 Million]”, *Benelux Agri Press*, August 28, 2013.

⁷⁰⁷ P. Luysterborg, “Grootschalige BTW-fraude met mosselen ontdekt. [Large-Scale Fraud Discovered with Mussels]”, *Het Laatste Nieuws*, August 22, 2013.

million. According to the police, out of the 20 million, 8 million is connected to fraud.⁷⁰⁸

In 2014, a criminal network of Belgian firms stood trial on charges of organising a VAT carousel. They exploited the zero rating of exports and the deferred payment regulation by exporting goods to Portugal, France, Germany and Austria. By using forged documents they tried to claim over €10 million in 2009.⁷⁰⁹ Another classic VAT carousel was dismantled in Brussels in that same year. Seven firms from all over Belgium moved their firms to the same city between 2011 and 2013 and started handing in similar VAT declarations. They declared purchases including VAT in Belgium and sales abroad excluding VAT. Between March 2011 and March 2014 the tax administration paid €4.8 million to the seven firms. One suspect managed to cash €600,000 in three months' time. Seven companies have been identified and three suspects have been arrested. Two of them are being suspected of being front men for the organisation.⁷¹⁰

On the first of January 2005, **trade in carbon emissions rights** was enabled in the EU. This trade occurs between smoke-stack industries that emit a lot of hazardous fumes and is the result of the Kyoto Protocol that obliged countries to reduce greenhouse gases. The objective for Belgium was a reduction of 7.5% between 2008 and 2012.⁷¹¹ The Kyoto Protocol allowed industries to achieve its objectives by buying emission rights abroad. Each year, EU member states deposited the allocated emission rights on the accounts of the companies. When companies did not achieve their objectives, they had to buy emission rights from other companies that had realised a surplus. In most cases these rights were bought through trade platforms. According to the World Bank, the global emission trade had a value of €103 billion.⁷¹² In 2009, Europol estimated that due to carousel fraud with carbon emission rights, around €5 billion was lost. In some countries, up to 90% of the whole market volume was caused by fraudulent activities.⁷¹³ In Belgium, there was a loss of €79 million. As a result, as of January 2010 the reverse charge rule was introduced which stipulated that it was no longer the seller but the buyer that had to pay VAT. After the introduction of the reverse charge rule, the volume of carbon emission rights sold on the Dutch exchange market Climex dropped by 75%.⁷¹⁴

In 2002, some 40 criminal organisations active in organised VAT fraud were known to the police. The real figure is reported to be 20% to

⁷⁰⁸ Federal Police, "BTW-fraude in een groothandel van voedingswaren voor pitazaken [VAT fraud in wholesale business for food for pita restaurants]", Press release, May 20, 2014.

⁷⁰⁹ Tmas, "Acht beklagden riskeren tot veertig maanden cel voor BTW-fraude", *Het Belang van Limburg*, March 25, 2014.

⁷¹⁰ Bové, "Criminelen verdienen miljoenen dankzij lakse BTW-controle [Criminals Earn Millions Thanks to Lax VAT Audits]".

⁷¹¹ L. Barrezele, "Fraude met broeikasgasemissierechten [Carbon Emission Fraud]", *Audit, Control and Governance* 14(9), no. 1-3 (2011).

⁷¹² World Bank, *State and Trends of the Carbon Market 2010* (Washington, DC: The World Bank, Carbon Finance, 2010).

⁷¹³ Europol, "Carbon credit fraud causes more than 5 billion euros damage for European taxpayer", Press release, December 9, 2009.

⁷¹⁴ Barrezele, "Fraude met broeikasgasemissierechten [Carbon Emission Fraud]".

40% higher.⁷¹⁵ According to the police, in 2014, between five and ten active organised crime groups were involved in VAT fraud. Most of these groups were specialised in VAT fraud and were, in principle, only involved in VAT fraud. There are exceptions, however. Some groups were also involved in drug trafficking. According to the police, there were clear links between carbon emission fraud and cocaine trafficking (BE-E1).

The connection between organised VAT fraud and drug trafficking might not come as a surprise as organised VAT fraudsters specialised in MTIC, for example, are experts in customs administration and in import and export of goods. On April 2, 2014, a well-known organiser of VAT carousels was sentenced to seven years imprisonment after he had been caught shipping a container with 702 kg cocaine from Panama to Belgium.⁷¹⁶ He was approached by two drug dealers because of his expertise and experience with shipping goods abroad and his knowledge of customs administration (CP42). In other words, the drug dealers used a VAT carousel organiser because of his expertise (BE-E1).

The size of criminal groups involved in organised VAT fraud depends on the project (BE-E1). Based on data from 2002, there was an estimate that within each criminal network, an average of 16 persons is involved. One person typically controls the activities and relies on two lieutenants. Besides his lieutenants, the organiser can count on an average of 13 straw men.⁷¹⁷ In some of the bigger cases the police had dealt with, there were 35 persons involved. The inner circle usually consists of three to four persons. Though these figures might suggest a certain sustainable working relationship between the fraudsters, in reality, the connections within these groups are flexible. Generally, there is an organiser who conducts a number of projects with several people. An organiser did not only have accountants working for him, but also two managing directors of bank agencies. That is, however, rather exceptional (BE-E1).

Personnel turnover is reportedly high. According to the police, the organisation could look completely different within two years. This is partially due to arguments about money (sharing of profits). Still, according to the police, the organisation resembles a legal business: it is all about business deals and projects. Management instruments are being used as well (BE-E1).

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

Criminal groups venturing into organised VAT fraud need capital for establishing or creating companies and acquiring goods. However, language skills, knowledge, networks and expertise are far more important to

⁷¹⁵ C. Vanschoubroek and L. Van Eylen, "Gerecht kent veertig BTW-netwerken [Judicial Authorities Know Forty VAT Networks]", *De Standaard*, March 19, 2002.

⁷¹⁶ Ibo, "Celstraffen tot 7 jaar voor invoer van 700 kilo cocaïne. [Prison Sentences up to 7 Years for Trafficking Cocaine]", *Het Nieuwsblad*, April 02, 2014.

⁷¹⁷ Vanschoubroek and Van Eylen, "Gerecht kent veertig BTW-netwerken [Judicial Authorities Know Forty VAT Networks]".

organisers of VAT fraud schemes than money. The predominant source of capital are reinvestments: profits gained from previous criminal activities (very often VAT fraud) are invested in new projects. Organisers either use their own money or seek investors.

There are several ways in which organisers acquire capital for initiating and sustaining their criminal operations. Based on information received from the police a rather diverse picture can be drawn. In a recent case, a long-time VAT fraud organiser started a new project with old and new accomplices and invested money gained from an earlier project to initiate a new project. Sometimes, organizers have been found to have initiated the VAT fraud through “business loans.” In some cases legal businessmen granted organisers a loan in return for interests and capital repayments, but also for a share of the profits and the risks. A stock exchange broker, for example, was introduced into a fraud scheme and had decided to finance the operation with legal money (up to €60 million). The broker was largely compensated with legal and illegal profits for the services he had rendered. However, financing through loans occurs rarely because there is a lot of mistrust between and within criminal groups. Crime money, invested by other criminals for a share of profits was another source of start-up capital. Drug traffickers had been found to invest cash money in the fraud scheme in order to be refunded in larger bank notes. However, while crime money has indeed been invested in organised VAT fraud in some cases, criminals who are not familiar with organised VAT fraud very rarely step into the business themselves. Over a period of thirty years, the police once came across a drug dealer who had bought companies and had established a carousel in order to re-invest his drug money (BE-E1).

According to BE-E1, the investors and fraudsters are connected to each other through criminal links. The investors are often high-level, experienced organisers or organisations. Starting capital is needed to initiate a first operation, but soon afterwards the operation finances itself. In more recent fraud cases involving carbon emission rights, the investment schemes were more complicated. In these cases offshore accounts were frequently used to collect money from (offshore) investors (BE-E1). In one case there were temporary loans from Singapore to the profit taker (exporter) to cover the period of time that is needed to be reimbursed by the VAT administration (Ibid.). For carbon emission fraud, one needs to find companies that have money. One infamous fraudster, Alex Khan (real name Cyril Astruc), for example, targeted Fortis and Electrabel. The latter paid around €4 million, but was alarmed after ten days. It took Fortis much more time to detect danger and it lost €72 million as a result.⁷¹⁸ Groupe Energie One (GEO), nothing more than a post office box in Brussels and led by a straw man, bought carbon emission rights on Blue Next, the former European environmental trading exchange in Paris, for around €350 million. As this transaction was an intra-community delivery, no VAT was paid. GEO sold the emission rights including VAT to another decoy company IRM.

⁷¹⁸ M. Eeckhaut, “Zware klap voor CO₂-maffia [Heavy Blow for the Carbon Emission Mafia]”, *De Standaard*, January 12, 2013.

In turn, IRM sought companies that were willing to buy carbon emission rights at very low prices. While Electrabel was suspicious about the low prices, Fortis bought carbon emission rights for around €400 million. When Fortis raised the alarm, it was too late – GEO, the company that had cashed the VAT had never turned over the VAT to the Belgian Treasury.⁷¹⁹

The cases of the carbon emission fraud with Fortis and Electrabel demonstrate the important role of the end customer or retailer in acquisition fraud schemes (when goods or services are actually being sold to final customers). In the case of Alex Khan, it was important to sell carbon emission rights to Fortis, for example, because that way the initial investment could be recovered, profit made and VAT (paid by Fortis) embezzled. The scheme was not successful with Electrabel due to the quick reaction of its junior and senior staff (BE-E1). This does invite the question as to what extent the end users or retailers purchasing goods and services from fraudsters are informed about the schemes or even involved. During the study of the different cases, it is clear that both the police and the judiciary are very critical towards the role end customers or retailers may play in fraudulent schemes. There are indeed cases in which the authorities suspect retailers of having participated in fraud schemes. This is, however, difficult to prove. According to the law, if one knows or should know that the acquisition or sales of goods or services are part of VAT fraud he can be found accessory to organised VAT fraud. In one case, a computer dealer bought a large number of computers from a brand new supplier. The latter sold computers far below the market price. The authorities, however, were not able to prove that the computer dealer knew he was involved in a VAT fraud scheme. The Court of Cassation ruled that abnormally low prices do not indicate that one is implicated in organised VAT fraud.⁷²⁰ In the cases studied during the research, no hard evidence was presented that end customers or retailers invested money in VAT fraud schemes in order to benefit from lower prices.

Settlement of payments

Organised VAT fraud is a lucrative business. As already mentioned, organisers of VAT fraud schemes very often re-invest money earned from previous fraud schemes in new ones. In the case of Khan, it is reported that he was involved in cocaine trafficking and the sales of luxury goods such as cell phones, false papers, luxury cars, etc.⁷²¹ He stood trial in Toulouse for VAT fraud with cell phones in 2002.⁷²²

Pay settlements are either done in cash or through bank transfers. Payment platforms are also being used. Banks only see the financial

⁷¹⁹ J. Laruelle, "Fortis, victime des fraudeurs au CO₂ [Fortis, Victim of Carbon Emissions Fraud]", *La Libre*, January 21, 2013.

⁷²⁰ J. Sandra and S. Vancolen, "Abnormale lage aankooprijzen – geen bewijs medeplichtigheid aan BTW-fraude! [Abnormally Low Prices Are No Evidence of Complicity in VAT Fraud!]", 2013, <http://www.imposto.be/nl/kennisbank/nieuwsbrieven/abnormaal-lage-aankooprijzen-geen-bewijs-medeplichtigheid-aan-btw-fraude>

⁷²¹ W. Molinié, "[1er Volet] Les escrocs de la fraude à la taxe carbone: ceux qui ont été arrêtés [Carbon Emission Fraudsters: Those Who Got Arrested]", *20 Minutes*, March 12, 2014.

⁷²² Laruelle, "Fortis, victime des fraudeurs au CO₂ [Fortis, Victim of Carbon Emissions Fraud]".

movements of the payment platforms. These platforms are not located in Belgium. FCIB (First Curacao International Bank), which existed from 2004 – 2007, was a popular payment platform among criminal groups involved in organised VAT fraud. All known entrepreneurs/companies involved in VAT carousel fraud had an account with the FCIB (BE-E1).

Bank transfers, often to foreign accounts, or payment platforms are being used to kick-start the organised VAT fraud scheme but also to cash in the profits made from the fraud. These funds are then often laundered in the real estate market. Cash, however, does play a role as well. In the case of the seven companies involved in organised VAT fraud, for example, the revenues (€4.8 million) disappeared through foreign accounts in France and Spain or were cashed in. One suspect withdrew €600,000 in cash in a period of merely three months.⁷²³ Cash comes in handy to reimburse expenses or to pay accomplices. Within the network, agreements are being made on how the money is split. There are no standard agreements: in one case the “staff” receive a share of the profit, in another case remuneration for the services they have delivered (BE-E1).

In normal circumstances, organisers and the staff stick to their agreements. But in some cases violence has been used as well. In April 2010, a “button man” (a person doing the dirty work) who helped transport the millions of euros of profit made in the carbon emission fraud was killed in broad daylight in France. In military style, a death squad jumped out of a van, killed the victim and ran off on a motorcycle and a car after having set the van on fire in order to erase traces.⁷²⁴

Costs of doing business

The costs of doing business vary and depend on the nature of the VAT fraud project that is being set-up. In most typical VAT cases, the costs needed to start a VAT fraud scheme were relatively low. Shell companies are relatively easy to get and accounts often know people willing to take over a company (BE-E1). Creating a company in Belgium costs around €1,850.⁷²⁵ Additional capital is, however, needed in order to pay straw men, legal administration and transportation costs. The organiser will also have to look for a partner who is able to supply goods at a reduced price or even lend them. In order to initiate a VAT carousel, €50,000 is reportedly sufficient. Once up and running, the network sustains itself and no additional funds are needed (BE-E1). Of course, people need to be paid. Straw men and helpers usually receive a fixed amount. A straw man is usually entitled to one to two percent of the profit, which is well-paid.

⁷²³ Bové, “Criminelen verdienen miljoenen dankzij lakse BTW-controle [Criminals Earn Millions Thanks to Lax VAT Audits]”.

⁷²⁴ L. Bové, “BNPP Fortis doet België 70 miljoen cadeau un fraudezaak [BNP Fortis Gives Belgium a Present of 70 Million in Fraud Case]”, *De Tijd*, December 15, 2014; C. Cornevin and C. Louis, “Fin de partie pour les escrocs Franco-Israéliens du siècle [The End Game for the French-Israeli Fraudsters]”, *Le Figaro*, February 11, 2014.

⁷²⁵ AB Consult, “BVBA oprichtingskosten [Preliminary Flotation of Limited Liabilities Companies]”, 2013, <http://www.ab-consult.be/artikels/ondernemingen/bvba-oprichtingskosten-110/>

Profits and profit sharing

In the 1980s and 1990s, the profit criminal groups made from VAT fraud was around 3.5%, in some cases even 5%-6% (BE-E1).

The inner circle shares the net profits. There is a lot of stealing and cheating inside criminal groups and most of the organisations split up with arguments over money and the sharing of the profit. The VAT Cell of the Federal Police had a case in which they had found the detailed excel tables used by the criminal organisation to calculate the profits and the distribution of the profits. In general, the gross profit is the VAT stolen. But the sale at a loss (10%) has to be taken into account. The net profit is 5% to 7% of the fraudulent turnover (BE-E1).

Financers/investors make sure their share of profit or loan repayment is returned. They either steal from the members of the organisation or threaten them. Members of a VAT fraud scheme planned a raid on a disloyal member of the organisation who was accused of stealing money and who was suspected of leaking information to the police. The plot was uncovered through phone surveillance by the police (BE-E1).

Criminal groups involved in organised VAT fraud try to connect with legal activities as soon as possible. Often profits from organised VAT fraud are reinvested in legal businesses. One organiser, for example, started a legal transport company with partners from outside the criminal world. He also invested money in a beauty centre for his mistress which she tried to explain as her income from her earlier prostitution activities (BE-E1). In the case of the parallel circuit of the trade in trucks and trailers, in which 35 persons stood trial in 2012, the VAT revenues were laundered through the real estate market by the purchase of a villa with horse stables, luxury cars and horses. The other part of the money went to the world of jumping and horse-breeding.⁷²⁶ In the case of Alex Khann (carbon emissions fraud), the profits were spent on luxury cars, a luxury house in Israel (worth €20 million), four shops and a night club in Tel Aviv.⁷²⁷ These stories corroborate the findings of the police that the profits of organised VAT fraud are being spent on real estate (abroad) and the creation of new companies. Of a profit of around €300,000, €100,000 is being reinvested in companies. The profits of organised VAT fraud are also spent on personal expenses, new VAT fraud schemes, on other criminal businesses as a re-investment, in legitimate businesses, in property or are being set aside in bank accounts abroad. With regard to re-investments in criminal businesses, drug trafficking and swindles have turned up in police case files (BE-E1).

Access to capital in critical moments

Most organisers of organised VAT fraud who had been convicted tend to recommence their fraudulent activities once released from prison. An example was given of a missing trader who worked with straw men in Belgium and Germany. The organiser contacted his lieutenant while the latter was on penitentiary leave (he was convicted for carousel fraud). On

⁷²⁶ T. Verheijen, "Man opgepakt voor grootschalige BTW-oraude. Gazet van Antwerpen. [Man Arrested for Large-Scale VAT Fraud]", *Gazet van Antwerpen*, June 28, 2011.

⁷²⁷ Cornevin and Louis, "Fin de partie pour les escrocs Franco-Israéliens du siècle [The End Game for the French-Israeli Fraudsters]".

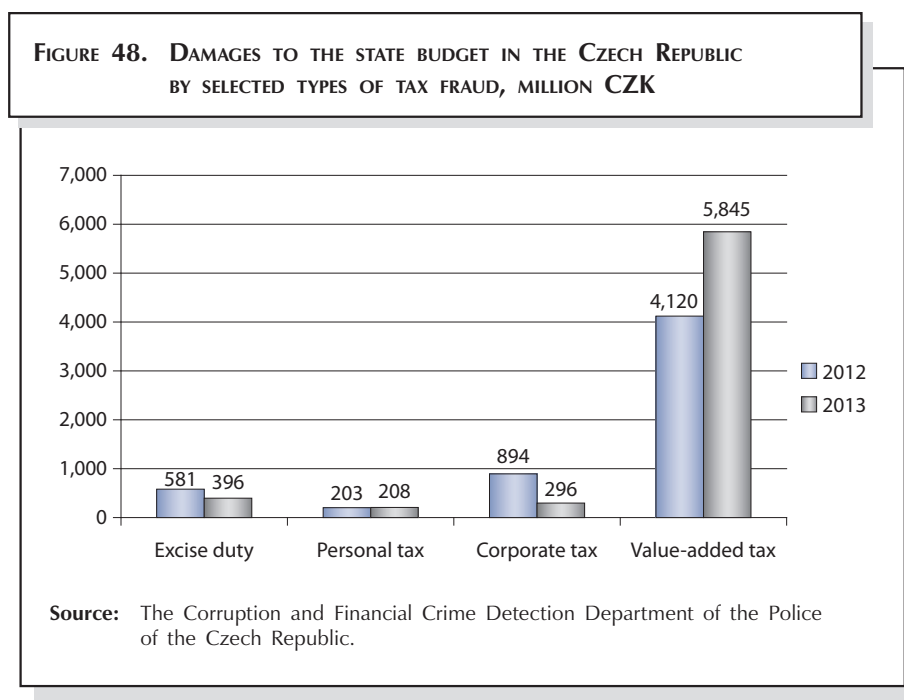
his leave, the lieutenant and the organiser had several meetings (BE-E1). Start-up capital is found in savings or investments from previous activities or in cooperation with others, as indicated in the example above.

Of course, when the organiser is caught, he will need access to capital to refund the suppliers and pay the lawyers. However, according to BE-E1, the suppliers very often do not get paid and as a consequence their business relationships with organisers always end in arguments over money. Lawyers, on the other hand do get paid. In one case, the lawyer was paid through an offshore account. The organiser was paying the lawyer with the money he had earned from the carousel fraud.

6.3. CZECH REPUBLIC: AN INCREASINGLY SOPHISTICATED TRADE

Introduction

In the Czech Republic, VAT fraud present one of the most serious organised crimes with losses of revenue reaching up to millions of euros. However, the estimations of the scale of tax losses and tax liability differ. According to Czech national authorities' estimations, in 2013 the total tax loss amounted to CZK 369 million (€14,430 million). However, the Czech police reports that the estimated damage to the budget of the investigated cases related to tax frauds amounted to €249 million in 2013 (Figure 48). **VAT fraud constitutes 87% of tax frauds**; the rest relates to corporate and personal tax, excise duty frauds etc. Other estimates put the VAT gap in the Czech Republic at €4,241 million in 2011, i.e. the VAT gap as a share of VAT Total Tax Liability reached 28%.⁷²⁸



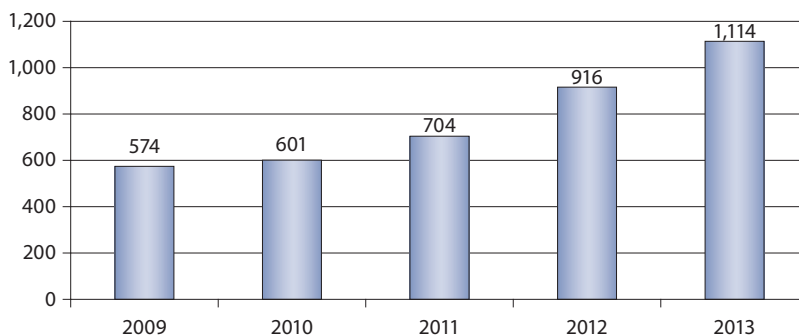
In general, the roots of tax fraud go back to the period of the transition from the communist model to a market economic model in the early 1990s. In the times of transition, the Czech Republic had a spontaneous privatisation with poor legislation. A number of entrepreneurs took advantage of an unclear legal environment and started businesses running tax frauds, insurance frauds, and intentional bankruptcies of privatised companies. In many cases the entrepreneurs used violence to settle disputes. Following the economic and political consolidation in the 2000s, the use of violence

⁷²⁸ The estimated VAT Tax Liability in 2011 came up to €15,235 million (CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report*, 29).

subsidised at the expense of fraudulent business becoming more sophisticated.

From a practical standpoint, the legal regulation of VAT is not difficult to evade due to the requirements for payments (request of quarterly or monthly tax payments), rapid stock rotation of some goods, and regulations and competencies concerning tax collection and tax refunds. However, most vulnerable to tax fraud are **excisable goods**,⁷²⁹ especially the trade in mineral oils. Profits of excisable goods fraud (EGF) are enormous and there is little risk of being prosecuted by state authorities. In the case of a violation of the tax obligation, the offender is charged with paying the tax and is fined in administrative proceedings.⁷³⁰ However, this is a crime of high latency – according to customs officers, the clear-up rate of tax evasion is only 10%. The profits from the other 90% easily outweigh the losses, even when convicted to pay a fine and the evaded tax.

FIGURE 49. NUMBER OF DETECTED TAX OFFENCES IN THE CZECH REPUBLIC (2009 – 2013)



Source: Police of the Czech Republic, Corruption and Financial Crime Department.

Tax fraud consists of three main types, each representing about a third in the overall volume: **EGF with mineral oils**, **VAT fraud conceived as carousel frauds** with goods such as mobile phones, metal, landfill in general and **VAT refund fraud**, i.e. fictitious invoice costs, (for example, costs for “advertising” when a shell company invoices advertisement costs).

The adoption of European Commission Regulation 2719/92/EHS and the introduction of the EMCS have had a positive impact on the detection of tax

offences, according to customs authorities. Since 2009, the rate of detected tax offences almost doubled (Figure 49).

VAT fraud in the Czech Republic has a number of characteristics:

- **VAT fraud is becoming increasingly sophisticated.** In the 1990s, it was sufficient to use only one company (one actor) or to trade in fictitious goods to run tax fraud. In fact, the most common method used to be “trial and error.” At the time of the transition to a market economy, the Czech tax and customs administration was not ready to face such criminal behaviour. Today, as the public administration became

⁷²⁹ Excisable goods frauds are always connected with VAT frauds because of the tax collection system in the Czech Republic. The VAT and the excise duty are both collected by the tax administration.

⁷³⁰ The criminal code is applied when the damage surpasses CZK 5,000,000 (€180,000). In administrative or even criminal proceedings, according to the Czech tax code, the tax subject has to pay a fine just from the last known tax in the amount of: a) 20% if the tax is increased; b) 20% if the tax reclaim is lowered; c) 1% if the tax loss is lowered.

more professionalised, so tax fraud became more sophisticated. For example, the scheme of a tax fraud now includes a chain of several companies/actors (missing trader, buffer, etc.).

- Tax fraud entrepreneurs usually **specialise** in only one type of goods/services (for example, trade in mineral oils, alcohol, tobacco, electronics, etc.) due to the necessity of detailed knowledge of the sector and of important contacts with suppliers, importers (conduit companies).
- While in the past fraudsters had traded in fictitious goods, now they use **actual goods**. Depending on the scheme of the tax fraud, in their tax declarations the fraudsters declare the goods with lower/higher value than the actual one. Another way to make profit based on tax fraud with real goods is to re-export the goods through a shell company to a third country. The profit in such cases is 21% of the value of the goods.⁷³¹
- Fraudsters now form **exclusive social groups** based on the economic capacity of their members, personal contacts established in the 1990s. These are well-connected networks with links to the public administration. Within the network there is shared knowledge of the business and criminal environment, especially **know-how** on evading the law, on tax fraud schemes, on information of business sectors vulnerable to fraud, exchange of contacts in the public administration or among policy makers for corruption purposes, etc.
- Because of the financial crisis, tax fraud has spread beyond the typical criminal entrepreneurs. Nowadays, previously legitimate businesses are getting involved in tax fraud, seeking to increase their profit by declaring only part of their turnover, while the rest is subject of tax evasion.
- There is a **high rate of crime latency**. The latency of tax crimes is caused mostly by the difficulty of collecting evidence against the offenders because of the high sophistication of the crime, difficult infiltration in the criminal group and corruption (cf. different data about VAT gaps). Furthermore, neither witnesses nor convicted offenders (usually middle-level operatives in an organised criminal group involved in VAT fraud) are willing to testify and to uncover the structure of the operation.
- VAT fraud schemes are **nonviolent** – actors prefer to co-operate rather than to compete and fight.
- Organised tax fraud could not be successfully carried out without **corruption**. It thus requires the involvement of civil servants in financial/tax units, customs units and the police.
- VAT fraud profits are **laundered with the help of foreign criminal groups**.

Market overview

In the Czech Republic, VAT frauds can be grouped under several types: a) according to regularity and organisation (ad-hoc or organised); b) modus operandi (missing trader, carousel VAT fraud, fraudulent excessive VAT refund); c) the type of excisable goods (mineral oil, alcohol, tobacco, metal, sugar, wood, etc.), d) violations of tax liability (VAT frauds,

⁷³¹ In the Czech Republic, the rate of VAT is 21% of the total value of the taxable goods.

VAT frauds in connection with excisable goods fraud, VAT frauds in connection with customs fraud); e) geographical scope (national, intra-EU, international fraud).

VAT fraud at individual and cross-border level is based on occasional purchases of goods (mostly motor fuel, tobacco) in a EU member state, and transport to another EU member state (mostly to the domicile of the trader). The traders confirm the payment of the VAT by themselves and then reclaim it during the further purchase. Another method targets refunds of VAT in the country of residence. The traders utilise the purchased goods or sell them in small amounts at lower prices without invoicing. However, these are ad hoc VAT frauds which do not constitute the main business of the traders; they usually run the rest of their businesses legally.

VAT fraud as an organised crime represents a serious threat to the tax system of the EU member states due to: a) the size of the financial losses for the government budget; b) violation of the principle of fair competition; c) being organised by powerful economic actors with links to politics, not only able to gain a market advantage but also to influence inspections and investigations, and the process of decision-making and legislation. This fraud occurs at the national, intra-EU and international levels and is the main business for the criminal entrepreneurs. Organised VAT fraud requires a sophisticated chain of at least three companies.

VAT fraud in connection with excisable goods fraud

Fraud related to the imports of mineral oil in the Czech Republic has a considerable effect on tax collection. This type of fraud is well organised, and countermeasures by the tax administration or law enforcement usually come with a delay. In the case of light fuel oil (LFO), for example, fraudsters took advantage of a legislative gap in the 1990s when LFO was freely interchangeable with motor fuel but without the excise duty. Estimates of revenue loss in the field of mineral oils were as high as 1,138 million CZK (€41 million) in 2012 (Table 52). Customs authorities had warned about the tax evasion schemes but the Czech legislative body reacted with a delay.⁷³²

In these cases, the tax obligation is not fulfilled within the conditional excise duty exemption (so called “customs procedure 42”⁷³³). Customs procedure 42 is “the regime a trader uses in order to obtain a VAT exemption when the goods imported from outside the EU into the member state of importation will be transported to a second

⁷³² According to the interviews with the criminal entrepreneurs, the actors engaged in LFO fraud are the same as those involved in VAT fraud in the mineral oil trade or other taxable supplies. In contrast to LFO fraud as a Czech phenomenon, VAT fraud with mineral oil has a Europe-wide dimension, and not only local specifics. The parallels between LFO fraud and VAT fraud with mineral oils can be seen in the fact that both kinds in some way exploit legislative gaps.

⁷³³ This procedure is commonly known as customs procedure 42 because in such cases the importer of the goods must indicate in box 37 of the Single Administrative Document a code starting with the digits 42.

Member State. The VAT is due in the latter, the member state of destination.⁷³⁴

There are several models of VAT fraud with mineral oils. A common method is to declare import products that are not subject to excise duty (e.g. BASE OIL, RUST CLEANER, BIOSEPAR, FORMEX), thus concealing that the imported product is in fact oil from a different category.⁷³⁵ By using different types of transport (road or rail) and different types of packaging (e.g. 1,000 litre plastic containers) mineral oil is delivered to a network of petrol stations or fuel dispensing points for high-capacity transporters without paying the excise duty. Another method is mixing components which are tax-free with already taxed fuel. Unlawful activities are also involved in the circumvention and misuse of the EMCS during transports of selected products to/from other EU member states. The tax evasion loss on one truck of untaxed motor fuel amounts to 361,350 CZK (€13,169). Even if the initial capital is low, the proceeds are parlayed into more illegal revenues.

Insolvent trader VAT fraud. Under this scheme, a company proclaims bankruptcy or insolvency thus ensuring that it will not be liable to pay taxes (VAT, excise duty) in such a way that in previous tax period they increase the volume of the imported fuel from another EU member state for which the tax has not been paid. Finding proof of intentional wrongdoing in these cases is very difficult.

TABLE 57. RESULTS OF THE WORK OF CZECH CUSTOMS WITH RESPECT TO MINERAL OILS CONTROL

Year	2009	2010	2011	2012	Index 2012/2011
Number of violations	75	106	172	275	159.9%
Revenue leakage (duties and taxes; million CZK)	862	193	284	1,138	392.9%

Source: Celní správa ČR [Czech Customs Administration], *Informace o výsledcích činnosti Celní správy za rok 2012 [Information on the Activities of the Customs Administration of the Czech Republic in 2012]* (Prague, 2013).

Alcohol-related fraud. The main types of alcohol-related VAT fraud involve illegal imports of alcohol from other member states of EU or third countries, illegal production of alcohol in the Czech Republic, counterfeiting of excise stamps for labelling of spirits, infringement of brand owner's rights. The wholesale warehouses are liable for holding goods with an illegitimate origin. When there is mix of goods with illegal and legal origin, the tracing and identification of the illegal goods is made difficult for law enforcement.

⁷³⁴ European Court of Auditors, *Does the Control of Customs Procedure 42 Prevent and Detect VAT Evasion?* (Special Report No.13, 2011), 9.

⁷³⁵ Declaring category KN 27101999 instead of KN 27101941.

After the methanol affair (2012 – 2013),⁷³⁶ the market for illegal alcohol production was suspended. Criminal groups involved in the illegal alcohol business have shifted their operations into other illegal acquisitions, especially into illegal tobacco trade. This trend is distinctive in Silesia (the North-Eastern part of the country).⁷³⁷

TABLE 58. RESULTS OF THE WORK OF CZECH CUSTOMS WITH RESPECT TO ALCOHOL CONTROL

Years	2009	2010	2011	2012	Index 2012/2011
Number of violations	381	641	1,293	1,869	144.6%
Amount involved (million litres)	0.3	0.4	0.5	2.7	540
Revenue leakage (duties and taxes; million CZK)	14	25	109	709	650.6

Source: Celní správa ČR [Czech Customs Administration], *Informace o výsledcích činnosti Celní správy za rok 2012 [Information on the Activities of the Customs Administration of the Czech Republic in 2012]* (Prague, 2013).

VAT fraud in connection with customs fraud

Illegal import of goods typically relies on declaring incorrect tariff data, false quantities, identity confusion with other goods, broken customs seals. **Fraudulent imports from third countries resulting in a loss of customs revenue** is a Europe-wide problem with a significant effect in the Czech Republic. In the Czech Republic, it is mostly South Asian organised groups that are engaged in the import of goods from third countries that result in reduced collection of customs duties and taxes. They often lessen the customs value of the imported goods by using shell companies, declaring false origin of the goods, including breaching anti-dumping rules, placing the goods under the customs procedure codes 4000 and 4200,⁷³⁸ and subsequently avoiding VAT payment.

The disadvantage of the tax system in the country consists in the fact that when importing goods the collection of taxes and duties are separated: goods imported into the territory of the Czech Republic are

⁷³⁶ In September 2012, methanol poisonings occurred in the Czech Republic, Poland and Slovakia. There were 51 dead and many others suffered from permanent health damage. The Czech government established a central emergency response council and there was a 20-day prohibition of selling liquors of more than 30% proof. The police arrested several people: two of them were sentenced to life imprisonment; the other eight to imprisonment for 8 to 21 years.

⁷³⁷ Earlier, customs officials discovered most of the illegal distilleries in the Ostrava region. Half of the confiscated counterfeit alcohol comes from the Moravian-Silesian region.

⁷³⁸ Customs regime 4000 is the regime when goods coming from a third country with payment of the customs duties and VAT and/or excise. When code 40 applies goods are not subject of a VAT-exempt supply to another member state, however, the goods may be subject to other exemptions from VAT. Code 4200 is the exemption from payment of VAT and, where applicable, the excise duty suspension, is granted because the import is followed by an intra-EU supply or transfer of the goods to another member state.

charged with customs duty by the customs office but the VAT is to be paid separately by the importers in monthly or quarterly periods. This separate collection is misused mainly by South Asian crime groups which pay customs duty, but subsequently the company importing the goods and liable for the taxes disappears, thus withholding VAT.

The export of goods to third countries resulting in reduced VAT collection (abuse of the tax refund) is carried out by declaring a disproportionately high value of the goods and their subsequent export, resulting in an excessive refund, through fictitious exports of goods, or by using conduit companies in a chain of taxable transactions carried out on an open or closed carousel.

Market structure and actors

Key actors in the criminal market

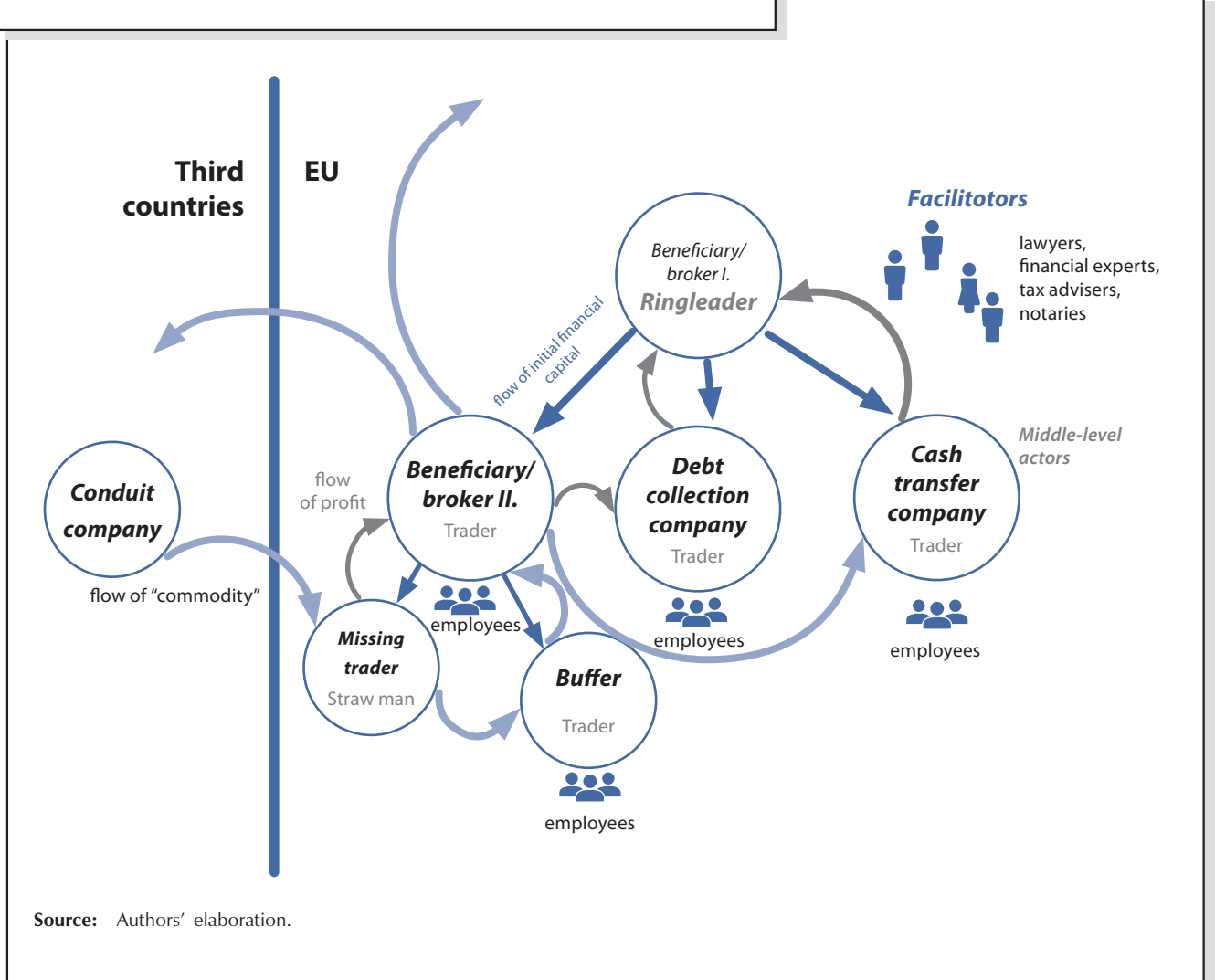
In VAT fraud, foreign criminals (Russian, Ukrainian, French) are often in the position of financiers, facilitators, and money launderers for Czech companies since they have the expert knowledge and necessary background and networks; they often use Czechs as straw men (e.g. in the case of emission allowances). Vietnamese and Chinese criminal groups are hard to infiltrate because they are ethnically exclusive and well organised with strict hierarchy. The Vietnamese groups specialise in drug trafficking and illegal tobacco trade. On the Czech side, there are a lot of companies that have exclusively Czech ringleaders and members. They own indirectly a set of companies with domiciles in other countries (e.g. the Cayman Islands, Cyprus, Liechtenstein, Luxembourg).

The key actors are specialised in trading in one type of goods/service at any one moment (e.g. mineral oils, tobacco, alcohol). They are, however, sufficiently flexible for moving their portfolio to another sector following government intervention or tightening of the legislation. The networks of actors include straw men, facilitators (including lawyers, financial experts, tax advisers, and notaries), traders, ringleaders, and employees. It is important to note that the actors, especially on the middle-level of the fraud in the missing trader scheme or carousel fraud, do not know each other and often do not know even who the ringleader is. Employees such as drivers, assistants, manual workers, etc., are mostly unaware of their employers' illegal activities. Facilitators are rewarded for their services by the ringleader in the form of a fee, a share in the profits, or an opportunity to purchase goods at lower prices.

Besides the established players from the 1990s, the range of criminals involved in this type of fraud has expanded to include those who dealt in drugs, pimping, racketeering, etc., which often involved violence. For them, VAT fraud presents lower risks and higher profits than violent crime. There are also generational differences: the older generation with strong economic positions cooperate with each other, and their position is built on a personal reputation. The younger generation, on the other hand, are often not members of social elites involved in white-collar

crime and are thus more competitive with each other. Suspicion, distrust, security measures such as jammers of wiretapping, surveillance, limited use of mobile phones and internet banking are common among players involved in VAT fraud.

FIGURE 50. THE MISSING TRADER SCHEME, KEY ACTORS AND FLOW OF MONEY



The most common VAT fraud requires at least 4 actors – **conduit company, missing trader, buffer, and beneficiary**. In an ideal case, a debt collection company⁷³⁹ is involved in the chain. Buffers are legitimate businesses trading in real goods and services that would purchase VAT free goods or services and that in many cases might not be aware of the fraudulent scheme. Trust is the key concept of these kinds of businesses. Buffers resell the goods or services to large multinational retail chains.

⁷³⁹ A debt collection company can figure as the fifth actor in the supply chain. The main task of debt collection companies is to transfer money among actors, especially between missing traders and brokers/ringleaders. For example, in the Czech Republic there was a detected case of supply chain with a debt collection company (a virtual bank) with a domicile on the Comoro Islands. The virtual bank provided e-platform for fictitious money transfers via bank software aimed at a VAT refund. The players were able to prove the realisation of payment via fictitious account statement to the tax collection administration.

The model of chains looks like a spider-web: at the top there is a ring-leader (an inner circle player,⁷⁴⁰ his name does not appear in any official documents and stands outside the structure), few of the middle level actors (conduit companies), missing traders (according to the estimations of states officers and interviews with convicted offenders there are approximately about 12 companies in one chain), buffers or directly the final customer (legally working business companies, such as Mittal Steel in the case of the illegal trade with scrap metal).

In case the ringleaders want to prevent law enforcement monitoring of the flow of the funds through bank account they involve another link in the supply chain – a **cash transfer company** (such as a petrol station) – which receives money in cash. A lot of small petrol stations have emerged in the Czech Republic offering fuel at a lower price but on the condition of cash payments only. Therefore, it is easy to launder money using those petrol stations.

Risk minimisation: members of supply chains do not know each other (unless they “need to know”). The ringleader has a lot of companies – missing traders and traders. The timeframe of the existence of the missing trader is the key: he runs the business on average one and half years, after which the company is dissolved and the straw men leave the activities; after six months or one year he is again involved in a new supply chain as a new missing trader.

Organised groups do not operate regionally, they are able to transfer their portfolio abroad, sometimes it is hard to recognise the structures, as they often have a domicile of the company in third countries, especially in tax havens. Managing directors (straw men) come from disadvantaged social groups.

Modus operandi

In the Czech Republic, several types of fraud of varying degrees of sophistication have been identified:

Carousel fraud. In the case of a carousel fraud, the goods are supplied abroad and then returned to the Czech Republic. Variability of goods is a feature of the carousel fraud. Such goods must have these characteristics: **rapid stock rotation** (the subject of the taxable supply is readily saleable), **difficult identification** (the subject of a taxable transaction cannot be easily distinguished from another (pieces, litres, etc., as liquid, oil, metal etc.)), **to be easily repositioned** and of **low value** (sugar, metal, rapeseed oil, wood, construction materials/fabrics) or **small size** (tablets, mobile phones, gold, rechargeable coupons), and **not be in the reverse charge system.**⁷⁴¹ The reverse charge system is already applied

⁷⁴⁰ The ringleader is an organiser who is responsible for the design and the organisation of the fraud. Although he would usually get the lion's share of the profits, in most cases their names would not appear on any document or in the companies involved and other actors from the chain do not know who he is.

⁷⁴¹ The national authorities respond ex post. „Reverse charge” system according to the Czech customs and police authorities must be introduced on all commodities.

to gold, construction industry, metal, emission allowances in the Czech Republic.⁷⁴² Currently the Czech government is preparing amendment of the Tax Code to include also the acquisition of mobile phones to the reverse charge system.

Missing trader fraud.⁷⁴³ This scheme requires intra-community trade in actual goods, in which the first company (a limited liability company) is liable for the VAT as it is a registered payer of VAT, but is unable to meet his tax obligation for various reasons. The company buys the goods, resells them but fails to pay the VAT, thus creating competitive advantages for its goods on the market (the price of goods is lower by about 21%); after this, the missing trader resells the goods to the buffer. The mission of the buffer is to legalise the goods – provide a new identity for them – then create an unassailable invoice and resell the goods to the final customer. The task for the missing trader is to make a financial transaction in order to transfer the money to the ringleader.

Intra-community VAT fraud involving **international buffer/broker**. The export of goods to third countries is difficult to detect, especially when the international buffer/broker comes from countries which do not have agreements on mutual legal assistance with EU member states. A problem appears also in the case when the exported goods are easy to confuse (e.g. to confuse metal for other raw material) and thus customs officers are not able to verify the declaration. It happens also that customs officers are involved in the fraud.

The insolvent trader VAT fraud. This model is equivalent to the missing trader model. Player A who is responsible for the VAT payment, admits tax obligations to the tax/financial office with the purpose of legalising the goods or services that are resold to player B. The VAT is not paid because player A declares bankruptcy and, at the same time, company B requests a refund of the VAT.

Frauds with fictitious invoices resulting in VAT refunds on national level. Shell companies are established for the purpose of scamming excessive refunds. One player can manage tens of companies and request tax refunds from the financial administration that does not have enough capacity to check all tax declarations. In the case of an investigation of a tax declaration, some of the players cease their criminal activities, while

⁷⁴² Sections 92b, 92c, 92d, 92e of the Act No 235/2004 Coll., on Value Added Tax.

⁷⁴³ In the Czech Republic, many missing trader frauds were detected concerning a purchase of emission allowances. The modus operandi with emission allowances fraud is based on the following model: The ringleader of the fraud delegates agents to find straw men. The agents describe the trade with emission allowances to the straw man as a legal business, where they can profit CZK 0.30 from one emission allowance, i.e. monthly CZK 200,000 (€7,000). The straw man gets the start-up capital for running a business with emission allowances, setting up the company. According to analysed sources a start-up capital comes either from international organised groups (see section about market players) or from legal businesses. The funds are transferred to the straw man in cash, at first usually an amount lower than €15,000. The ringleader of the fraud and the agent start to buy emission allowances abroad and resell them in the name of the new company in the Czech Republic, proceeds from the trade with emission allowances goes to the account of the ringleader, but he does not pay taxes because this obligation is on the new company, as a result of which the straw man could be imprisoned.

others continue and through other companies issue the invoices for the purpose of getting VAT refunds. Prague's financial offices are especially overloaded.

Unjustified requests for refunds in the Czech Republic range from 50,000 CZK (€1,812) up to 80 million CZK (€2.9 million); in one case the refund amounted up to 70 billion CZK (€2.55 billion), according to one interviewee (CZ-E4). The fictitious invoices are listed on the accounts of advertising services. The construction industry is widely used for fictitious invoices, but other business sectors have also been identified such as car rentals, car services, cleaning services, locksmiths, sponsorship (national hockey competition, football league), and charity.⁷⁴⁴ These are primarily services where the actual delivery and transactions are difficult to prove. Advertising services or sponsorships are used also as a system for money laundering.

Laundering involves an entrepreneur (whose job is also to launder money in a chain of companies) who establishes, for example, a legal motocross track (i.e. the main declared business purpose of the shell company is running motocross tracks). The entrepreneur encloses the piece of land around the motocross track by a fence and offers this "fence" for advertisement. Other companies from this criminal chain pay significant amounts for advertising at the fence (e.g. over €3,000 per month). The real aim of the advertisement is fictitious increasing of costs of the companies that order the advertising service. The model of the fraud is based on the fact that the entrepreneur keeps just 10% of the price of advertising and the remaining 90% is sent back to the customer through a chain of companies.

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

VAT fraud and financial crime in general are typical white-collar offences committed by business and entail a number of related problems: political and administrative corruption, tax evasion, clientelistic networks. In the Czech Republic, the **source of the capital for these is often linked to legal or illegal business activities in the 1990s**. Fraudsters started a business in the time of the transition from a socialist to a capitalist economy using: a) personal contacts to gain access to privatised property (social capital); b) saved money from the socialist past derived mainly from activities such as illegal trade in foreign currencies, sales on the black market, smuggling, or a business without an administrative authorisation (financial capital).

The social capital for initiating a criminal operation comes in the form of a social network as the most important requirement and gatekeeper for

⁷⁴⁴ The law requires the provider of charity to send just 40% of collected money to the beneficiaries and 60% of the amount can be used for running the charity, i.e. organisational and personal costs. A system of fictitious invoices is sometimes misused and the main cover purpose of the charity is to get money for the charity provider (i.e. 60% of collected money on charity purposes).

an admission to the criminal environment. It provides contacts, shared know-how, space for searching for business partners. This kind of social environment is socially and economically exclusive;⁷⁴⁵ actors create their own social norms, values and rules that do not always correspond to legal norms (circumventing the law with the purpose of self-enrichment is perceived as normal or even valuable). Especially valuable is the capacity to influence the public administration or local/national politicians (as they are also part of that social environment).⁷⁴⁶

A **legal business** is another source of financing criminal activities. Ringleaders involved in VAT fraud with motor fuel need to have economic potential⁷⁴⁷ and expert knowledge, and if they want to generate significant profits they need a substantial investment in the initial business. A VAT fraud is not only an opportunity for crime and as such attracts both legitimate and criminal business people. Several options have been identified in the Czech Republic: the entrepreneurs do not reinvest profits into another criminal activity; they reinvest money in the legal business; or they proceed with VAT frauds.

Besides traders who are clearly involved in VAT frauds as a main activity, there is another group of traders who run a part of their business in a legal way, another part of their **business is connected with a criminal activity** (breweries, illegal alcohol distilleries, tobacco). The illegal production is intended mostly for legal distribution (bars, pubs and restaurants). This group of businessmen run legal business as a cover-up for a criminal activity, especially Vietnamese community covers illegal trade with alcohol and spirits, tobacco or drugs by operating groceries, street stalls, etc.

VAT fraud is connected with other types of illicit activities such as abusing classified information in business, corruption, and forgery of documents. Tax fraud entrepreneurs are businessmen and according to the research findings they are not involved in other crimes such as drug smuggling, human trafficking, etc., although criminal activities may be a source of capital for initiating VAT fraud. Violence among high level tax fraudsters is minimal, while at the middle-level of the business there can be some violence associated with assaults, extortion, especially in cases when the victim is not able to pay his debts. For these "services" fraudsters hire foreign criminal groups (Serbian, Ukrainian, Russian). It is here that a connection between the economically powerful (white-collar) stratum and the criminal, violent "underworld" (blue-collar crime).

⁷⁴⁵ Especially, the social network incorporates economically strong actors who meet each other at social events.

⁷⁴⁶ Another situation has appeared on the territory of Eastern Moravia (Zlín region). There, strong social ties exist between criminal entrepreneur who are bounded by secrecy and hierarchy if prosecuted, and they take care of the families of fellow criminals during their imprisonment, and provide them with a new car, an apartment or start-up capital after their release.

⁷⁴⁷ In the case of VAT fraud with motor fuel, the petrol stations paid the goods on a pro forma invoice in advance. The start-up capital is around 500,000 CZK (€18,000) according to interviews with prosecuted criminal entrepreneurs. This means that there are no formal or practical barriers to securing entrepreneurial funding.

In brief, research has revealed that the sources of the initial capital of VAT frauds can be distinguished as: a) own money re-invested from another criminal business; b) own money re-invested from another legal business; c) crime money invested by other criminals for a share of the profits; d) a loan from a criminal entrepreneur; e) a loan from a legal businessman.

As regards the **capital for sustaining criminal activities**, a successful carousel fraud or a missing trader fraud generates enough profits to sustain it if the operators want to stay in the criminal business and cover other costs of doing business. If customs finds legal violations, the amount of penalties in administrative proceedings is far less than the amount of profit. Furthermore, it is only the members from the lower levels of the organisation of VAT fraud that are sentenced. Thus, after the imprisonment of some in their organisation, the ringleaders still have their profits almost intact. The property of the convicted members is promptly transferred to family members, friends, etc., thus shielded from confiscation. All of these schemes make the criminal prosecution and imprisonment of fraudsters not very effective.

Settlement of payments

The top management of VAT fraud schemes usually consists of one or two people that are not formally involved in any trading, but influence the activity through other people formally registered as representatives of business entities; the latter further give other instructions to a wider range of people – facilitators, straw men, traders etc. The lion share of the profits goes to those at the top of the pyramid. Significant rewards are received also by people who formally represent the leaders as they take a significant risk. Even in the case of these people it is an individual rather than a larger number of people. Agents/facilitators are rewarded *ex post* for their collaboration by the ringleader in the form of a fee for their service, a share of the profits, or an opportunity to purchase goods at lower prices.

The retailers or petrol stations usually pay a deposit in advance to the buffer's account. **Advance payments** are made just on the basis of **trust** among the traders without written contracts. The profits are paid in most cases in cash to prevent monitoring the flow of the funds and the connection among players. According to interviewed criminal entrepreneurs, in order to avoid detection when bank transactions are used they are for amounts lower than €50,000.

Apart from the uncollateralised payments among players, they use also legal tools. Higher amounts are transferred through debt collection companies: the payment arrangement is based on order of payments in favour of ringleader, or accounting of debt.

TABLE 59. SETTLEMENT OF PAYMENTS IN VAT FRAUD IN THE CZECH REPUBLIC

Type of payments	Source	Payment arrangement
Initial capital	Own money from another criminal business re-invested	-
	Own money from another legal business re-invested	-
	Crime money invested by other criminals for a share of the profits	Cash Order of payments Bill of exchange
	Loan from a criminal entrepreneur	Cash Order of payments Bill of exchange Real estate collateral
	Loan from a legal businessman	Cash Bank transfer (on the basis of trust or contract)
Loans	See section on Initial capital	
Profit sharing	Salaries	Cash Bank transfer
	Cash transfer company	Cash
	Debt collection company	Bank transfer Order of payments Accounting of debt
Capital for sustaining business	Revenues from VAT frauds	See section on profit sharing (below)
	Own sources	See section on source of capital (above)
Capital in critical moments	Own money of fraudster	-
	Loans	See section on source of capital (above)

Source: Authors' elaboration.

Costs of doing business

The cost usually depends on the type of commodity that is the object of the fraud. For VAT fraud in connection with fuel imports from abroad to the Czech Republic, for example, offenders usually have to possess millions of CZK for the initial purchases of fuel. Significantly lower costs are needed in cases of fake goods exports, which either do not take place or only worthless/minimal value goods are exported, while the declared export value is significantly higher than the actual.

Designing, starting and running a VAT fraud scheme requires certain initial investments. The start-up capital covers costs such as: setting up shell

companies (the price for an off the shelf company is €911), purchasing goods, paying to VAT warehouse operators and shipping companies for the movement of goods across borders, corrupting tax and customs officials, paying for specialised services of accountants, lawyers, tax advisors, etc. A company involved in an emission allowance fraud starting with a turnover of, say, CZK 530,000 can reach CZK 700 million in 6 months.

Another significant factor for costs is the fraud method. In the case of fictitious goods the costs are lower than in the cases where a real commodity is involved in the fraud. According to a senior Czech officer (CZ-E6), for trading in fictitious goods the required expenses amount to approximately 60 thousand Czech crowns for buying fictitious off-the-shelf companies, some 10 thousands Czech crowns for administrative fees and 10% of the total amount invoiced as a reward for a straw man.

The volume of the initial capital differs also depending on the aim of criminal operations. If the offenders plan to reach quick enrichment and then withdraw, they do not need a complicated and sophisticated chain of companies, at least they need just 3 another actors. It means that the initial capital will be lower than in the case when offenders' target is to proceed with VAT fraud as a main activity.

Profits and profit sharing

The profit gained from a tax fraud depends on the commodity which is used. In a VAT fraud with fuels, the revenue from the fraud is about 6 Czech crowns per one litre and our estimate is that the profit is between 3 and 4 Czech crowns per one litre. In the case of a volume of 60 million litres per month, the total revenue is about CZK 240 million (€8.7 million) per month. Less profitable are business with emission allowances, where the revenue reaches up to CZK 1 billion (€36.44

TABLE 60. ANNUAL PROFIT, COSTS, REVENUE PER SUPPLY CHAIN IN THE CZECH REPUBLIC

Commodity	Annual revenue (€)	Costs (€)	Annual profit (€)
Advertisement	437,280	393,552 (laundered money for clients) 3,000 (running of motocross business)	40,728
Alcohol	500,000-511 million	70,000-1 million	430,000*-510 million**
Emission allowance	33.44 million	20,000	33.42 million
Fuel	155.23 million	55.33 million	99.9 million
Metal	87,456	2,733 (3 shell companies) 21,600 (transport)	63,123

* Per 42,000 litres of alcohol.

** Per 500,000 litres of alcohol.

Source: Authors' elaboration based on the interviews, analysis of media sources and government documents.

million) per annum. Profits from the illegal trade with alcohol are lower (Table 53 above). The revenue from pure alcohol is €10 per each litre. The revenue of the trade with metal amounts to about CZK 200,000 (€7,288) monthly (2 trucks loaded with 30 kg of metal) (if there are more missing traders, profit multiplies). In the case of an advertising fraud with fictitious invoices resulting in a VAT refund, the price for one advertisement is around CZK 100,000 (€3,644) monthly, with facilitators keeping 10% of that.

How profits are invested depends on the actor's position in the supply chain. Low-level and medium-level actors of organised VAT frauds expend their profits on private costs. On the other hand, high-level actors invest the profit into another type of legal or illegal business.

In general, the criminal entrepreneurs invest their profit into:

Private purpose

- i. **Personal expenses/lifestyle.** Lower level actors of organised VAT usually buy luxury cars, boats, yachts, designer clothes, electronics, or membership in sporting club as golf club, etc. They also invest into their hobbies, sports, or travelling. Often, the low-level actors of supply chains use the services of nightclubs, bars and discos.
- ii. **Investing in real estates or other luxury commodities.** The investment into real estate is typical for all actors of organised VAT frauds. According to their share of the profits and position in the supply chain players proportionally purchase real estates in the Czech Republic for residential purposes, invest in (holiday) residencies abroad, or in real estate for rental or to be sold for profit. The purchase of luxury commodities depends on the value of the goods, price stability, and resale possibility with higher or stable profit. In general, they invest into buying gold, antiques, artworks, highly valued collections of coins, antique weapons, etc.

Business purpose

- iii. **Expanding existing or starting new VAT fraud schemes.** In this case, there is usually a reinvestment of profits in an **identical or similar** area of organised VAT fraud where actors already have experience. The existence of organisational, material and human resources structure (e.g. interconnectedness of importers of fuel with operators of service stations, etc.) facilitates new organised VAT fraud, and reduces costs.

It is not common for VAT fraudster to split their interests by investing into other criminal fields such as drugs trafficking, human trafficking, gambling, or even organised VAT fraud with other goods/services.

- iv. **Investing in legitimate businesses.** Legal traders invested in most cases into an activity that was previously performed illegally, or else the funds were invested in real estates, which were then rented and thus turned into a legitimate source of funds. This usually covers

the purchase of the real estate, primarily land for building and hotel facilities. The real estate is purchased in the name of companies controlled by the tax crime perpetrators but not involved in such crimes. The companies usually have a hidden ownership structure and established in a tax haven, in order to make it difficult or impossible to determine the true identity of the individuals controlling this property.

In the case a new legal business is started, they prefer a sector/market where **a lot of actors** are involved and where there is **low government regulation** (e.g. pubs, restaurants, bakeries, pawn shops).

- v. **Capital investment.** Ringleaders or brokers – the players at high levels of the supply chain – prefer investing in financial markets (shares, securities, etc.), or deposit money on bank accounts abroad in the name of their family members.

Access to capital in critical moments

According to interviews with criminals convicted of VAT fraud, there is zero tolerance and solidarity between the actors. If sentenced, lost money, power or influence, they also lose contact with the business environment. Some of them tried to run a business again, but without access to capital it was impossible and could only assume the role of a straw man in a VAT fraud.⁷⁴⁸ Legal provisions to prevent convicted fraudsters from obtaining a loan are missing in the Czech legislation (the terms of borrowing are defined by providers – bank and non-bank institutions). However, if middle-level actors are prosecuted (see Footnote 746 above), but do not incriminate other members of the chain, after they are released from prison they can obtain new initial capital from the ringleaders as a reward for their loyalty.

6.4. SPAIN: A GROWING ILLEGAL ACTIVITY

Introduction

Since the European internal market was created in 1993, EU member states have had a common Value Added Tax (VAT). This means that goods can move freely within the internal market as border controls have been removed. A temporary system was introduced for VAT, whereby the zero rate applies to the supply of goods to another member state. To be eligible for this zero rate, an entrepreneur must have a valid VAT identification number and must be able to verify that its trading partner also has a valid VAT identification number. In addition to the

⁷⁴⁸ The formal barriers for convicted fraudsters' subsequent involvement in commerce are regulated in the provision 46, Act No. 90/2012 Coll. on commercial companies and cooperatives „1) [t]he member of the body of a business corporation cannot be one who is blameless in the sense of the Trade Act, and even the one in whom the occurrence of the event, which is a trade barrier. 2) Who has become a member body of a business corporation, previously the founder of the business or corporation informs about whether his property or business property of corporations in which they operate or worked in the past 3 years as part of an organ, was led by an insolvency proceeding [...], whether or not given him the other barrier function.”

VAT return, entrepreneurs must file a quarterly return to their intra-community suppliers so that they can be monitored.

VAT generates significant revenue (more than a fifth of world total tax revenue, including social contributions) and has been introduced in around 140 countries. In this regard, VAT is a relatively efficient collecting instrument because it has no impact on intermediary levels of production and does not affect their decisions. In addition, because it affects the final consumer, the potential for its collection is very high. It is also the main source of revenue in some EU member states and plays a relevant role in ensuring public finance stability.⁷⁴⁹

Nevertheless, for some years, the VAT system has been showing signs of vulnerability and no longer fits the bill for taxpayers and public authorities alike. Its increased complexity creates unnecessary costs and burdens, inhibits the functioning of the European market and the deduction mechanism has become a source of international fraud.⁷⁵⁰ VAT offers evasion and fraud opportunities, especially through abuses of the credit and refund mechanism. In the last few years, this type of tax fraud has increased, though it is not clear to what extent this rise is due to increased fraud or increased detection and investigation. Eurojust offers some figures of the last five years and VAT fraud has more than doubled since 2009. Eurojust registered 39 cases in 2009 and 89 in 2013.⁷⁵¹ Thus, the potential impact on the economy of the reduction of VAT fraud is quite significant.

VAT fraud, and its different levels of complexity constitute a serious problem for the European Commission and member states not only because it entails a heavy loss in tax collection, it has a significant impact on trade and gives rise to considerable distortions in the economic sector competence, in the GDP, in employment, in labour and capital income and in general welfare.

Market overview

In 2011, Spain suffered €15.2 billion in losses due to VAT fraud, which represented 1.4% of its GDP. The Spanish tax authorities estimate that Spanish fraud represents 10% of the VAT collection.⁷⁵² Spain's VAT fraud figures are below those of Italy (€26 billion), France (€32 billion), Germany (€26.9 billion) and the United Kingdom (€19 billion). Romania, Greece, Latvia and Lithuania have even higher fraud rates. However, losses have been on the rise since 2008, especially in Spain and other countries such as Greece, Latvia, Portugal and Slovakia.

Spain has traditionally been in the middle in Europe as regards to the tax fraud rate, with Italy and Greece comprising 15% of the VAT gap. The VAT gap is the difference between the expected VAT revenue and

⁷⁴⁹ Borselli, *Organised VAT Fraud: Features, Magnitude, Policy Perspectives*.

⁷⁵⁰ Keen and Smith, "VAT Fraud and Evasion: What Do We Know and What Can Be Done?"

⁷⁵¹ Eurojust, "MTIC Fraud", *Eurojust News*, no. 11 (2014).

⁷⁵² N. Miranda Fuertes and S. De Navascues Aybar, *El fraude de IVA en operaciones intracomunitarias. Medidas y propuestas para combatirlo [VAT Fraud in Intra-Community Transactions. Measures and Proposals to Combat It]* (Report for the Advanced Course III International Taxation, 2011).

the VAT actually collected by national authorities. It has been estimated that in the 1990s the level of fraud in Spain was around 26-28% of the potential tax collection.⁷⁵³ Recently, a study funded by the European Commission estimated that the VAT gap was in the range of 21% in 2011, and 12% on average between 2000 and 2011. In the European Union, Spanish estimates are higher than the European average rate calculated in 2011 in the EU-26 (18%) and lower than the average rate between 2000 and 2011 (15%).⁷⁵⁴

Spain does not provide disaggregated data regarding tax fraud revealing the reported cases. The tax authorities state that they are conducted mainly in Madrid, Catalonia and Andalusia, one of the main economic and most populated areas, where most of organised crime is concentrated.

Market structure and actors

The transitional arrangement between member states was supposed to be replaced by a definitive system for the taxation of trade between member states based in principle on the taxation in the member state of origin of the goods or services supplied. This transitional system still applies today, which makes possible the missing trader intra-community (MTIC) fraud.

Since business-to-business intra-community acquisitions are considered taxable transactions, such intra-community supplies are VAT free. Actually, they are zero-rated which means that the supplier is entitled to a VAT deduction or a refund of input VAT in the exporting member state. The purpose of zero rates is to safeguard the principle of taxation in the country of destination. The intra-community supplier can therefore deduct or claim a refund for the amount of its input VAT regarding the supplied goods in the country of origin. In the country of destination the acquirer must account for the amount of VAT on this transaction and can, at the same time, deduct this amount.

MTIC fraud takes two forms, based on two key features: the VAT zero-rating of exports and the system of deferred payment for VAT on imports adopted in the EU since the removal of fiscal frontiers in 1992.

Acquisition fraud or MTIC fraud

Acquisition fraud is a “commodity based fraud in which standard-rated goods or services are purchased zero-rated for VAT purposes from a supplier based in another EU Member State and sold in other EU country for domestic consumption. The importer, who is known as the ‘acquirer,’ subsequently fails to account for the VAT due on the standard-rated taxable supply to the customer’s country.”⁷⁵⁵

⁷⁵³ C. Díaz, A. de la Fuente, and C. Herrera, *Evaluación del fraude en el impuesto sobre el valor añadido [Evaluation of VAT Fraud]* (Madrid, Instituto de Estudios Fiscales, 1990); P. Gómez de Enterría, F. Melis, and D. Romero, *Evaluación del cumplimiento en el IVA: Revisión de las estimaciones años 1990 a 1994 [Assessment of Compliance VAT: Revision of Estimates from 1990 to 1994]* (Working Paper, No. 18/98, Instituto de Estudios Fiscales, 1998).

⁷⁵⁴ CASE, *Study to Quantify and Analyse the VAT Gap in the EU-27 Member States – Final Report*.

⁷⁵⁵ Eurojust, “MTIC Fraud”.

In acquisition fraud, the fraudster or missing trader supplies the goods in the market of final consumption. Embezzling all the VAT debited, it generally sells the goods at a price below their market value. This fraud results in a loss of revenue and a restriction of competition. In this case the missing trader is a front company positioned between the importer and the distributor. The criminal investigations carried out reveal that organisations use straw men to run these companies. They include homeless people, foreigners or professional straw men. They are used to incorporate the company and to open bank accounts, and are remunerated for their services. Occasionally, straw men would not be aware of the situation. However, it is the criminal organisation that controls the money and its movement.

Carousel fraud

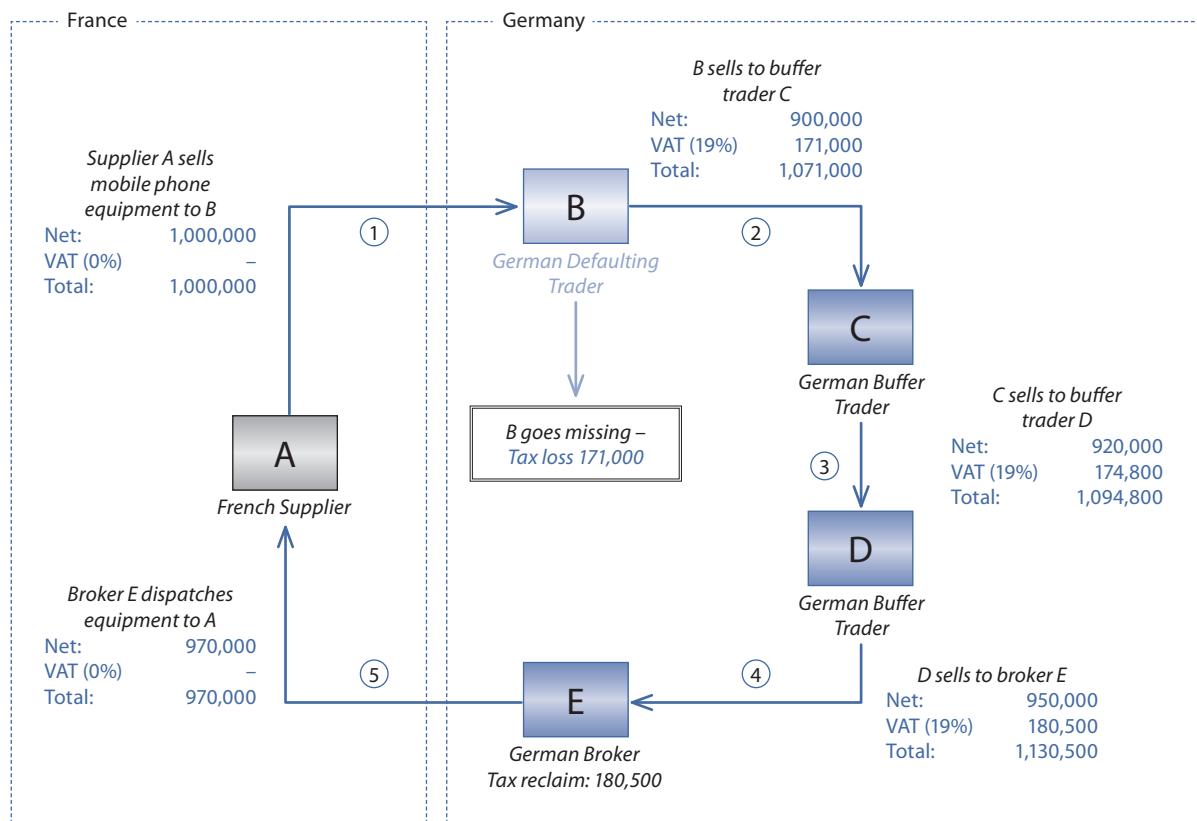
Carousel fraud “is a financial fraud that is an abuse of the VAT system resulting in the fraudulent extraction of revenue from the EU member Treasury. It may involve any type of standard-rated goods or services. As with acquisition fraud, goods and services are acquired zero-rated from the EU, with the acquirer then going missing without accounting for the VAT due on the onwards supply. However, the goods or services do not become available in the EU member state for consumption, but are sold through a series of companies in the EU member state and then exported or dispatched, prompting a repayment from [the customs and revenue service] to the exporter/dispatcher. This process can be repeated over and over again using the same goods or commodities.”⁷⁵⁶

This is the most profitable type of fraud because profits are substantially higher and it is the tax authorities which are being defrauded. Carousel fraud is a more complex version of the MTIC fraud. A group of companies sell the same goods or services in a circle to achieve an illegal profit by repeating the MTIC formula over and over again. The same goods (whether real or fake) are repeatedly supplied in a circular pattern. After the missing trader’s purchase from another member state, goods are sold through a series of domestic companies and then re-exported to the EU country of origin (the goods move in a “carousel”). Although the missing trader does not pay VAT to the tax authorities, the company at the end of the domestic supply chain (the “exporter”) claims back the input VAT paid. Therefore, with every turn, the tax authorities suffer a loss. As in acquisition fraud, the missing trader generally charges its counterparts a lower price. The main difference between MTIC and carousel fraud is thus that goods or tradable services eventually make their way back to the original seller, and the loop is completed.

The model in Figure 51 assumes a German missing trader (B) buying goods from a French company (A) without paying VAT (destination principle) and selling them for a VAT-included price to (C), without paying the corresponding tax to the tax authorities. After several transactions, the same goods are exported to (A) and the carousel begins again.

⁷⁵⁶ Ibid.

FIGURE 51. MODEL OF A CAROUSEL VAT FRAUD (AMOUNTS IN €)



Source: International VAT Association, *Combating VAT fraud in the EU. The way forward*, Report to the European Commission, March 2007.

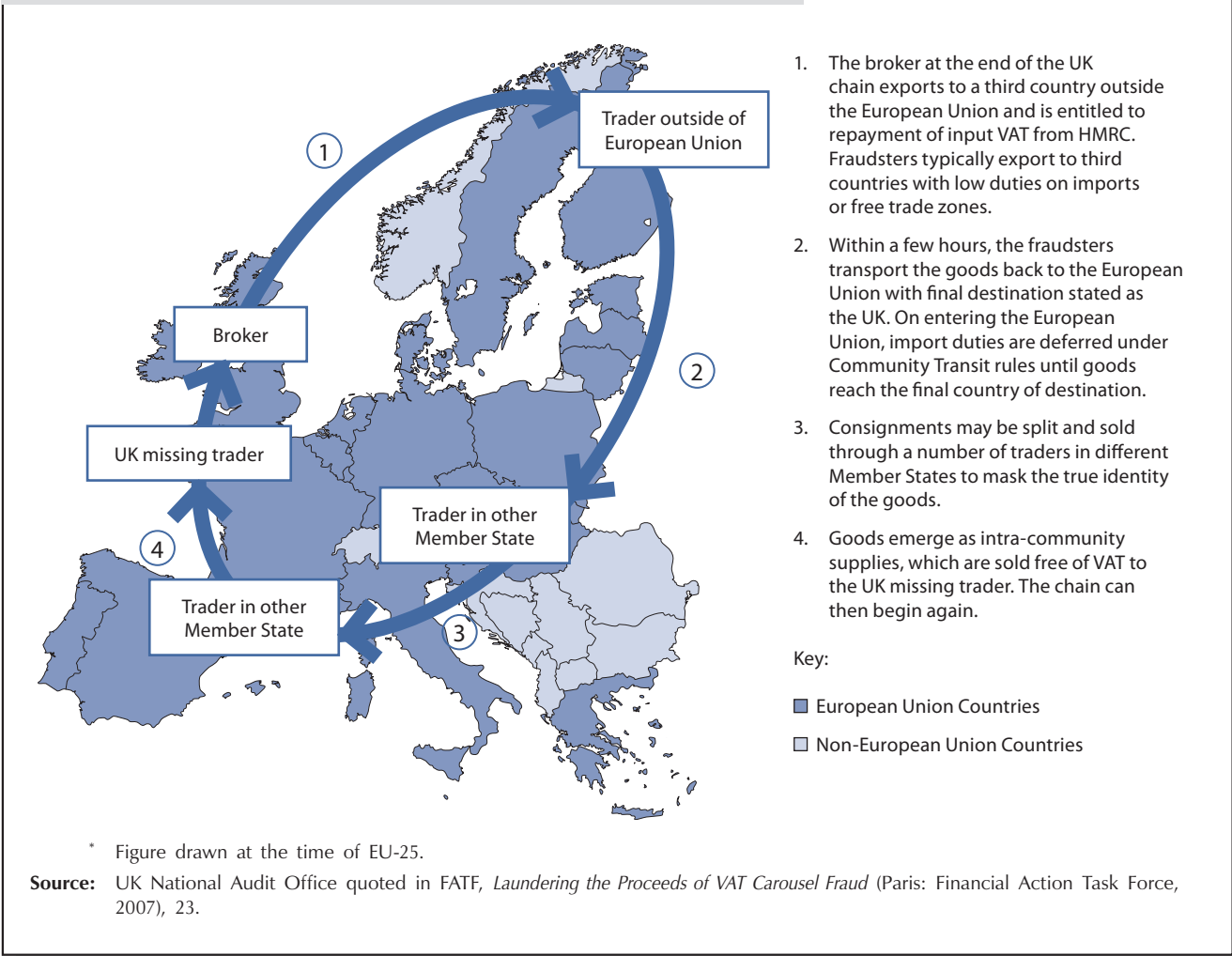
With every turn, the German broker (E) claims back the input VAT paid (€180,500) from the authorities. The net loss for the German government is €171,000 (VAT collected by (B) and not paid to the authorities). Under this method, all transactions are simulated, and sometimes no commodity is created. Fictional transactions are created with invoices and paperwork but there is no product as such.

VAT carousel fraud often involves intra-community transactions. In addition to this type of fraud, the EU has seen a rise in cross-border carousel fraud where the cross-border supply comes from a non-EU country. In Spain, many cases of fraud involving third countries (e.g. China) have been reported.

Nevertheless, there are variations of the same basic fraud:

- No circulation of products, only boxes or packaging.
- No circulation, all operations are simulated by fictional invoicing and fake transportation documents.
- Strategic placing of several buffer companies, distancing the missing trader company and the final consumers even further.

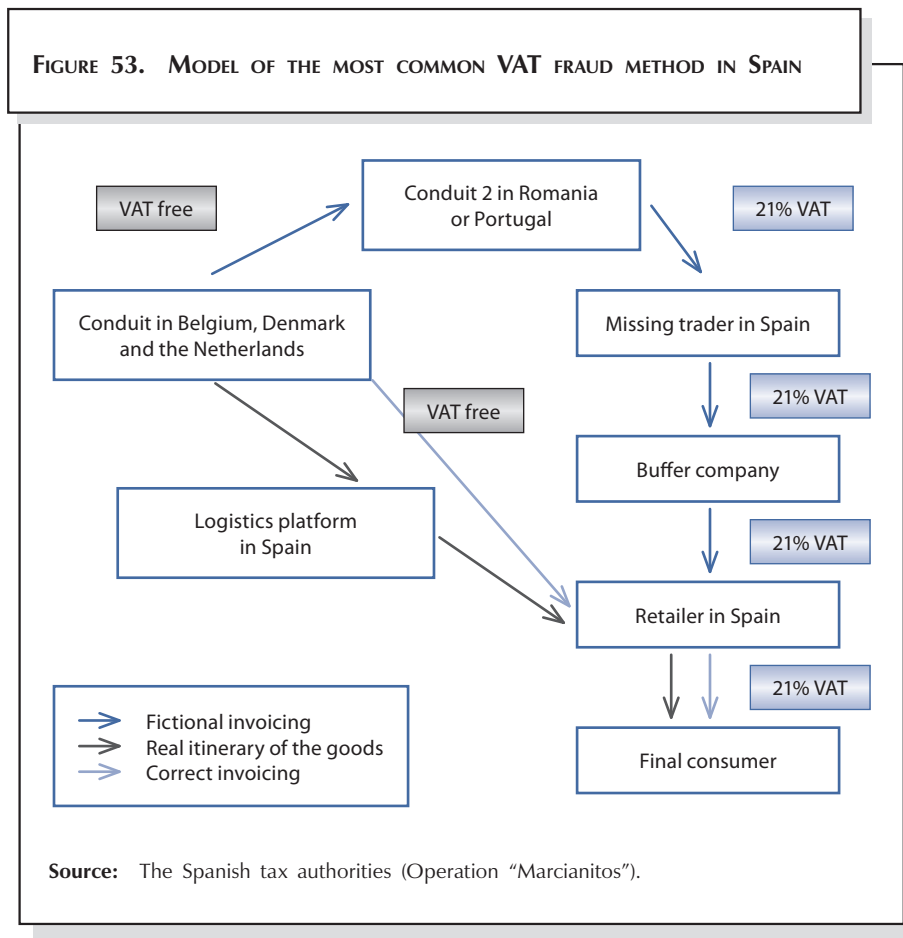
FIGURE 52. VAT CAROUSEL FRAUD USING A THIRD COUNTRY*



- A company in a country simulates an intra-community transaction but the commodities are in fact introduced in the same country market.
- The so-called “Belgian cross”: there is an inner channel between the manufacturer and the distribution company that sells correctly in the internal market. However, the company that should have paid most of the amount of tax charged has obtained tax deductions through another fraudulent channel, in such a way that none or very little of the tax due is ultimately paid.

The key players in missing trader fraud and carrousel fraud are:

- Conduit company:** This company is the source company which conducts the intra-community zero-rated transaction to another country. This company will claim the refund of input VAT from the treasury of the country of origin.
- Missing trader.** This trader is usually a transitory company (it may exist just for several months) formally controlled by straw men. This company is always at the beginning of the chain and enables the VAT



fraud because it fails to account for the VAT due. The company is often bought off the shelf from company formation agents and is registered under a fake or non-existent address. These companies perform no activity and have no facilities or staff. The tax authorities have some control at the initial phase when the authorisation is granted, at which stage they seem to have a legal appearance but once this phase ends no further activities or business are carried out. These shell companies can offer services to more than one organised crime group. Frequently, distributors create a missing trader and disappear within a year.

iii. **Buffer enterprise or trader.**

These are fully compliant traders carrying out regular business. Their involvement is basically to make the fraud pattern more complex and to conceal the fraudulent transactions within their legitimate business. They may even be unaware that they are part of a chain of transactions aimed at defrauding VAT from the tax authorities. Nevertheless, they usually do not pay any tax and sell products at very low prices. Even if they are not aware that they are part of a chain of transactions, they are aware that the prices are below market prices.

iv. **Logistical platform in Spain:** if the real products are sold to consumers, they are usually sold by a logistical platform in Spain which is in contact with the end consumer.

v. **Lawyers or other professionals providing support to set up new and shell companies.** There are plenty professionals who have dormant companies ready to be sold to criminal organisations. The cost of incorporating a company in Spain is around €3,000 and the sellers provide support and assistance to change the management, to substitute shareholders, etc.

At the infrastructure level of the general illegal market, there are plenty of unspecialised and versatile organisations that search for a business opportunity and offer their services to those who pay. They are not differentiated between organisations involved in drug trafficking (cocaine) and organisations involved in VAT fraud: if a

VAT fraud opportunity arises because of the absence of control and supervision, they will enter this market. Initially, their organisers will be inexperienced, but they will develop and become more sophisticated and specialised. Lawyers, transport organisations, groups with contacts in borders and ports, and other types of groups offer infrastructure both for VAT fraud and for drug traffickers. "During the economic crisis in Spain, some individuals coming from the construction sector have been involved in organised crime, specifically in organisations providing logistics" (ES-E3).

The sectors most vulnerable to VAT fraud include:

- Computer products;
- Mobile phones and technology;
- Luxury vehicles;
- Scrap, to be sold to the metallurgical industry;
- Carbon emission certificates;
- Alcohol;
- Fuel and hydrocarbons;
- Silver.

Financing and financial management

Sources of capital for criminal operations. Profile of financiers in criminal operations

The funds required to start up a legal business in Spain are not particularly significant. Under Spanish law a company can be incorporated for €3,000, thus a company can be created relatively easily. Usually, there are entrepreneurs who know that there are opportunities to defraud in a particular economic sector and they are able to offer products with profit margins of 21% or less in case of real goods.

The funds to start up a business can come from legitimate or illegal sources:

- **Legal sources:** fraudsters can obtain money from local government or entrepreneur subsidies. An example was provided of a fraud that was funded initially with European funding for fishing companies.
- **Illegal sources:** the initial amount can come from previous illegal activities. Investors can also help fund a type of fraud in a sector that is less monitored and that generates large amounts of money. The income can come from fraud facilitators, who in turn start up their own fraud operations, often through "business loans" from those who are already established in the business chain. The initial funds can also come from other types of illegal activities (drugs, etc.).
- In the case of **carousel fraud**, funds generally come from the tax authorities (legal funds). The illegal activity is funded by the tax authorities because fraudsters claim tax refunds.

Some lawyers and business centres have many dormant companies which are sold to these types of organisations. The fraudsters would buy a company, change its management, its shareholders and its field

of activity to enable them to run the business smoothly. In addition, since VAT does not have to be paid until the end of the year, they have a period of time to close up shop and disappear, or buy another company.

Some criminal entrepreneurs have a more professional profile, with vast experience in this type of fraud, and can therefore move from one sector to another when evading law enforcement because fraud mechanisms are similar. They usually start a company in a vulnerable sector, selling the product at a lower price than their competitors; this has a contaminating effect on the rest of the sector which must follow suit if they want to compete. They have a margin of 21% (the current VAT rate in Spain) to reduce the price of the product in the market.

Settling payments. Profits and profit sharing

Criminal organisations in this type of fraud act as legitimate companies. In the case of acquisition fraud, the missing trader is a shell company that needs to appear legitimate in order to obtain the compulsory inclusion in the Register of Intra-Community Operators or the VAT Information Exchange System (as intra-community trader). It provides all the documents and invoices as a legitimate company but the amount owed to the tax authorities is ultimately not paid.

The profits of carousel fraud are very high, especially, in certain sectors such as fuel. Even if the initial required investment is very high (e.g. €3 million), organised crime groups can get hold of the amounts to obtain the legal permits to start the business but then rapidly divert these amounts to other activities. Profits can reach €600,000 per month.

A consequence of the circular nature of the fraud is that the goods become increasingly expensive as they are “traded”, which – if unchecked – would lead to out of control prices. This means that in every carousel, the goods are undervalued before they are circulated again. This often occurs when the goods are in third countries (China, etc.). This undervaluation has the added advantage that it reduces the import tax/levy due in the third country. The VAT repaid by the EU member state more than covers the financial loss to the organisation.⁷⁵⁷

Fraudsters will frequently use accounts in the same off-shore bank.⁷⁵⁸ These accounts conceal the money flows in the transactions from member state law enforcement agencies and obscure the onward movement of money to other jurisdictions. Additionally, using accounts held in the same bank speeds up money transfers and reduces the chances of mistakes being made and maintains the secrecy of the operations. It also enables traders to transfer money online, which helps the criminals remain anonymous and operate from the comfort and safety of their own computer.⁷⁵⁹

⁷⁵⁷ FATF, *Laundering the Proceeds of VAT Carousel Fraud*.

⁷⁵⁸ There are two off-shore zones around Spain: Gibraltar and Andorra.

⁷⁵⁹ Ibid.

Money laundering strategies

Carousel fraud provides the highest number of money laundering strategies because of the illegal income generated. According to a study by the FATF,⁷⁶⁰ most of the money is laundered through the banking sector. The same study reveals some factors that explain why a specific destination is used for money laundering:

- Speedy availability of funds (online banking facilities or other features of advanced financial systems);
- Deep-rooted money laundering expertise and experience;
- Availability of legitimate investment opportunities (e.g. opportunities to invest in construction projects);
- Low level international cooperation and regulatory enforcement;
- Country of origin of criminals (related to influence on the movement of laundered money);
- The amount of legitimate trade that already occurs which can conceal illegal transactions;
- Close cultural and commercial links with other parts of the world;
- Lack of formal agreements in relation to legal assistance and extradition.⁷⁶¹

When asked about the most common money laundering strategies, officers in of tax fraud investigation units stated the following:

- Sending money to tax haven jurisdictions;
- International transfers to third countries;
- Ghost companies;
- Local investments are less common due to exposure to detection;
- Compensation systems: typical compensation systems such as the hawala involve two intermediaries (hawadalars) at the locations of origin and destination. Under this type of system, if a subject in one country wishes to send an amount of money to another subject (living in the country of destination) this transfer is made through intermediaries in each country in order to avoid traceability. In country A, the intermediary receives the money from subject A, and in the country of destination the money is sent to subject B by the intermediary in this country. The money is then exchanged between intermediaries.

⁷⁶⁰ Ibid.

⁷⁶¹ Ibid., 10.

POLICY RESPONSES AND IMPLICATIONS

The current report has provided a different viewpoint on criminal finances and an alternative approach for researching the subject. In light of this it suggests possible steps toward the introduction of novel approaches to tackle organised crime. Criminal investments attracted academic attention as early as the 1980s,⁷⁶² however interest in the topic has remained largely theoretical. This is largely due to a number of impediments that continue to deter empirical research on the topic. Most important among these are the **lack of interest in the issue of criminal financing by most law enforcement institutions** and the **reluctance of criminal entrepreneurs to discuss their methods of financial investment** in any detail. Indeed, these deterrents also posed certain limitations to the findings of the current study.

The method of gathering data from criminal entrepreneurs used in the development of the current report proved to be quite challenging. In most countries, researchers succeeded in reaching a number of small to medium-scale entrepreneurs operating at retail or wholesale level. In most cases the work of these criminals needed little or no financing and they appeared to have fragmentary knowledge about the financial aspects of the upper levels.

The empirical evidence collected within the study confirmed that intelligence gathering by law enforcement agencies has typically been focused on identifying members of criminal groups and tracing illicit goods or services they sell, whereas their financial transactions have rarely been traced. The reason for this is that criminal prosecution in all member states is entirely focused on collecting evidence that related to the possession, transporting, manufacturing or sale of illicit products or services. Therefore information on the financial aspects of organised crime has been regarded as irrelevant and no deliberate efforts to collect and analyse such data have been made. The quality of financial information collected (when it is collected) is fragmented and compromised because law enforcement agents operating at the local level lack knowledge and experience in financial matters.

⁷⁶² See, for example, P. Reuter, *The Organisation of Illegal Markets: An Economic Analysis* (Washington, D.C.: National Institute of Justice, 1985).

KEY FINDINGS OF THE STUDY

The initial objective of this report was to map and describe the existing sources, mechanisms and approaches being used to finance organised crime activities and, therefore, to contribute to different and more effective approaches to investigations of organised crime and money laundering. The analysis covered three major organised crime activities – drug trafficking, the illicit tobacco trade and organised VAT fraud – which were selected as they represented three types: an illicit product market, a licit product traded illegally, and a predatory criminal activity. Therefore, the main findings and conclusions can be extrapolated to other criminal activities.

One of the main conclusions of the current study is that the **social capital of criminal entrepreneurs – their trusted connections and reputation – is very often more important than the financial capital for entering, operating and succeeding in a given criminal market.** Social capital appears to be a precondition for access to all levels in any criminal market. It could also act as a substitute for the financial capital needed to start and operate in a given market, insofar as it can secure access to advance payments from customers or revolving credit agreements from a supplier. This is particularly apparent in drug markets, where revolving lines of credit seem to be commonplace in many countries, especially at retail level and wholesale level. The relatively high profit margins and low production costs may encourage this, since failures hurt opportunity costs rather than fixed costs. The empirical evidence collected suggests that **the bigger the level of risks associated with a given criminal activity, the greater the role social capital** plays in entering the market. Within this context, the presence of brokers is paramount for the creation of social capital, since they are the link between two or more disconnected parts of a criminal network. In addition, social capital is embedded in occupations, activities and relationships within legal businesses which act as a platform upon which *legal* relationships (i.e. business partners, employer-employee, etc.) transform into *illegal* relationships.⁷⁶³

Likewise, upward mobility in criminal markets is not merely a matter of accumulating financial capital. Social capital is of utmost importance in terms of building a customer base of trusted clients and establishing trusted relationships with suppliers from upper levels. Furthermore, the operations of large-scale importers of drugs, illicit tobacco traders or big VAT fraud ring leaders are also dependent on their corrupt relationships with government officials, without which they would not be able to operate on that level and scale. Corruption links can also be viewed as a form of social capital, although obviously they cannot thrive without steady financial incentives.

⁷⁶³ E.R. Kleemans and H. van de Bunt, "The Social Embeddedness of Organised Crime", *Transnational Organized Crime* 5, no. 1 (1999): 19-36; E.R. Kleemans and H. Van de Bunt, "Organised Crime, Occupations and Opportunity", *Global Crime* 9, no. 3 (2008): 185-97; K. von Lampe and P.O. Johansen, "Organised Crime and Trust: On the Conceptualization and Empirical Relevance of Trust in the Context of Criminal Networks", *Global Crime* 6, no. 2 (2004): 159-84.

As largely expected, **reinvestment of criminal proceeds is reported as the main form of financing** for the criminal operations in all 3 criminal activities studied. However, numerous other forms of financing – both from legal and illegal sources – were reported. In general, the research has found that purely criminal forms of financing can be classified according to the following three categories: investing proceeds from other crimes or criminal businesses, shared investment schemes and borrowed capital.

The study results suggest that, although criminal entrepreneurs do accumulate expertise and specialise in certain criminal markets, **they also readily move their criminal funds to other prospective and more profitable activities**, thereby taking opportunities that might bring higher returns. Examples include proceeds from extortion or loan sharking used to finance drug trafficking, drug trafficking revenues invested in the illegal tobacco trade or VAT fraudsters moving into the illegal tobacco trade. Furthermore, conventional crimes such as burglaries or robberies might be used to secure start-up capital in order to enter drug markets, especially at retail and wholesale level. This is not to suggest, however, that all criminals can and do move flexibly between markets; but if there are no major “discomfort zones” or technical/social obstacles, some do so.⁷⁶⁴ Where there are no organisational links available, personality traits or cultural preconditions may play a role, however, they are yet to be explored in detail.

Shared investment schemes seem to be common for all supply chain levels across different markets. This form of financing not only allows criminal entrepreneurs to kick-start a given project when they cannot raise the necessary financial resources on their own, but more importantly it is a tool for sharing business risks. Therefore, it appears to be practised even at very high levels of the supply chain, although the entrepreneurs at that level can easily provide their own financing for a given project.

Borrowing capital from other criminal entrepreneurs appeared to be the least practiced form of financing, that was usually only used in critical moments. Although the research team hypothesised the existence of “black” bankers, the study results suggested a more nuanced reality in which the existence of such specialised financiers is an exception. Such illicit lending rather could be obtained by other well-established, career criminals in their wider network in virtue of established trusted relationships or through a trusted surety. Further on, it usually requires certain collaterals; these range from valuable assets to giving family members as hostages. In some of the countries studied, loan sharks appear to act as illegal criminal lenders, but only for smaller sums and usually at lower levels of the criminal market.

A significant finding was that **along with the criminal proceeds, legitimate sources also play an important role in the financing of criminal undertakings**. While this is widely contended with regards to terrorist

⁷⁶⁴ E.R. Kleemans and C. J. de Poot, “Criminal Careers in Organised Crime and Social Opportunity Structure”, *European Journal of Criminology* 5, no. 1 (2008): 69-98.

financing, little if anything is known about the use of legitimate funds for organised crime purposes. The study results presented in this report show that legitimate money is invested in criminal markets and this takes place from the retail level up to importation and manufacturing levels. The analysis of the organised VAT fraud also revealed that investment of legitimate funds in tax evasion schemes is common. As the scale of this financing is obviously bigger at the upper levels, this necessitates specific efforts to conceal the origin of the funds. Therefore, various methods for “reverse money laundering”⁷⁶⁵ are employed, whereby the legitimate funds are turned into cash or channelled through a number of companies in order to obscure their origin. This is most apparent in cases of large-scale organised VAT fraud schemes, where various bogus and offshore companies and straw persons are introduced into the fraudulent chain to obscure the origin of the funds.

At the retail or wholesale level of drug and illicit tobacco markets, these legitimate funds might come from personal savings, revenues from a legal business of the criminal entrepreneur, loans from family or friends, payday loans, and small bank credits. At higher levels of drug trafficking or illicit tobacco markets, as well as with large scale VAT frauds, such legitimate funds may originate from legal business revenues, EU or national subsidies, and bank loans. Certainly, in some of the cases analysed, obtaining bank loans for initiating or perpetuating criminal operations was linked to corrupt bank officials. At this level also, already laundered funds were reported as possible sources of financing, thus blurring the line between legitimate and criminal funds (and, logically, requiring the reverse laundering of the funds, de-integrating them in the still officially employed but outdated methodology of placement-layering-integration). Shared investment schemes in which other legitimate businessmen invest their own legitimate funds for a share of profit were also reported.

In most Eastern European countries the so called “oligarchs” are an example of entrepreneurs with legitimate businesses that invest legal revenues in the criminal economy; such examples were provided for Bulgaria and the Czech Republic. Typically, these oligarchs enjoy strong political protection over their business. Given their apparent unscrupulousness, it may not be a surprise that the overlap of legitimate and criminal businesses for this group is the rule rather than the exception, so they often move capital from their licit to their illicit activities and vice versa. They are also a fine example of how **political corruption is an important mechanism for funnelling legitimate public resources to criminal businesses** through privatisation, public procurement or national or EU subsidies. A somewhat similar example in the older member states can be found in Italy, where the mafia families have acquired – through extortion or political corruption – various legitimate businesses, but at the same time continue to invest in organised crime activities.

Legitimate funds are also provided for criminal purposes by established legal entrepreneurs who resort to criminal practices in order to

⁷⁶⁵ S.D. Cassella, “Reverse Money Laundering”, *Journal of Money Laundering Control* 7, no. 1 (2003): 92-94.

maximise their profits or survive harsh times. This appeared to be more common in the illicit tobacco trade and organised VAT fraud, where it is easier to conceal such financial operations through manipulation of tax receipts, although such examples were also provided for the drug trafficking business. In this respect, it is interesting to compare typical money laundering with reverse money laundering. Classic money laundering usually aims at full legitimisation of criminal proceeds in order to prevent subsequent confiscation in case of investigation and prosecution. Therefore, the process usually involves three stages – placement, layering and integration. Reverse money laundering simply aims at obscuring the link between the origin of the money and the criminal project: therefore, it comprises of placement and layering. There is a need for “full laundering” only when there is a risk that someone would investigate and act vigorously following that investigation.

The empirical evidence collected within the study showed that **grey revenues resulting from undeclared labour and various forms of tax avoidance** are among the important sources of financing, specifically in regards to organised VAT fraud. The findings suggest that a larger share of the grey economy is conducive to greater availability of financing to organised crime: undeclared income can readily be invested even without undergoing any reverse money laundering.

The methods used to access capital in critical moments – such as following police arrests of key actors in the criminal network, seizing or loss of merchandise, freezing or seizing of funds or assets – do not differ much from those used to raise capital for initiating or sustaining criminal operations. However, two interesting forms deserve special attention. The analysis across all countries studied showed that in many cases **criminal entrepreneurs put aside money in contingency or “rainy day” funds** which are supposed to cover such unanticipated losses and one-time expenses. Such funds are usually kept in cash in safety deposit boxes or deposited in offshore accounts, since quick liquidity is a priority in critical moments. A somewhat similar form, typical for Russian organised criminals, is the criminals’ mutual fund, also known as “obschak.”⁷⁶⁶ This fund is a collective contingency form; money from it covers support for imprisoned criminals and their families, which has the additional benefit (and perhaps intention) of also binding them to the group.

Loan sharks also appear to play a role as providers of quick bridging loans to criminal entrepreneurs in critical moments, especially at the retail and wholesale levels. However, the analysis showed that in most countries their role was confined predominantly to ethnic minorities, whether to reduce the visibility of their operations or as a by-product of strong trust and fear relationships.

In terms of how payments are settled, various methods were identified. Contrary to the widespread opinion about the criminal economy as predominantly cash driven, the outcomes of the study suggest that this is valid mostly for the retail and wholesale levels, whereas at importation

⁷⁶⁶ Described in more detail in the chapter on Estonia in the current report.

level the picture is reversed. Even with drug trafficking, where both the product and the its distribution are illegal, **a great deal of the payment is carried out through the legitimate financial system** – either through money order services, or bank transactions and recently through virtual platforms and the use of cryptocurrencies, which are gaining momentum from a low base rate. Straw persons, front and bogus companies are used to conceal the source and nature of the financial transactions.

In the beginning of the chain of organised VAT fraud there is a usually a legal purchase of some goods or services from a large wholesaler or manufacturer and, therefore, all payments must be carried out through the bank system. This is also the case with the “illicit whites” – cigarettes legally manufactured in one country only to be smuggled and sold in another country without excise tax being paid – and with the import of raw tobacco from legal tobacco manufacturers producing cigarettes for the illegal market. Some drug trafficking cases also indicate that importers pay their South American counterparts through front companies using the legitimate financial system. This inevitably necessitates criminal organisations operating at these levels to use a variety of money laundering techniques and simple cash couriering in order to avoid detection of the flows of criminal money. The settlement of payments involves both (a) reverse money laundering aiming at introduction of the “black” cash revenues into the banking system to initiate new criminal projects and (b) classic money laundering, whereby criminal entrepreneurs cash out and invest the proceeds of their criminal operations in the legal economy. These cash-in and cash-out flows are often streamed through offshore branches of international companies, or largely offshore companies that have correspondent banking facilities with major banks. This is especially the case with Western European countries. In some countries malpractices or negligent due diligence of bank institutions in the EU involving corrupt bank officers were also reported. However, the analysis suggests that in general, **law enforcement efforts are mainly focused on the cash-out flows, whereas the cash-in flows are largely neglected.**

The analysis of the costs and profits of doing criminal business also pointed out several interesting implications. First of all, the study demonstrated that costs can be used as an **indicator of market entry thresholds** and provide useful information about the start-up capital needed by criminal entrepreneurs to operate at a given level. Given that all countries seemed to experience co-existence of different modi operandi, as well as both large-scale and small-scale players at all levels of the supply chain, the market entry thresholds also differ depending on the modus operandi.

Furthermore, the analysis suggests that **cost and profit analysis might be useful in estimating the financial and corruption potential of a given criminal group.** Thus it could be instrumental in threat assessments and in setting up operational priorities of law enforcement bodies. It can be also used to predict the effect of increased law enforcement pressure on a specific organised crime activity, since changing risks and opportunity costs prompt criminal entrepreneurs to consider switching to other modus operandi or shifting to other criminal activities.

The currently well-developed methodologies for macroeconomic assessments of the size of criminal markets – drugs, prostitution, illicit tobacco, missing trader fraud – already provide good estimations of the number of consumers, size of demand and supply, and average prices at the different levels of the supply chain. Finding the right number of price points is a problem for researchers in highly differentiated drug markets. Comparing such macro data with intelligence data collected by law enforcement about investments, costs and profits of criminal groups or networks from different levels of the supply chain could provide a clearer picture of the number of criminal actors and groups in a given local or national market, and thus help detect yet unidentified criminal players. Furthermore, it can provide more precise estimation of the operational and financial capacities of the criminal players at each level of the supply chain, even at the hard-to-trace higher level actors.

RECOMMENDED POLICY MEASURES TO TACKLE ILLICIT FINANCING

Building on the key findings from the study a set of recommendations at the EU and national level could be proposed.

Policy proposals at the EU level

- The European Commission should consider developing and adopting an EU strategy on financial investigations. The strategy should invite member states to make parallel financial investigations a routine component of all serious and organised crime investigations and thus complement the existing money laundering investigations and confiscation of criminal proceeds. This would require an upscaling of financial investigation resources and in the current age of austerity, this might mean some reallocation from other current activities.
- The strategy should recognise that the investigation of finances – including the financing of crime – is a basic tool for tackling organised and cross-border crime. The term “financial investigation” should be used in its widest sense including the purposes of Article 6(1a) and 6(1b) of the UN Convention on Transnational Organised Crime (the “Palermo Convention”). The assumption that the standard model for proceeds is layering, placement and integration is an obstacle to a clearer focus on the financing of crime.
- The EU strategy should recognise the important role of grey economy practices, including those by otherwise legitimate businesses, as well as political corruption and protection in financing crime.
- The definition of money laundering as laid down in Article 2 of the 3rd Anti-Money Laundering Directive should be extended to criminalise “reverse money laundering” (i.e. provision of legal funds by any means, either directly or indirectly) with the purpose to finance organised crime activities.

Policy proposals at the level of member states

- Member states should consider developing national financial investigation strategies to counter the finances of organised and cross-border crime which aim, *inter alia*, at ensuring equal status to the investigations of predicate crimes and the investigation of finances that motivate and pay for these crimes.
- National strategies should acknowledge that dedicated trained financial investigators should be assigned to tackle organised and cross-border crime alongside ordinary criminal investigators, rather than as an afterthought to see if proceeds are available for confiscation.
- National strategies should recognise the role of grey economy practices (including those by otherwise legitimate businesses), as well as political corruption and protection in financing crime.
- Member states should take steps to insure that offences such as conspiracy and “conduct related to a criminal organisation” as laid down in article 1 (a) of Council Framework Decision 2008/841/JHA of 24 October 2008 on the fight against organised crime, be considered more commonly for cases where prosecutors can show how crime is financed.
- Member states should ensure mechanisms for effective and flexible cooperation among revenue authorities, customs services and law enforcement agencies for financial investigations in organised crime cases.

Proposals to law enforcement agencies

- Law enforcement agencies should consider more effective use of intelligence for systematic gathering of financial information about the organised crime groups such as financial flows, investments, costs, profits and settlement of payments with the aim of more effective prevention and investigation of criminal activities.
- Law enforcement agencies should employ criminal financial analysis more actively by drawing on the financial data collected and in combination with publicly available macro and microeconomic data and social research data.

ANNEX: LIST OF INTERVIEWEES

In-depth interviews provided valuable information on the issues analysed in this report. In order to preserve the anonymity of the sources who are frequently referenced throughout the text each respondent has been assigned a code and in the tables below is described by his/her position, institution and country. The first two letters of the code signify the country, “E” identifies an expert, while “C” identifies a criminal entrepreneur.

LIST OF INTERVIEWEES IN THE SECTION ON COCAINE TRAFFICKING

Code	Position	Country/Institution/Role
BG-E1	Officer, Drug trafficking unit	State Agency for National Security-Bourgas office, Bulgaria
BG-E2	Officer, Drug trafficking unit	State Agency for National Security-Sofia office, Bulgaria
BG-E3	Officer, Drug trafficking unit	State Agency for National Security-Pazardzhik office, Bulgaria
BG-E4	Officer, Drug trafficking unit	State Agency for National Security-Varna office, Bulgaria
BG-E5	Officer, Drug trafficking unit	State Agency for National Security-Plovdiv office, Bulgaria
BG-E6	Retired police officer	Drug Trafficking Unit, Ministry of Interior, Bulgaria
BG-C1	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level cocaine dealer in Plovdiv
BG-C2	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level cocaine dealer in Plovdiv, track record in selling various kinds of drugs
BG-C3	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level cocaine dealer in Plovdiv, track record in selling heroin
BG-C4	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level heroin dealer in Pazardzhik
BG-C5	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level heroin dealer in Sofia (also selling amphetamines and cannabis)
BG-C6	Criminal entrepreneur (male, Bulgarian, prisoner)	Retail level heroin dealer in Sofia (also selling amphetamines and cannabis)
EE-E1	Head of Estonian Financial Intelligence Unit	Estonian Police and Border Guard Board

LIST OF INTERVIEWEES IN THE SECTION ON COCAINE TRAFFICKING (CONTINUED)

Code	Position	Country/Institution/Role
EE-E2	Head of Drug Crime Department	Northern Police Prefecture, Estonia
EE-E3	Head of Criminal Assets Unit	Central Criminal Police, Estonia
EE-E4	Head of Drug Crime Unit	Central Criminal Police, Estonia
EE-E5	Head, Department of Serious and Organised Crime	Northern Police Prefecture, Estonia
EE-E6	Senior (Leading) Investigator, Department of Serious and Organised Crime	Northern Police Prefecture, Estonia
EE-E7	Head of Drug Unit	Estonian Tax and Customs Board
EE-C1	Criminal entrepreneur (male, Russian speaking, prisoner)	Imprisoned for the second time, both times for drug crimes. Operates at retail level. Estonia
EE-C2	Criminal entrepreneur (male, prisoner)	Operates at large scale level, cross-border; third time in prison, Estonia
EE-C3	Criminal entrepreneur (male, prisoner)	Operated at mid-market level, Estonia
EE-C4	Criminal entrepreneur (male, Russian speaking, prisoner)	Dealt in fentanyl and marijuana, Estonia
FR-E1	Police officer, Drug Trafficking Unit	National Antinarcotic Department (OCRTIS) – Marseille unit, France
FR-E2	Head of Drug Trafficking Unit	National Antinarcotic Department (OCRTIS) – Marseille unit, France
FR-E3	Police officer, Drug Trafficking Unit	National Antinarcotic Department (OCRTIS) – Paris unit, France
FR-E4	Customs officer, Drug Trafficking Unit	National Intelligence Unit (DNRED) – Paris unit, France
FR-E5	Customs, Head of Drug Trafficking Unit	National Intelligence Unit (DNRED) – Paris unit, France
FR-E6	Police liaison officer, French embassy in Spain	National Cooperation Direction (DCI)- Madrid
FR-E7	Police liaison officer, French embassy in Netherlands	National Cooperation Direction (DCI)- The Hague
FR-E8	Customs officer, French Asset Recovery Office	National Asset Recovery Office (AGRASC), Paris, France
FR-E9	Magistrate, Head of French Asset Recovery Office	National Asset Recovery Office (AGRASC), Paris, France
FR-E10	Head of Unit	Police Patrimonial Investigation Unit (OCRGDF), Paris, France

LIST OF INTERVIEWEES IN THE SECTION ON COCAINE TRAFFICKING (CONTINUED)

Code	Position	Country/Institution/Role
FR-E11	Officer	Police Patrimonial Investigation Unit (OCRGDF), Paris, France
FR-E12	Officer	Identification Asset Platform Unit (PIAC), Paris, France
FR-E13	Officer	National Criminal Investigation (BAC) of Gendarmerie Nationale, Paris, France
FR-E14	Head of Unit	National Criminal Investigation (BAC) of Gendarmerie Nationale, Paris, France
FR-C1	Criminal entrepreneur (male, prisoner)	Retail level, France
GR-E1	Head	Sub-Directorate of Drug Enforcement – Hellenic Police, Ministry of Public Order and Citizen Protection, Greece
GR-E2	Sub-Director	Sub-Directorate of Drug Enforcement – Hellenic Police, Ministry of Public Order and Citizen Protection, Greece
GR-E3	Deputy Public Prosecutor, Vice President of the Association of Judges and Prosecutors	Court of Appeal (Piraeus) – Ministry of Justice, Transparency and Human Rights, Greece
GR-E4	Expert	Department of Drug Enforcement -Financial and Economic Crime Unit, Ministry of Finance, Greece
GR-E5	Expert	Department of Drug Enforcement – Financial and Economic Crime Unit, Ministry of Finance, Greece
IT-E1	Senior police official	State Police, Region of Trentino-Alto Adige, Italy
IT-E2	Officer	Guardia di Finanza, Excise and Revenue Police – Group on Investigation of Organised Crime, Region of Trentino-Alto Adige, Italy
IT-E3	Officer	Guardia di Finanza, Excise and Revenue Police – Group on Investigation of Organised Crime, Region of Trentino-Alto Adige, Italy
IT-E4	Head	Special Operations Team, Carabinieri, Region of Trentino-Alto Adige, Italy
IT-E5	Police officer	State Police, Region of Trentino-Alto Adige, Italy
IT-E6	National prosecutor	Region of Trentino-Alto Adige, Italy
IT-E7	Prosecutor	Anti-Mafia District Directorate (DDA), Region of Trentino-Alto Adige, Italy

LIST OF INTERVIEWEES IN THE SECTION ON COCAINE TRAFFICKING (CONTINUED)

Code	Position	Country/Institution/Role
IT-E8	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Friuli-Venezia Giulia, Italy
IT-E9	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Veneto, Italy
IT-E10	Prosecutor	Anti-Mafia District Directorate (DDA), Region of Piedmont, Italy
IT-E11	Prosecutor	Anti-Mafia District Directorate (DDA), Region of Liguria, Italy
IT-E12	Head	Investigative Division, Carabinieri, Region of Liguria, Italy
IT-E13	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Tuscany, Italy
IT-E14	Commander in chief	Investigative Unit, Carabinieri, Region of Tuscany, Italy
IT-E15	Senior police official	State Police, Region of Emilia-Romagna, Italy
IT-E16	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Marche, Italy
IT-E17	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Abruzzo, Italy
IT-E18	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Latium
IT-E19	Police Director	Central Antidrug Bureau (DCSA), Ministry of the Interior, Region of Latium, Italy
IT-E20	Prosecutor	Anti-Mafia District Directorate, Region of Latium, Italy
IT-E21	Police officer	Anti-drug Unit, State Police, Region of Latium, Italy
IT-E22	Senior police officer	Central Antidrug Bureau (DCSA), Ministry of the Interior, Region of Latium
IT-E23	Head of Police Administration	State Police, Region of Latium, Italy
IT-E24	Head of Mobile Squad	Anti-drug Crime Unit, State Police, Region of Campania, Italy
IT-E25	Head of Investigative Division	Carabinieri, Region of Calabria, Italy
IT-E26	Lieutenant colonel	Judicial Police Division at the Prosecutor Office, Region of Puglia, Italy
IT-E27	Investigative journalist	Balkan area
IT-E28	Journalist	Central Italy area

LIST OF INTERVIEWEES IN THE SECTION ON COCAINE TRAFFICKING (CONTINUED)

Code	Position	Country/Institution/Role
ES-E1	Chief of Money Laundering Section	Unit on Organised Crime, Guardia Civil, Spain
ES-E2	Chief of Cocaine Section	Drugs and Organised Crime Unit (UDYCO), Cuerpo Nacional de Policía, Spain
ES-E3	Deputy Director of Operations	Judicial police from Tax Administration (Vigilancia Aduanera), Spain
ES-E4	Chief of Money Laundering Unit	Economic and Tax Crimes Unit (UDEP), Cuerpo Nacional de Policía, Spain
ES-E5	Chief of Unit on Organised Crime	Guardia Civil, Spain
UK-E1	Police Officer	Cleveland Police, United Kingdom
UK-E2	Retired Head of Detection	Border Agency/HMRC, United Kingdom
UK-E3	Operations Manager with previous experience in the National Drugs Intelligence Unit	National Crime Agency, United Kingdom
UK-E4	Academic with expertise in drug use and markets, especially retail level cocaine dealing and drug importation. Past experience and personal contacts in the illegal drug trade.	Teesside University, United Kingdom
UK-E5	Academic with expertise in the international cocaine trade, drug mules and female dealers	The University of Leicester, United Kingdom
UK-C1	Criminal Entrepreneur (male, British, based in the UK)	Various experiences as a runner/transporter and retail level dealer, United Kingdom
UK-C2	Criminal Entrepreneur (male, British, based in the UK)	Previously a retail level dealer, now an online dealer, United Kingdom
UK-C3	Criminal Entrepreneur (male, British, based in the UK)	Retail-level dealer, United Kingdom
UK-C4	Criminal Entrepreneur (male, British, based in the UK)	Middle-level dealer, United Kingdom

LIST OF INTERVIEWEES IN THE SECTION ON ILLICIT TOBACCO TRADE

Code	Position	Country/Institution/Role
BE-E1	Attaché, Directorate of National Investigations	Belgian Customs
BE-E2	Police officer	Directorate of Combating Economic and Financial Crime, Belgian Federal Police
BE-E3	Police officer	Federal Police Antwerp, Economic and Financial Crime Unit, Belgium
BE-E4	Legal Counsel BeLux	British American Tobacco Belgium
BG-E1	Former Senior Police Officer	Internal Security Department, Ministry of Interior, Bulgaria
BG-E2	Senior Police Officer	Internal Security Department, Ministry of Interior, Bulgaria
BG-E3	Former Director	Directorate General Combating Organized Crime, Ministry of Interior, Bulgaria
BG-E4	Former Director of a Regional Directorate	Ministry of Interior, Bulgaria
BG-E5	Former Director a Regional Directorate	Ministry of Interior, Bulgaria
BG-E6	Deputy Director of a Regional Directorate	Ministry of Interior, Bulgaria
BG-E7	Senior Police Officer	Ministry of Interior, Bulgaria
BG-E8	Senior Police Officer	Ministry of Interior, Bulgaria
BG-E9	Director of a Regional Police Department	Ministry of Interior, Bulgaria
BG-E10	Director of a Regional Police Department	Ministry of Interior, Bulgaria
BG-E11	Senior Prosecutor	Bulgaria
BG-E12	Prosecutor	Bulgaria
BG-E13	Former Director of Customs Intelligence and Investigation	Customs Agency, Bulgaria
BG-E14	Senior Officer	National Revenue Agency, Bulgaria
BG-E15	Director of Integrity Department	Multinational tobacco company, Bulgaria office
BG-E16	Director of Integrity Department	Multinational tobacco company, Bulgaria office
BG-E17	Former Director of Integrity Department	Bulgarian tobacco company
BG-E18	Officer of Integrity Department	Multinational tobacco company, Bulgaria office
BG-E19	Officer	Multinational tobacco company, Bulgaria office

LIST OF INTERVIEWEES IN THE SECTION ON ILLICIT TOBACCO TRADE (CONTINUED)

Code	Position	Country/Institution/Role
BG-E20	Former Deputy Director	Directorate General Combating Organized Crime, Ministry of Interior
BG-E21	Former Bulgarian State Security Officer	Agent in the Arab countries, Bulgaria
BG-E22	Director	Customs Agency, Bulgaria
BG-C1	Criminal entrepreneur	High level importer of illegal cigarettes from Greece, indicted (Bulgaria)
BG-C2	Criminal entrepreneur	Middle level trader of illegal cigarettes (Bulgaria)
BG-C3	Criminal entrepreneur	Served sentence for organised illegal tobacco trading (Bulgaria)
BG-C4	Criminal entrepreneur	Served sentence for organised illegal tobacco trading (Bulgaria)
BG-C5	Money-lender	Independent agent (Bulgaria)
CZ-E1	Senior Officer	General Directorate of Customs, Czech Republic
CZ-E2	Senior Officer	Ministry of Finance, Czech Republic
CZ-E3	Methodologist	Corruption and Financial Crime Detection Department, Police of the Czech Republic
CZ-E4	Senior Officer	The Customs Office for the Moravia-Silesian region, Czech Republic
CZ-E5	Prosecutor	Supreme Public Prosecutor's Office
CZ-E6	Law Specialist	The Customs Office for the South-Moravian region, Czech Republic
CZ-E7	Law Specialist	The Customs Office for the Moravia-Silesian region, Czech Republic
CZ-C1	Criminal entrepreneur	Czech Republic
CZ-C2	Criminal entrepreneur	Czech Republic
CZ-C3	Criminal entrepreneur	Czech Republic
CZ-E8	Security expert	Phillip Morris International, Czech Republic
CZ-E9	Security expert	Phillip Morris International, Czech Republic
CZ-E9	Journalist	Organised Crime and Corruption Reporting Project, Czech Republic
FR-E1	Customs Officer, Office D3, Fraud Control	Directorate-General of Customs and Indirect Taxes
FR-E2	Director, National Customs Judicial Enquiries Department	Directorate-General of Customs and Indirect Taxes

LIST OF INTERVIEWEES IN THE SECTION ON ILLICIT TOBACCO TRADE (CONTINUED)

Code	Position	Country/Institution/Role
FR-E3	Customs Officer, Cyberdouane	Directorate-General of Customs and Indirect Taxes
FR-E4	Customs Officer, Cigarettes Observatory	Directorate-General of Customs and Indirect Taxes
FR-E5	Customs Officer, Cigarettes Observatory	Directorate-General of Customs and Indirect Taxes
FR-E6	Former Director, Inter-Regional Directorate of Customs in Marseille	Directorate-General of Customs and Indirect Taxes
FR-E7	Customs officer, Division of Marseille-Fos	Directorate-General of Customs and Indirect Taxes
FR-E8	Regional Director, Regional Directorate of Customs in Perpignan	Directorate-General of Customs and Indirect Taxes
FR-E9	Head of Division in Cerdagne	Directorate-General of Customs and Indirect Taxes
FR-E10	Head of Judicial Investigations	Police headquarters of la Goutte d'or (18 th district of Paris)
FR-E11	Head of Transversal Investigation	Police headquarters of 4 th district of Paris
FR-E12	Deputy Head of Transversal Investigation	Police headquarters of 4 th district of Paris
FR-E13	Police officer	Police headquarters of Marseille, 1 st district
GR-E1	Deputy Public Prosecutor	Court of Appeal (Piraeus), Greece
GR-E2	Civil servant, Department of Drug Enforcement	Financial and Economic Crime Unit, Greece
GR-E3	Civil servant, Department of Drug Enforcement	Financial and Economic Crime Unit, Greece
GR-E4	Civil servant, Enforcement Department	Customs Office (Piraeus Port), Greece
GR-E5	Director of Corporate Affairs	Papastratos SA company, Greece
GR-E6	Communications Director	Papastratos SA company, Greece
GR-E7	Police officer	Department of Protection of Property Rights – Directorate of Security (Attica), Greece
GR-E8	Police officer	Department of Protection of Property Rights – Directorate of Security (Attica), Greece
IT-E1	Head of Group on Investigation of Organised Crime – Excise and Revenue Police, Guardia di Finanza	Region of Trentino-Alto Adige

LIST OF INTERVIEWEES IN THE SECTION ON ILLICIT TOBACCO TRADE (CONTINUED)

Code	Position	Country/Institution/Role
IT-E2	Head of Group on Investigation of Organised Crime – Excise and Revenue Police, Guardia di Finanza	Region of Friuli-Venezia Giulia
IT-E3	Head of Investigative Unit, Provincial Command – Guardia di Finanza	Region of Lombardy
IT-E4	Head of Investigative Unit – Central Directorate Local Police and Security, Local Police	Region of Lombardy
IT-E5	Prosecutor at DDA – Anti-mafia District Directorate	Region of Piedmont
IT-E6	Officer at Airport Customs	Region of Piedmont
IT-E7	Head of Prevention Unit – Group on Investigation of Organised Crime – Excise and Revenue Police Guardia di Finanza	Region of Liguria
IT-E8	Custom officer – Intelligence and Anti-fraud Unit	Region of Liguria
IT-E9	Head of Group on Investigation – Airport Customs, Guardia di Finanza	Region of Emilia-Romagna
IT-E10	Head of Investigation Unit, Guardia di Finanza	Region of Tuscany
IT-E11	Head of Investigation Unit, Guardia di Finanza	Region of Marche
IT-E12	Official – Aeronaval Section, Guardia di Finanza	Region of Latium
IT-E13	Head of Investigation Unit – Airport Customs, Guardia di Finanza	Region of Latium
IT-E14	Head of Intelligence Unit – National Anti-fraud and Control Directorate, Customs and Monopolies Agency	Region of Latium
IT-E15	Head of Group on Investigation of Organised Crime – Excise and Revenue Police, Guardia di Finanza	Region of Campania
IT-E16	Head of Excise and Revenue Police	Region of Basilicata
IT-E17	Prosecutor at DDA – Anti-mafia District Directorate	Region of Apulia

LIST OF INTERVIEWEES IN THE SECTION ON ILLICIT TOBACCO TRADE (CONTINUED)

Code	Position	Country/Institution/Role
IT-E18	Head of Prevention Unit – Group on Investigation of Organised Crime – Excise and Revenue Police Guardia di Finanza	Region of Apulia
IT-E19	Head of Group on Investigation of Organised Crime, Guardia di Finanza	Region of Apulia
SE-E1	Senior official	Tobacco company involved in an umbrella organisation for the sector, Sweden
SE-E2	Senior officer	Swedish Customs
SE-E3	Tobacco administrator	County Administrative Board, Sweden. Advisor to other tobacco administrators in the Boards.
SE-C1	Former criminal entrepreneur	Middle level, smuggling OCG, Sweden
SE-C2	Former entrepreneur	Currently imprisoned, used by an OCG, Sweden
SE-C3	Former criminal entrepreneur	Active participant in tobacco trade 10-20 years ago, Sweden
UK-E1	Investigative journalist	United Kingdom
UK-E2	Officer (investigation)	HMRC, United Kingdom
UK-E3	Academic researching illicit trade in tobacco	United Kingdom
UK-E4	Academic researching illicit trade in tobacco	United Kingdom
UK-E5	Head of Division, Detection, North East	HMRC, United Kingdom
UK-C1	Criminal entrepreneur (male, British, active)	United Kingdom
UK-C2	Criminal entrepreneur (male, British, active)	United Kingdom
UK-C3	Criminal entrepreneur (male, Kurdish, active)	United Kingdom
UK-C4	Criminal entrepreneur (male, British, active)	United Kingdom
UK-C5	Criminal entrepreneur (male, British, active)	United Kingdom
UK-C6	Criminal entrepreneur (male, British, active)	United Kingdom

LIST OF INTERVIEWEES IN THE SECTION ON ORGANISED VAT FRAUD

Code	Position	Country/Institution/Role
BE-E1	Head of VAT Cell CDGEFID	Belgian Federal Police
BE-E2	Public Prosecutor	Public Prosecutor's Office, Belgium
BG-E1	Officer, Risk Management Directorate	National Revenue Agency, Bulgaria
BG-E2	Officer, Economic Crimes Unit	General Directorate Criminal Police
BG-E3	Officer, Tax Crimes Unit	State Agency for National Security, Bulgaria
BG-E4	Former senior official	National Revenue Agency, Bulgaria
BG-E5	Judicial expert	Bulgarian Association of Judicial Experts
BG-E7	Officer, Economic Crimes Unit	Criminal Police – Pazardjik, Bulgaria
BG-E8	Officer, Customs Intelligence and Investigations Unit	Customs Agency, Bulgaria
BG-E9	Officer, Economic Crimes Unit	Criminal Police, Bulgaria
BG-E10	Officer, Customs Intelligence and Investigations Unit	Customs Agency, Bulgaria
BG-E11	Retired police officer	Internal Security Directorate, Ministry of Interior, Bulgaria
BG-E13	Prosecutor	Prosecution's Office, Bulgaria
BG-E14	Officer, Customs Intelligence and Investigations Unit	Customs Agency, Bulgaria
BG-E15	Officer, Economic Crimes Unit	Criminal Police, Bulgaria
BG-E16	Former managing director	Large sugar wholesale company, Bulgaria
BG-E17	Officer	Customs Agency, Bulgaria
BG-E18	Retired officer	State Agency for National Security, Bulgaria
BG-E19	Former managing director	Large sugar wholesale company, Bulgaria
BG-E20	Officer, Tax Crimes Unit	State Agency for National Security – Bourgas, Bulgaria
BG-E21	Officer, Tax Crimes Unit	State Agency for National Security – Plovdiv, Bulgaria
BG-E21	Officer, Tax Crimes Unit	State Agency for National Security – Varna, Bulgaria
BG-C1	VAT fraud offender	Served sentence for organised VAT fraud, Bulgaria
BG-C2	VAT fraud offender	Served sentence for organised VAT fraud, Bulgaria
CZ-E1	Senior Officer	General Directorate of Customs, Czech Republic
CZ-E2	Law Specialist	Customs office for the Moravia-Silesian region, Czech Republic

LIST OF INTERVIEWEES IN THE SECTION ON ORGANISED VAT FRAUD (CONTINUED)

Code	Position	Country/Institution/Role
CZ-E3	Law Specialist	Customs office for the South-Moravian region, Czech Republic
CZ-E4	Methodologist	Corruption and Financial Crime Detection Department, Police of the Czech Republic
CZ-E5	Prosecutor	Supreme Public Prosecutor's Office
CZ-E6	Senior Officer	Ministry of Finance, Czech Republic
CZ-C1	Criminal entrepreneur	Serves 7 years prison sentence for tax evasion, Czech Republic
CZ-C2	Criminal entrepreneur	Serves 5 and half years prison sentence for tax evasion, Czech Republic
CZ-C3	Criminal entrepreneur	Serves 7 years prison sentence for tax evasion, Czech Republic
CZ-C4	Criminal entrepreneur	Serves 5 and half years prison sentence for tax evasion, Czech Republic
ES-E1	Chief of Tax Fraud Section	Policia Nacional, Spain
ES-E2	Officer	Tax Administration, Section of Intra-community VAT frauds, Spain
ES-E3	Deputy General Director of Operations	Judicial Police of the Tax Administration, Spain
ES-E4	Police officer	Judicial Police of the Tax Administration, Spain
ES-E5	Police officer	Judicial Police of the Tax Administration, Spain
ES-E6	Chief of Economic Crimes Section	Organised Crime Unit, Guardia Civil, Spain

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