tobacco smuggling

Sherman G. Boone
10/21/97 02:04:08 PM

Record Type: Record

To: Thomas L. Freedman/OPD/EOP, Jerold R. Mande/OSTP/EOP

cc:
Subject: FW: Smuggling

FYI, Dan Tarullo met with Shalala yesterday morning and agreed on the following points:

1. The trade issues should be handled low-key, but we should also push harder internally to get tobacco off the table in trade negotiations. We can point to the absense of trade actions (as compared to the 1980s) as this Administration's policy statement. It's too easy to antagonize Congress on this one.

2. Should push to conclude commercial guidelines, along the lines of the most recent State Department draft (which I have not circulated inter-agency as of yet). These could be rolled-out at a Gore-Shalala event, but should try to include someone from Commerce (new head of Foreign Commercial Service if confirmed) or State.

3. HHS will cooperate with Treasury on creation of a new fund using non-appropriated resources. HHS staff will begin doing homework on absorbtion cpacity of intended recipients (primarily multilateral institutions, but also some bilateral programs and, presumably, NGOs). Will then have to get together later this fall with Treasury, legal types, to structure how such a fund will work.

Jim O'Hara

-------------------- Forwarded by Sherman G. Boone/OPD/EOP on 10/21/97 01:49 PM --------------------

mpe0 @ cdc.gov
10/21/97 01:40:00 PM

Record Type: Record

To: Sherman G. Boone

cc:
Subject: FW: Smuggling

Sherman - If i remember correctly, you're interested in smuggling as well as other aspects of international tobacco control.

From: Eriksen, Michael
To: Langguth, Shelley M.; Yurekli, Ayda Aysun; Giovino, Gary A.; Woollery, Trevor; Pechacek, Terry F.
Cc: Eriksen, Michael
Subject: Smuggling
Date: Tuesday, October 21, 1997 1:24PM

1) Convention WHO Int'l

1) Convention

2) Short-term steps

3)

MEMORANDUM

TO: ELENA KAGAN

CC: JERRY MANDE

FROM: TOM FREEDMAN, MARY L. SMITH

RE: TOBACCO SMUGGLING

DATE: AUGUST 25, 1997

SUMMARY

Cigarette smuggling to other countries has almost tripled in the last few years up to 280 billion cigarettes a year. Smuggling increases have correlated to increases in duties and taxes imposed on foreign cigarettes. Tobacco companies have a role in cigarette smuggling in that they sell to traders and dealers who, in turn, funnel the cigarettes to smugglers. There are criminal cases currently pending in Spain, China, Canada, and the United States. Two Brown & Williamson sales managers have recently pleaded guilty to federal charges of aiding smugglers.

The recent upsurge in smuggling could have impacts on the proposed settlement with the tobacco companies, specifically with respect to the FDA regulation of nicotine in that the settlement, as written, requires the FDA to prove that a change in the level of nicotine or other harmful components "will not result in the creation of a significant demand for contraband." Because the levels of contraband in other countries is already so high, by requiring the FDA to prove a negative, the settlement sets up an extremely high standard. In addition, given the experience of other countries that have raised cigarette prices, the proposed settlement might open the door to increased smuggling in the United States.

Other than its involvement in the specific cases mentioned in this memo in Syracuse and New Orleans, DOJ reports that it does not have a nationwide, coordinated effort or task force to combat smuggling.

FACTS ON SMUGGLING

- The volume of cigarette smuggling around the world has nearly tripled.
- Researchers estimate that one-fourth of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes.
- Criminal investigations in several countries show that people in the tobacco industry have played a major role in stimulating and facilitating the smuggling of cigarettes. The most

common way in which cigarette companies play a role is that each year they sell billions of dollars of cigarettes to traders and dealers who, in turn, funnel the cigarettes to smugglers.

RECENT CRIMINAL INVESTIGATIONS

1. Canada

- Newly released court documents in Syracuse show that R.J. Reynolds Tobacco Company, the second-largest American cigarette maker, sponsored trips to a luxury Canadian fishing resort for several dealers who have subsequently been charged with conspiring to smuggle cigarettes to Canada. On one fishing trip in 1995, one Reynolds salesman, Les Thompson, even joked to the dealers about the smuggling, implicitly acknowledging that he had knowledge of it.

- One informant said it was clear that Mr. Thompson from Reynolds knew that the dealers were selling to cigarettes to American Indians who smuggled them across the St. Lawrence River.

- The investigation involving R.J. Reynolds is centered in Syracuse and Canada. In June, a grand jury in Syracuse indicted 21 people on charges that they were involved in smuggling $700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996.

- In another investigation in New Orleans, two Brown & Williamson sales managers have recently pleaded guilty to charges of aiding smugglers in bringing cigarettes illegally into Canada.

2. Spain

- One of Europe's biggest cigarette traders, Michael Hanggi, admits that he had been buying Winstons from R.J. Reynolds for 15 years and had resold many of them in Spain.

- Mr. Hanggi said that his three-person trading company in Switzerland had handled $100 million in sales last year.

- Authorities estimate that last year that 2.3 billion Winstons made by R.J. Reynolds, or $200 million worth, were smuggled into Spain.

- Investigators found a series of faxes showing that for years Reynolds officials in Geneva kept track of the volume of cigarettes that were supposedly being shipped to Senegal in West Africa but instead were illegally diverted to Spain. Given that all the shipments were diverted to Spain, the figures could not possibly have matched Reynold's sales reports from Senegal. In fact, USDA figures show that Senegal imports no more than 500 million cigarettes a year -- less than one-fourth of the amount diverted to Spain.

3. Italy

- Two organized crime groups in Italy take in $500 million per year by smuggling Malboros they buy from Swiss dealers selling products made by the Philip Morris Companies, the largest cigarette maker in America.

4. China and Hong Kong

- Later this year, Hong Kong prosecutors plan to place a former marketing manager for the British-American Tobacco Corporation, a subsidiary of B.A.T. Industries and a British affiliate of Brown & Williamson, on trial on charges that he accepted more than $3 million in bribes from dealers involved in smuggling cigarettes into China.

- Smuggling accounts for 4 to 5 percent of the cigarettes sold in China. But the market is so vast that this amounts to 70 billion to 85 billion cigarettes a year.

QUESTIONS AND ANSWERS

Q: What is the scope of the smuggling?

- Market Tracking International Ltd., a research firm in London that provides data to tobacco industry publications, estimates that 280 billion of the 1 trillion cigarettes exported each year by all producing nations pass through the hands of smugglers, up from 100 billion in 1989.

- In Spain, Winston, manufactured by R.J. Reynolds, is the most popular foreign brand, and last year 60 percent of its sales were contraband. The smugglers can sell a pack of contraband Winstons for $1.30 to $1.60, about the same price as a local brand and one-third less than the price of legal Winstons.

Q: What are the causes of the recent surge in smuggling?

- There are many causes from the relaxation of customs inspections in Europe to the opening of markets in Russia and Eastern Europe. The surge is also attributable to the expansion of sales overseas by American tobacco companies. High taxes, limits on imports, and corrupt distribution systems also help account for the increase in cigarette smuggling.

Q: What have the cigarette companies said?

- Spokespersons for the three cigarette companies, R.J. Reynolds, Philip Morris, and Brown & Williamson, publicly maintain that they did not knowingly sell to dealers who supplied to smugglers. The companies urge that their executives did not do anything wrong and that they should not be held accountable for illegal activity that occurred after they sold their product. However, some of the evidence in criminal cases in Spain, Canada, and China indicates that the companies did have some knowledge. For instance, R.J. Reynolds kept track of the shipments of cigarettes allegedly destined for Senegal but that were instead diverted to Spain.

Q: How much does the smuggling cost?

- The smuggling costs foreign governments an estimated $16 billion a year in lost revenues. But more important, health experts say it threatens to undermine initiatives in many nations to discourage smoking, particularly among teenagers.

Q: What is the potential impact for the settlement?

- **FDA authority to regulate nicotine.** The proposed agreement says that before the FDA could order the companies to lower the nicotine in cigarettes, it would have to guarantee that smugglers would not bring in more potent substitutes. But given how easily smuggling can take place, the President said last month that this provision was unreasonable and should be changed. Specifically, the settlement provides that the FDA shall be permitted to require the gradual reduction of nicotine and the possible elimination of other harmful components of tobacco products, provided it can demonstrate that the changes: (1) will result in a significant reduction of the health risks associated with such products; (2) are technologically feasible; and (3) will not result in the creation of a significant demand for contraband or other tobacco products.

- **Raising prices could lead to smuggling in U.S.** There is a potential that raising prices in the U.S. could cause an increase of smuggling in American brands manufactured elsewhere.

- **Increased smuggling worldwide.** With the restrictions imposed on the tobacco companies in the proposed settlement, the tobacco companies are expected to step up their efforts to expand their markets in other countries. With sales expected to decrease in the U.S. as the result of the settlement, there could be an even greater increase in smuggling worldwide.

- **Tobacco companies' attitudes and cooperation with investigators.** Tobacco companies have demonstrated that they are not willing to try to stop smuggling. In fact, investigators in Europe stated that tobacco company officials hide behind Swiss law which basically does not view smuggling as a crime and contains provisions on secrecy in commercial transactions.

MEMORANDUM

TO: ELENA KAGAN

CC: JERRY MANDE

FROM: TOM FREEDMAN, MARY L. SMITH

RE: TOBACCO SMUGGLING: ATF EFFORTS

DATE: AUGUST 26, 1997

SUMMARY

ATF has provided us with a fuller written summary of their efforts on smuggling (attached).

* The most interesting point is the obvious: when you raise the excise tax on cigarettes, you increase the likelihood that cigarette smuggling will occur. Canada raised taxes to increase revenue and discourage smoking and has faced this problem. The enterprise currently under indictment had assets from the illegal activity estimated at over $500 million.

* ATF has some things going on, approximately "65 investigations involving Canada/US, Mexico/US, interstate and Native American sales" but no apparent national strategy. ATF reports a large increase in investigations in tobacco contraband since 1992.

* Regarding the settlement, the most promising thought would be to add to the settlement some provision to encourage American efforts to liaison with international efforts on smuggling.

"All the News
That's Fit to Print"

The New York Times

Washington Final
Washington and Baltimore: More clouds than sun, a brief shower. High mid 70's. Tonight, ample clouds. Low in 60's. Tomorrow, partly sunny. High upper 70's. Details are on page A18

VOL. CXLVI . . . No. 50,895 | MONDAY, AUGUST 25, 1997 | ONE DOLLAR

Bialowieza Journal

Polish Home That Bison Still Roam

By JANE PERLEZ

BIALOWIEZA, Poland, Aug. 22 — In one of the paradoxes of nature, the last fragment of the primeval forest that stretched from the Atlantic to the Urals, from the Mediterranean to the northern seas, remains intact here on the eastern border of Poland, one of modern Europe's most polluted countries.

Descendants of the bison that appeared in early man's cave paintings still roam through bogs and swamps. Small gray horses, a sedate subspecies of the wild horses of the steppe, still graze on native grasses. And in the early dawn, thin shafts of light pierce the darkened world hidden beneath a towering canopy of oak, ash and elm trees.

Once the playground of kings and czars, of German Nazis and Polish Communists, Bialowieza Forest survived because the leaders wanted it preserved for their grand and gory hunting parties.

Today, though, a democratic Poland has begun to fear for the forest's future — partly because the public has begun to enjoy it — and so there is a growing sentiment among conservationists that access needs to be restricted more if it is to remain pristine.

In the old days, paradoxically, it was the very lust for the hunt on the part of aristocrats and tyrants that kept the forest pristine.

King August of Poland and his friends proudly killed 42 bison and 13 elk one afternoon in 1752 as his wife, Queen Maria Jozefa, seated in a specially erected grandstand — that's how they often hunted in those days — killed 20 bison released into an arena before her and read a French novel between rounds.

When the czars annexed part of Poland in 1795, they commandeered Bialowieza (pronounced bee-ah-wo-vee-YEH-zha). For more than a century they exploited it for wood, fur and skins but never so much that their hunting pastime would be ruined. Hermann Göring took time out in World War II to hunt, and Nikita Khrushchev was entertained here by his Polish comrades.

But now, even as hunting and

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Karol Zub/Reuters, for The New York Times

This is the last forest primeval: the Bialowieza Forest in eastern Poland, home to bison and a subspecies of small gray horses as well as less exotic deer. Conservationists want stricter limits on humans there.

Cigarette Makers Are Seen As Aiding Rise in Smuggling

Tobacco Giants Deny Role in Illegal Trade; Inquiries Show There May Be One

By RAYMOND BONNER and CHRISTOPHER DREW

The largest tobacco companies are selling billions of dollars of cigarettes each year to traders and dealers who funnel them into black markets in many countries, say law enforcement officials and participants in the trade.

In the last decade, the volume of cigarette smuggling around the world has nearly tripled, according to a leading tobacco research organization. This reflects a general surge in cigarette sales abroad, especially for American brands. And industry officials acknowledge that a sizable share — the researchers say one-fourth — of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes and sell major brands at a discount.

The companies say they do nothing to encourage the smuggling and do not condone it. But recent criminal investigations in several countries show that people in the tobacco industry have played a significant role at times in stimulating and fueling it.

In one case, two sales managers for the Brown & Williamson Tobacco Corporation have pleaded guilty to aiding smugglers. But what law enforcement agents say is far more common is for the companies to sell huge quantities of top brands to traders and dealers who are little more than pipelines to the smugglers.

For instance, newly released court documents show that the R. J. Reynolds Tobacco Company, the second-largest American cigarette maker, sponsored trips to a luxury Canadian fishing resort for several dealers who have since been charged with conspiring to smuggle cigarettes into Canada. On one fishing trip in 1995, a Reynolds salesman even joked with the dealers about the smuggling.

And some of the dealers admit that they pour huge volumes of cigarettes right into the smuggling networks.

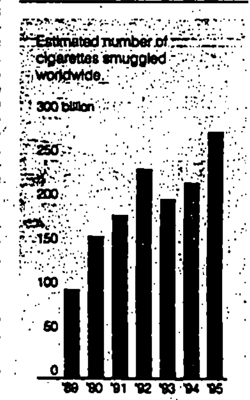
One of Europe's biggest cigarette traders, Michael Hänggi, said in an interview that he had been buying Winstons from Reynolds for 15 years and had resold many of them to smugglers in Spain. Mr. Hänggi said his three-person trading company in Switzerland had handled $100 million in sales last year. "Of course I know where the cigarettes are going," he said. "But is that my problem?"

Other inquiries show that two organized crime groups in Italy take in $500 million a year by smuggling in Marlboros they buy from Swiss dealers selling products made by the Philip Morris Companies, America's largest cigarette maker. And later

Continued on Page D12

CONTRABAND SMOKES

A special report.



Source: World Tobacco File

The New York Times

Yearlong Effort Key to Success For Teamsters

By STEVEN GREENHOUSE

Early on a brisk March morning, 150 brown-suited drivers and loaders huddled outside the United Parcel Service terminal just off Interstate 80 in New Jersey, chanting: "It's our contract. We'll fight for it."

Though it was four months before their contract expired, four months before a strike deadline, these workers in Saddle Brook, like those at rallies in 30 other cities around the country that morning, were already gung-no volunteers in the teamsters' efforts to mobilize members to stand up to U.P.S. — and to stand firm in a strike, if it came to that.

The rallies received scant attention, but they turned out to be part of an unusual — and unusually sophisticated — mobilization effort that was pivotal in the teamsters' winning most of what they sought in their 15-day strike against U.P.S. It was labor's biggest victory in years, and it came in the nation's biggest strike in more than a decade.

The teamsters' yearlong mobilization included scores of rallies at U.P.S. sites as well as other major efforts, like sending questionnaires to 185,000 teamsters asking what they wanted from the U.P.S. negotiations and collecting 100,000 signatures backing the union's demands. But the union did not neglect minor [illegible]: at one point, it distributed 30,000 whistles for use at the rallies.

By the time the July 31 strike deadline approached, the teamsters had turned their U.P.S. membership into a Juggernaut that the company's executives underestimated. In dozens of interviews with U.P.S., union and Federal officials, the

Continued on Page A15

President's Photo Used in Fraud, Police Say

By DON VAN NATTA Jr.

MIAMI, Aug. 22 — Executives of a jewelry company arranged for a photo opportunity with President Clinton at a fund-raiser in Florida last fall, then used the photographs to help win credibility and court vulnerable investors in what authorities say was a scheme that defrauded 15,000 people of $38 million.

Some investors lost their homes and life's savings after buying necklace-making kits of beads and thread for as much as $3,000 a set, and a Miami circuit judge shut down the company, Unique Gems International Corporation, in March. The judge appointed a receiver to investigate the company's operations, which authorities described as an illegal Ponzi scheme, and to process thousands of investors' claims for restitution.

The receiver, Lewis B. Freeman, has found that Unique Gems had used third parties to contribute $85,000 to the Democratic National Committee to buy seats at the fund-raising dinner for roughly 30 of its executives and its most productive necklace assemblers. Federal law prohibits political donations from third parties.

Mr. Freeman said the executives had tried to cash in on their brief brush with the President, whom they met on Oct. 22, 1996, at the Biltmore Hotel in Coral Gables, Fla. After eight executives had their photographs taken with Mr. Clinton, the one-year-old American corporation showcased some of the images in glossy newsletters as a way to prove its legitimacy to potential investors.

The company even suggested that the President had personally endorsed Unique Gems. "The company has been honored by President Clinton for its role in helping many people with real opportunities to earn a well above-average income," read a caption accompanied by a photograph of a smiling Mr. Clinton, in a flier used to recruit investors.

Advocates of campaign finance overhaul say the episode is an example of how some contributors have exploited the Democrats' vetting process for fund-raisers.

The details of Unique Gems' use of Mr. Clinton's image in its marketing strategy are described by the receiver, Mr. Freeman, in a lengthy investigative report filed in court here today. After a preliminary investigation by the State Attorney General's office, the matter has been referred to the United States Attorney's office in Miami and the State Attorney's office in Dade County.

Four of the top executives of Unique Gems have left the United States and are now believed to be living abroad, the authorities said.

A spokesman for the Democratic National Committee, which has no record of any political contributions from Unique Gems, said that the committee's lawyers were working with Mr. Freeman to determine whether third parties had made contributions on behalf of Unique Gems or its executives.

Steve Langdon, the spokesman, said, "The D.N.C., along with a number of others, were exploited by this company. The D.N.C. was not aware of any involvement of Unique Gems in making these contributions through conduits or any of its activities." Mr. Langdon said any donations linked to the company would be given to the restitution fund.

Those few moments that Unique Gems' executives shared with the President were featured in several of the company's marketing pitches. Upon seeing a photograph of Mr.

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The authorities say Unique Gems courted investors by using photos like this one of Enrique Pirela, its president, with President Clinton.

Political Memo

Governor Bush Is Emerging As New Hot Name in G.O.P.

By RICHARD L. BERKE

INDIANAPOLIS, Aug. 24 — The top billing, and the coveted Saturday night speaking slot, at a three-day Republican gathering here did not go to the Speaker of the House or to a former Vice President from this state or to the party's Vice Presidential nominee last year. It did not even go to the movie actor turned Senator who heads the committee investigating campaign finance abuses.

It went to George W. Bush, the Governor from Texas who in his first term has rapidly burst into the political stratosphere as the hottest figure among major players in Republican circles.

Despite the most open [illegible] in years, many political profe[illegible] are declaring, embarrassingly early, that Mr. Bush is the Republican to beat for the Presidential nomination in 2000. The buzz only intensified on Saturday when Mr. Bush, despite his protestations that his only concern is his re-election next year, [illegible] a rare foray into national politics, coming to this meeting, which showcased Presidential hopefuls.

Tantalizing his audience from the start, Mr. Bush said: "I'd like to get something off my chest. I know there's all kinds of speculation, and all kinds of rumors, about future politics. The national media — many of them are here today — are having a field day, wondering out loud whether I'm going to follow in my father's footsteps. I want to confront that matter head on tonight: I will not jump out of any airplanes." The audience roared.

It was probably Mr. Bush's best-received line of the evening. From there, he hurried through a stiffly delivered, though serviceable, 25-minute speech about how his accomplishments — like an overhaul of the state education system, a welfare overhaul and tort reform — could be a model for the nation. One danger of the high expectations for Mr. Bush was demonstrated here on Saturday. Republicans gave the Texan a respectful standing ovation, but later said they had been more impressed with the speech delivery of Dan Quayle, the former Vice President; Steve Forbes, the multimillionaire publisher; Senator Fred Thompson

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Associated Press

Pope and Church Show Vigor as Paris Rally Ends

Pope John Paul II said Mass yesterday before an estimated one million [illegible] Paris [illegible] church officials and [illegible]. And the enthusiasm of tens of thousands of young people from [illegible] countries for the Pope seemed to have been

INSIDE

Kent Markus

Cigarette Makers Are Seen As Aiding Rise in Smuggling

Tobacco Giants Deny Role in Illegal Trade; Inquiries Show There May Be One

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By RAYMOND BONNER and CHRISTOPHER DREW

The largest tobacco companies are selling billions of dollars of cigarettes each year to traders and dealers who funnel them into black markets in many countries, say law enforcement officials and participants in the trade.

In the last decade, the volume of cigarette smuggling around the world has nearly tripled, according to a leading tobacco research organization. This reflects a general surge in cigarette sales abroad, especially for American brands. And industry officials acknowledge that a sizable share — the researchers say one-fourth — of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes and sell major brands at a discount.

The companies say they do nothing to encourage the smuggling and do not condone it. But recent criminal investigations in several countries show that people in the tobacco industry have played a significant role at times in stimulating and fueling it.

In one case, two sales managers for the Brown & Williamson Tobacco Corporation have pleaded guilty to aiding smugglers. But what law enforcement agents say is far more common is for the companies to sell huge quantities of top brands to traders and dealers who are little more than pipelines to the smugglers.

For instance, newly released court documents show that the R. J. Reynolds Tobacco Company, the second-largest American cigarette maker, sponsored trips to a luxury Canadian fishing resort for several dealers who have since been charged with conspiring to smuggle cigarettes into Canada. On one fishing trip in 1995, a Reynolds salesman even joked with the dealers about the smuggling.

And some of the dealers admit that they pour huge volumes of cigarettes right into the smuggling networks.

One of Europe's biggest cigarette traders, Michael Hänggi, said in an interview that he had been buying Winstons from Reynolds for 15 years and had resold many of them to smugglers in Spain. Mr. Hänggi said his three-person trading company in Switzerland had handled $100 million in sales last year. "Of course I know where the cigarettes are going," he said. "But is that my problem?"

Other inquiries show that two organized crime groups in Italy take in $500 million a year by smuggling in Marlboros they buy from Swiss dealers selling products made by the Philip Morris Companies, America's largest cigarette maker. And later

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this year, Hong Kong prosecutors plan to place a former marketing manager for the British-American Tobacco Corporation, a subsidiary of B.A.T. Industries and a British affiliate of Brown & Williamson, on trial on charges that he took more than $3 million in bribes from dealers involved in smuggling cigarettes into China.

Spokesmen for the three cigarette companies said they did not knowingly sell to dealers who supplied smugglers. They declined to discuss any of the criminal cases. But they said that while a few salesmen might have been too aggressive, their executives had done nothing wrong and that the companies should not be held accountable for what happened once they sold their products.

The smuggling costs foreign governments an estimated $16 billion a year in lost revenue. But more important, health experts say it threatens to undermine initiatives in many nations to discourage smoking, particularly among teen-agers.

That is because young people tend to smoke more when they can buy cigarettes cheaply, and smuggled brands often sell for about a third less than ones on which taxes and customs duties have been paid.

The sheer scope of the smuggling also could force changes in the $368.5 billion settlement being negotiated with the American tobacco industry. The proposed agreement says that before the Government could order the companies to lower the nicotine in cigarettes, it would have to guarantee that smugglers would not bring in more potent substitutes. But given how easily smuggling can take place, President Clinton said last month that this provision was unreasonable and should be changed.

The recent surge in black-market sales has many causes, from the relaxation of customs inspections in Europe to the opening of vast new markets in Russia and Eastern Europe. Market Tracking International Ltd., a research firm in London that provides data to tobacco industry publications, estimates that 280 billion of the 1 trillion cigarettes exported each year by all producing nations pass through the hands of smugglers, up from 100 billion in 1989.

The rise in smuggling also has coincided with a huge push by the American companies to expand overseas, which they see as a way to offset a decline in sales at home. American cigarettes are regarded as top quality and are seen as chic in many countries.

But as popular as American and other Western brands are, the companies also run into various sales barriers, including high taxes, limits on imports and countries where cigarette distribution is corrupt.

The smugglers, though, have increasingly maneuvered around such limits.

To be sure, in cities from Naples to Bogotá, Colombia, the image of street peddlers hawking contraband cigarettes has been an enduring one.

The manufacturers [?] that they normally receive the same price for cigarettes whether they end up in contraband markets or not. And despite markups by dealers, smugglers and salespeople, contraband cigarettes can still be sold cheaply and profitably because the savings from evading taxes can be so great.

Law enforcement officials say that the dealers usually provide such a distance between the companies and the smugglers that it would be hard to consider charging the companies with doing anything illegal. Yet even some dealers say that they and the companies sell the cigarettes so indiscriminately that they both know certain sales are headed for the black market.

If the companies say they do not, "It's a lie," said Corrado Bianchi, who said he had sold Philip Morris cigarettes as a dealer in Switzerland before retiring two years ago. "Of course they know."

Mr. Bianchi said he had sold large quantities of Philip Morris brands "to 200 people maybe, and they come from all over: Dutch people, Germans, Spanish, Greeks, Italians." But, he said, he never asked the buyers what they were going to do with the cigarettes. "In our work, you can't ask what they do with the cigarettes."

One result is that Mr. Bianchi ended up selling Philip Morris products to an organized crime figure now on trial in Italy, prosecutors there say. Mr. Bianchi himself is not a defendant, and he denied that he did anything wrong.

Andre Reiman, a senior vice president for a Philip Morris subsidiary in Europe, questioned whether the company had sold cigarettes directly to Mr. Bianchi. "As far as we can determine, he has never been a customer," Mr. Reiman said.

He added: "I am not going to sit here and tell you there is not contraband in cigarettes. It's there. The causes are just a little more complicated than people believe."

Philip Morris officials in New York said smugglers also competed with the company's distribution system and had jeopardized its investments in overseas factories.

Adam Bryan-Brown, a spokesman for Reynolds' international tobacco subsidiary in Geneva, said governments were responsible. "The root causes of contraband are well known — the high duties and taxes imposed on cigarettes," he said.

But Per Brix Knudsen, the director of an antifraud unit for the European Union, said: "It's astonishing that these big producers are not more concerned that such a large quantity of their product is arriving on the illegal market. How is it that such a trade can take place?"

Smuggling by Sea

Cargo Goes to Spain Instead of Africa

When the Wendy I, a huge cargo ship, edged out to sea from a port near Antwerp, Belgium, late last year, it was loaded with 16,000 cases of Winstons, or 160 million cigarettes. R. J. Reynolds, a subsidiary of the RJR Nabisco Corporation, had made them in the United States and shipped them to a warehouse in Antwerp. And its Swiss subsidiary sold them to a company owned by Mr. Hänggi, the Swiss trader.

Mr. Hänggi said he then sold the shipment to a Panamanian company and told a warehouse worker to indicate on shipping documents that the Wendy was going to Senegal in West Africa. But it would go no farther than Spain, where the cigarettes would bring up to $15.5 million on the black market. And this was just the start of a rich tale of intrigue that shows how sophisticated the smuggling networks have become and how hard they are to stamp out.

The New York Times

MONDAY, AUGUST 25, 1997

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The stage was set in Antwerp because it is one of the main distribution hubs for American cigarettes. Vast quantities pass through the port on their way to Russia and other places. Some of the cigarettes stay in legitimate hands; others shift course.

Mr. Knudsen and other authorities described Mr. Hänggi, 48, as one of Europe's largest and most brazen suppliers of cigarettes to smugglers. And before Spanish police seized the Wendy in January, they said, it was part of a long-running operation that last year smuggled 2.3 billion Winstons — $200 million worth — into Spain.

Investigators said the Wendy and other ships typically stopped in international waters well beyond Spain's 12-mile limit to minimize risks. There they transferred their loads to a high-speed torpedo boat once used by the German Navy, which took the cargoes close to the 12-mile mark. Then another set of boats would rush the cigarettes to shore.

When investigators began to piece together what had happened, they found some tantalizing evidence at the Belgian warehouse — a series of faxes showing that for years Reynolds officials in Geneva kept track of the volume of cigarettes that Mr. Hänggi supposedly was shipping to Senegal.

Given that all the shipments were diverted to Spain, the figures could not possibly have matched Reynolds's sales reports from Dakar, the capital of Senegal, investigators said. In fact, United States Agriculture Department figures show that Senegal imports no more than 500 million cigarettes a year — less than one-fourth of what was unloaded from the ships that Mr. Hänggi dispatched to waters off Spain in 1996.

Referring to Reynolds officials, Carlos Castresana Fernández, a prosecutor in the Wendy case, said, "The amount is so high, they can't say they don't know."

Neither Mr. Hänggi nor Reynolds has been charged with any wrongdoing. Reynolds would not discuss the Wendy case or confirm that Mr. Hänggi was a customer.

But in an interview at a yacht club on Lake Geneva in Switzerland, the irrepressible Mr. Hänggi acknowledged that he had been buying from Reynolds and reselling to smugglers for 15 years — and insisted he had done nothing illegal.

Yes, he said, he had bought the cigarettes that were on the Wendy from Reynolds. Mr. Hänggi, who is struggling to break a three- to four-pack-a-day habit with antismoking patches, said he then shuffled ownership through three of his companies. Investigators suspect this was to mask the trail, though Mr. Hänggi says it was to reduce Swiss taxes.

He also said that he sold the cigarettes to the Panamanian company before they left the warehouse, and he maintained that he was no longer legally responsible after that.

Still, Mr. Hänggi, who got into the tobacco industry as an apprentice when he was 15, remained involved, shepherding the shipment on the Panamanian company's behalf.

He had workers at the Belgium warehouse remove labels specifying where the Winstons were made. He also said he had dispatched the one-time torpedo boat to meet up with the Wendy off Spain.

Why were the labels removed from the cases? That is what the Panamanian client wanted, Mr. Hänggi said.

Who was that client? He said he could not remember the company's name.

Mr. Hänggi also was coy about what Reynolds knew about where the shipments were going. He shrugged, grinned and said, "I cannot speak for the companies."

Mr. Hänggi also said the cigarette companies' motives for selling to middlemen like him were clear: to bolster sales in countries like Spain and Italy where American cigarettes normally cost much more than local brands produced by state-run monopolies.

In Spain, for instance, Winston is the most popular foreign brand, and last year 60 percent of its sales were contraband, industry officials there said. The smugglers can sell a pack of contraband Winstons for $1.30 to $1.60, about the same price as a local brand and one-third less than the price of legal Winstons.

For the investigators, it is one thing to know that Mr. Hänggi and others are dealing so openly with smugglers, and it is another thing to stop it.

Mr. Hänggi, a Swiss citizen who once worked in Spain, runs his cluster of trading companies from Switzerland, in a small office above a grocery and a dress shop in the tree-lined village of Muttenz, near Basel.

Much of Europe's tobacco trade takes place in Switzerland, where Philip Morris and Reynolds have their European headquarters. Swiss law basically does not view selling cigarettes to people who smuggle them into another country as a crime. Investigators throughout the rest of Europe say that Swiss authorities — and the tobacco companies themselves — are rarely willing to cooperate.

Mr. Knudsen of the European Union said that when his investigators posed questions to Reynolds officials, they responded: " 'We'd like to help you, but Swiss legislation on commercial secrecy prevents us.' So they have provided nothing."

In the Wendy case, the investigators still have not figured out who owned the company in Panama that bought the shipment from Mr. Hänggi. And Mr. Castresana, the prosecutor, said it seemed unlikely that he would get to the bottom of what happened.

The seizing of the Wendy did force the smugglers to suspend the sea operations. But they quickly turned to the air.

Early this year, a jet flew from Ukraine to Belgium, where it picked up 20 million Winstons supposedly meant for North Africa. The plane then flew to two other countries before landing in the Basque region of Spain, where the crew produced documents saying it was carrying auto parts.

Over six weeks, the plane made 11 such trips, hauling a total of 220 million cigarettes, until Spanish police seized it. Investigators do not know who sold the cigarettes to the smugglers.

"I did, of course," Mr. Hänggi said.

He said a company registered in Aruba bought the cigarettes. Did he know the crew was going to smuggle the cigarettes into Spain? He laughed. "No, I thought they were going to smoke them."

Assault on Canada

Higher Taxes Set Off A Lucrative Trade

It was a rainy day at a salmon-fishing resort in British Columbia in September 1995. Les Thompson, an R. J. Reynolds salesman, was sitting around a fireplace with some of his customers.

Unbeknownst to Mr. Thompson, one man was an American informant. And according to court records unsealed in Syracuse on Aug. 13, he later described to a grand jury how the conversation took an intriguing turn — right into a discussion about smuggling cigarettes into Canada.

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One document — an affidavit from a Federal law enforcement officer — quoted the informant as saying it was clear Mr. Thompson knew the dealers were selling the cigarettes to American Indians who smuggled them across the St. Lawrence River.

The informant said Mr. Thompson chided the dealers that if they did not keep better sales records, he would start selling directly to the Indians. And on another day when one guest fell ill on a fishing boat, Mr. Thompson joked that the man "should be used to the water from hauling the cigarettes," the affidavit said.

As raw as it might seem, industry critics and law enforcement officials say this episode was just the latest in a chain of evidence that the tobacco industry fueled a smuggling assault on Canada in the early 1990's.

The smuggling took off after Canada raised taxes several times largely to discourage cigarette consumption, one of the first countries to try this approach. Beginning in 1982, its taxes became increasingly stiffer. By 1992 a pack cost about $4.50 (United States) in Canada, compared with slightly less than $2 in the United States, making the situation ripe for smuggling.

Canadian health researchers think consumption did fall because of the taxes. And Canada's top three tobacco companies — each affiliated with either Philip Morris, Reynolds or B.A.T. — lobbied to repeal them.

The taxes did not apply to exports, and the companies started shipping large amounts of Canadian brands, like Players and Export A, to the United States even though few Americans smoke them.

Where once only a tiny portion of the cigarettes made in Canada had been exported, that total jumped to a third by 1993, with the bulk going to upstate New York and other border locales. Reynolds also began making Canadian brands in the United States and shipping them to dealers in border states. Most quickly found their way back into Canada through smugglers.

None of this was any secret in Canada. The industry "absolutely" knew that most of the exports were being smuggled back, Michel Descôteaux, a spokesman for Imperial Tobacco Ltd., which is partly owned by B.A.T., said in an interview.

But Mr. Descôteaux said this was not the industry's fault. "We had warned the Government for years that when the taxes were increased, there would be smuggling." He also said Imperial was simply "shipping cigarettes in response to orders" by American dealers. "What would you have us do?"

Still, by February 1994, the smuggling had become so intense that Prime Minister Jean Chrétien was forced to start rolling back the taxes. "The fact is," he said then, "that the Canadian tobacco manufacturers have benefited directly from this illegal trade." He said they had "known perfectly well" what was happening and added, "I believe they have not acted responsibly."

Since then, two criminal cases have reinforced what he said.

Federal undercover agents in New Orleans recorded talks with two Brown & Williamson sales managers in 1994 as they arranged shipments of Imperial products that were supposed to go to fishing vessels but were really smuggled back into Canada. Both men have since pleaded guilty to Federal charges of aiding smugglers.

Court documents show that one of them, Michael I. Bernstein, told an undercover agent that a sales official at Imperial had agreed to supply cigarettes for the smuggling as long as each order was kept small.

The documents quote Mr. Bernstein as saying the Imperial official would "go along with that." But, Mr. Bernstein cautioned, "he assured me that if and when we get snagged with the packet of stuff anywhere in Canada, they're going to cut me off."

Mr. Bernstein also told investigators that selling to smugglers was part of Brown & Williamson's marketing strategy. Brown & Williamson and Imperial officials have denied this, and Federal prosecutors recently closed the case without bringing additional charges.

The second investigation, centered in Syracuse and in Canada, is now raising similar questions about Reynolds.

The grand jury in Syracuse indicted 21 people in June on charges that they were involved in smuggling $700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996. Court documents state that some dealers regularly bought cigarettes from Reynolds and resold them — usually for cash — to members of an Indian tribe, who slipped them into Canada.

Affidavits by investigators in both countries show that Reynolds routinely entertained the dealers at the Sonora Island Resort in British Columbia, where the company sponsored an annual fishing tournament. One dealer told an informant last summer that he was about to take 12 to 14 associates to the tournament and that Reynolds was going to pay a $10,000 entry fee for each of them.

Reynolds says it does not condone smuggling and would not comment on the investigation. Mr. Thompson did not return calls for comment.

But David T. Sweanor, an antismoking advocate in Canada, said the industry "basically played Canada for a banana republic and got rewarded for it."

China Connection

Tobacco Floods Into Next Frontier

Tommy Chui's body was found floating in Singapore Bay on April 1, 1995.

Mr. Chui had been a cigarette dealer in Hong Kong, and had made sensational accusations about corrupt dealings there. These were the highlights: From 1986 through 1993, Mr. Chui's firm bribed a succession of B.A.T. marketing managers in Hong Kong to insure a steady supply of cigarettes. It resold most of them to smugglers running them into China, and the profits were so large that organized crime had muscled in.

Prosecutors in Hong Kong have chai Jerry Lui, who was B.A.T.'s commercial director there from 1991 to 1993, with taking more than $3 million in bribes from Mr. Chui's company. Mr. Lui has denied the charges, and B.A.T. executives have dismissed the whole affair as the work of rogue employees.

But there is no question that the smuggling has given B.A.T. a foothold in China, the most prized cigarette market. One-third of all the cigarettes in the world are consumed there. And the tobacco industry views China as its ultimate salvation.

So far, however, China has not played along. It wants to protect its state-run tobacco company, a major source of Government revenue. Chinese officials also have voiced concern about the health problems that could follow a marketing assault. And China has allowed foreign companies to form only limited ventures with its company.

So inevitably, smuggling is flourishing there. Industry analysts say it accounts for 4 percent to 5 percent of the cigarettes sold in China. But the market is so vast that this amounts to 70 billion to 85 billion cigaret a year. And B.A.T. accounts for half of that.

China also seems bewildered by how to stop the smuggling. China's customs agency seizes only a tiny fraction of the contraband, and it has almost never prosecuted any of the big operators behind it.

So if the smuggling remains unchecked, China and the developing world will "really be bearing the brunt of it," said Judith Mackay, an antismoking advocate in Hong Kong. And while the tobacco companies have pledged to reduce smoking by teenagers in the United States, she said, the flood of smuggled cigarettes will only increase smoking by young people in other countries.

The New York Times

MONDAY, AUGUST 25, 1997