

# **TENDANCES**

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**Update on current research**

## ***Contraband and tobacco sales 1999 – 2004***

### ***Comparison of the development of cigarette sales in France in the border and non-border zones***

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#### **Introduction**

Following big increases in the price of tobacco linked to tax rises,<sup>1 2</sup> cigarette sales in France saw falls of 14% in 2003 and 21% in 2004 (OFDT, {2005}). Over the period from 1999 to 2004, purchases of cigarettes fell by 34%. Over the same period, the prevalence of tobacco use among French people between the ages of 12 and 75 years fell by 10% (Guilbert *et al.*, {2005}).

The difference between sales of cigarettes and the prevalence of tobacco use can be explained by a fall in the quantity of tobacco used by smokers. Another explanation of the discrepancy observed between tobacco consumption and tobacco sales is the possibility that tobacco is being bought in other countries neighbouring France where cigarettes are not so highly taxed, or on illicit markets.

In order to quantify this change in buying habits, the volume of trans-border purchases of cigarettes is measured by comparing the rate of cigarette sales in the border and non-border zones of France.. First, a clear definition of contraband tobacco is required, and this will emphasise the difficulty in measuring this phenomenon.

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<sup>1</sup> The average tax rate on cigarettes rose from 76% of the sale price of the most widely sold packet in October 2003 to over 80% in January 2004.

<sup>2</sup> For a meaningful general overview of tobacco (sales, customs seizures, sales of substitutes containing nicotine, etc.), please consult the monthly tobacco log produced by the French Drug and Drug Addiction Observatory, [www.ofdt.fr](http://www.ofdt.fr).

## “Contraband” tobacco

Joossens *et al.* (2000) define the nature of “contraband” tobacco by assessing levels of criminality. It is therefore possible to categorise purchases of tobacco, at prices lower than those found in the consumer country, according to whether they are legal,<sup>3</sup> quasi-legal or illegal.

Legal trans-border purchases are limited in quantity and can be made only for personal consumption. These purchases are legal because tobacco taxes are paid in the neighbouring country and thus no fraudulent tax evasion is perpetrated. It should be noted that trans-border purchases can be made even inside a federal country whose states’ fiscal policies are independent of one another (the United States, for example). Trans-border purchases vary in quantity from one country to another, but can account for a considerable portion of sales. It is estimated that these border sales account for up to 85% of total sales in Luxembourg (Joossens and Raw, {1995}).

Purchases by tourists differ from trans-border purchases because the products do not necessarily originate from a neighbouring country. This type of purchase is naturally constrained by the customs legislations in force. However, it can represent a considerable amount of national tobacco consumption and depends partly on the number of travellers and the frequency of the journeys made by residents of the nation concerned. For Finland, Piha (1998) estimates this type of tobacco purchase at 12% of domestic sales (in Joossens *et al.*, {2000}).

“Duty free” purchases are the remaining legal method of purchasing tobacco at cut prices. As Joossens *et al.* specify (2000), such purchases are not taxed but are limited in quantity (200 cigarettes, 100 cigarillos, 50 cigars or 250 grams of tobacco). Once again, their volume will depend on the frequency of journeys made by residents of a country, since most of these purchases are made at airports and on aircraft and ferries. Since these points of sale were eliminated inside the European Union in July 1999, the volume of such purchases has seen a significant decline. Nevertheless, “duty free” sales were estimated at 45 billion cigarettes per year prior to 1999.

*A priori*, it is legal to buy and sell cigarettes on the Internet if a sales monopoly is granted to certain distributors, as in France. French customs officers can therefore stop and question an Internet cigarette purchaser for importing highly taxed goods (article 7 of the Customs Code). The international rules, however, are not so clear. For example, Joossens *et al.* (2000) report that the American courts have declared the on-line sale of cigarettes originating from Indian reservations illegal, but not those from websites based in certain US states. The legislation Internet cigarette sales is therefore unclear.

One form of contraband that is difficult to define from the legal point of view is the import of previously exported cigarettes (*grey market cigarette sales*). This type of contraband can be understood better through an explanation of its route: cigarettes produced in one country are sold and exported to international brokers. These cigarettes are then illegally re-imported into their country of origin to be resold. Their value to smugglers is that on export, no tax is applied, so these cigarettes can be retailed at a much lower price than on the underground market. The tobacco industry is clearly involved in this type of operation.

*Bootlegging*<sup>4</sup> is similar to illegal trans-border or tourist purchases. These purchases are described as “bootlegging”, and hence as an illegal activity, when the quantities exceed the legally authorised

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<sup>3</sup> Readers may be surprised to find the definition of a legal purchase of tobacco in a section covering smuggling, and hence an illegal activity. Obviously, legal purchases of cigarettes are not considered to be contraband.

<sup>4</sup> “*Bootlegging*” literally means “smuggling alcohol or alcoholic drinks” or “piracy”. The word is also used for cigarette smuggling.

thresholds and the products are intended for resale. They cease to be trans-border or tourist sales, and become bootlegging, depending on the legally transportable quantities concerned and whether or not the product is intended for resale.<sup>5</sup> The intensity of illegal trans-border purchases depends on the tobacco tariff policies of the countries neighbouring the nation concerned. Such sales have the potential to represent a large quantity of contraband because of the number of buyers involved, despite the small-scale volume and infrequency of the method.

The organisation of large-scale contraband is the key feature of the illegal tobacco market. According to the definition of Joossens *et al.* (2000), it involves the sale, distribution and transportation of large quantities of cigarettes and other tobacco products, avoiding taxes of all kinds. Although there are regional differences in this type of contraband, there are several universal characteristics.

Large-scale contraband often involves world famous brands of cigarettes, both counterfeit and otherwise, circulating through the international freight system, proving difficult to trace. Official market statistics show that more than one third of cigarettes registered for export do not reappear in the import figures (Joossens and Raw, {1998}). Moreover, this type of contraband implies the involvement of organised criminal networks. It is important to note such networks are often highly corrupt. This may explain the vast extent of contraband tobacco in certain countries (Merriman *et al.*, {2000}).

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<sup>5</sup> On a proposal by the French Member of Parliament Yves Bur, on 27<sup>th</sup> October 2005 the National Assembly voted for an amendment to the draft finance bill aimed at reducing the quantities of cigarettes that could be transported by an individual in France. The quantity of tobacco manufactured, retailed and allowed to circulate legally would have fallen from 2 kg, or 10 boxes of 10 packets of 20 cigarettes, to 0.2 kg, or one box of 10 packets of cigarettes. However, the Senate voted for an amendment deleting that text on 15<sup>th</sup> November 2005.

Tobacco smuggling is therefore a many-faceted activity that is difficult to characterise and assess. An approximation of trans-border purchases can be obtained via a rough estimate of the extent of bootlegging, comparing cigarette sales in border and non-border zones. Obviously, this estimate is biased in its failure to recognise other forms of smuggling, namely large-scale contraband. Nevertheless, the analysis concentrates on trans-border purchases since, *a priori*, tobacco smuggling by criminal organisations is not widespread in France.<sup>6 7</sup>

### **Methodological reference points**

**One way of estimating trans-border cigarette purchases in France is to compare the cigarette sales figures by department.**

**The departmental data on cigarette sales, expressed in kilograms or thousands of cigarettes, were supplied by Altadis Distribution France (formerly Seita Distribution) which, with only a few exceptions, is the sole supplier to the 75,000 points of sale in Metropolitan France.**

**However, it should be noted that Altadis Distribution does not supply the tobacconists of the French overseas departments or Corsica, so those regions are not included in the proposed comparative study. Since other distributors only supply a fraction of French tobacconists, and because Altadis Distribution's data cover 98% of Metropolitan France, only the data of that distributor have been taken into consideration.**

**The study was conducted at regional and departmental level. All the regions sharing a land border with a foreign country are considered to be border regions. Although Picardy, for example, has only a very short border with Belgium, it is still included among the border regions.**

**The border departments, essentially a sub-group of the border regions, all have a land border with a foreign country. For example, Haute-Saône is not considered to be a border department, although it is very close to Germany.**

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<sup>6</sup> The principal reason for the absence of large-scale tobacco smuggling in France is still the state monopoly of the distribution of tobacco products. In fact, unlike in Italy, Spain or Germany, the control exercised by the customs administration on manufacturing, marketing and distributing allows for a more vigilant monitoring of tobacco smuggling. Nevertheless, the General Customs Administration estimates tobacco smuggling at between 1 and 2% of total tobacco consumption in France (General Customs Administration, {2000} in Kletzen, {2003}).

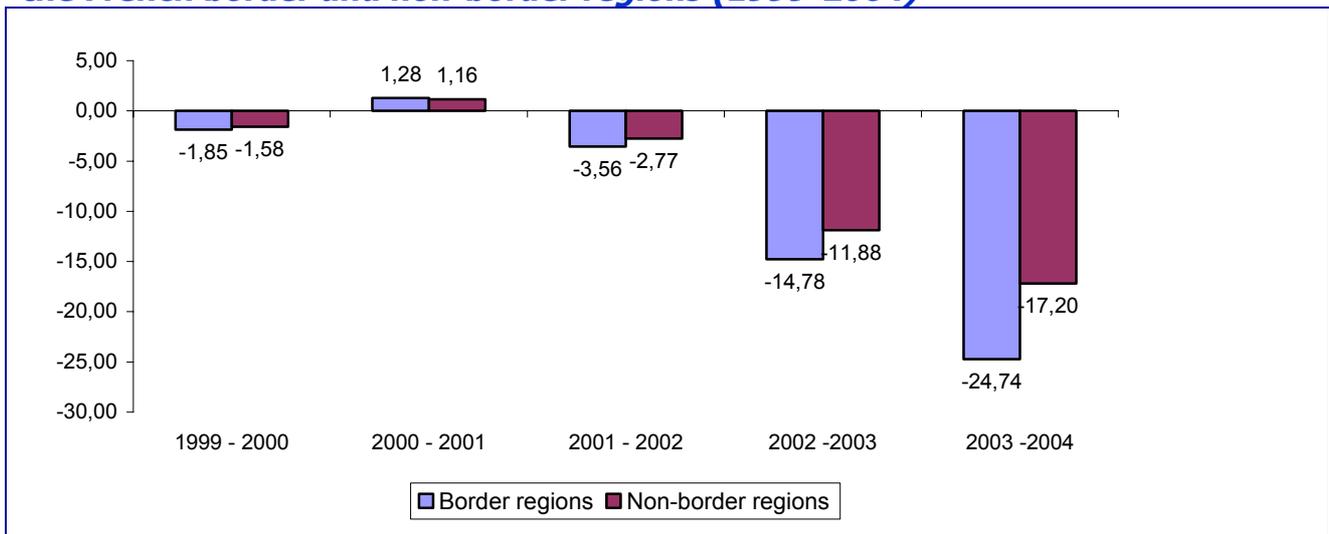
<sup>7</sup> Large-scale tobacco smuggling is more likely to be prevalent in a country where there is a high level of corruption (Merriman *et al.*, {2000}). France was placed 22<sup>nd</sup> in the list of least corrupt countries in 2004. The consequence of this low level of corruption is that, *a priori*, large-scale smuggling is unlikely to be widely present in France. <http://www.transparency.org/cpi/j2004.en.html#cpj2004> (visited on 12.10.2005).

## Results

Cigarette sales over the period from 1999 to 2004 came to 454 billion cigarettes. Differences can be seen in cigarette sales statistics between border and non-border regions. Over the period 1999-2004, cigarette sales in the French border regions fell by 38% whereas those in the non-border regions showed a decline of 29%. Graph 1 shows more clearly that this difference in the cigarette sales figures developed in 2001-2002: the non-border regions showed a fall in sales of 2.8% and, over that same time, cigarette sales in the border regions fell by 3.6%. This difference between border and non-border regions became more marked over time: over the period 2003-2004, sales in the non-border regions fell by 17% and those in the border regions by nearly 25%.

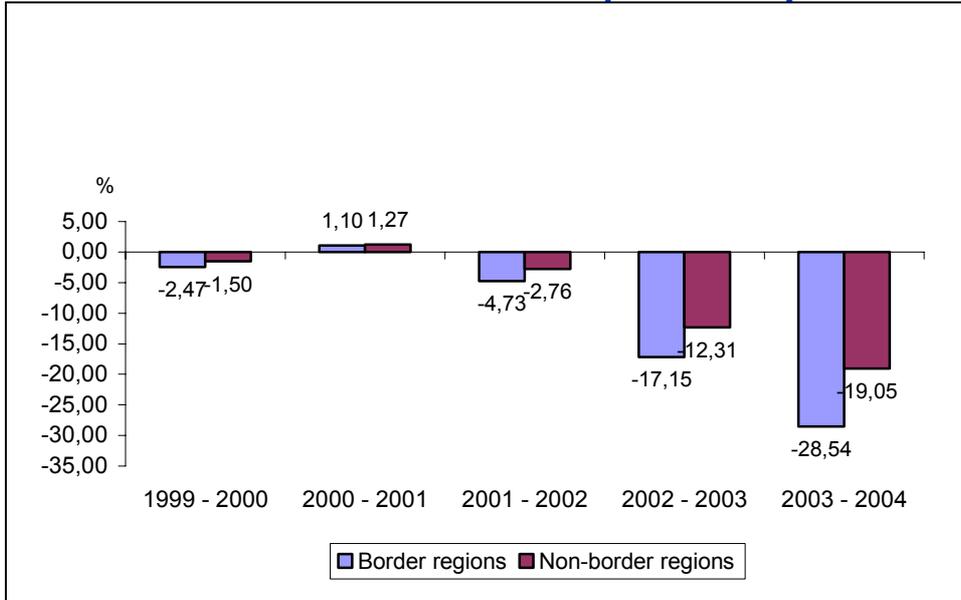
To refine the analysis, the maps below present the disparities cigarette sales growth rates in the French regions and departments. They are designed to give the precise locations of variations in cigarette sales. Map 1 shows that the regions with the greatest reductions in cigarette sales were Lorraine (56%), Alsace (54%), Nord-Pas-de-Calais (51%) and Aquitaine (41.5%). Conversely, the regions with the smallest reduction in cigarette sales were Pays de la Loire (28%), Basse-Normandie (27.5%) and Brittany (26%). Again, there are clear the divergences in cigarette sales figures between border and non-border regions.

**Graph 1 – Comparison of the average annual growth rates of cigarette sales of the French border and non-border regions (1999-2004)**



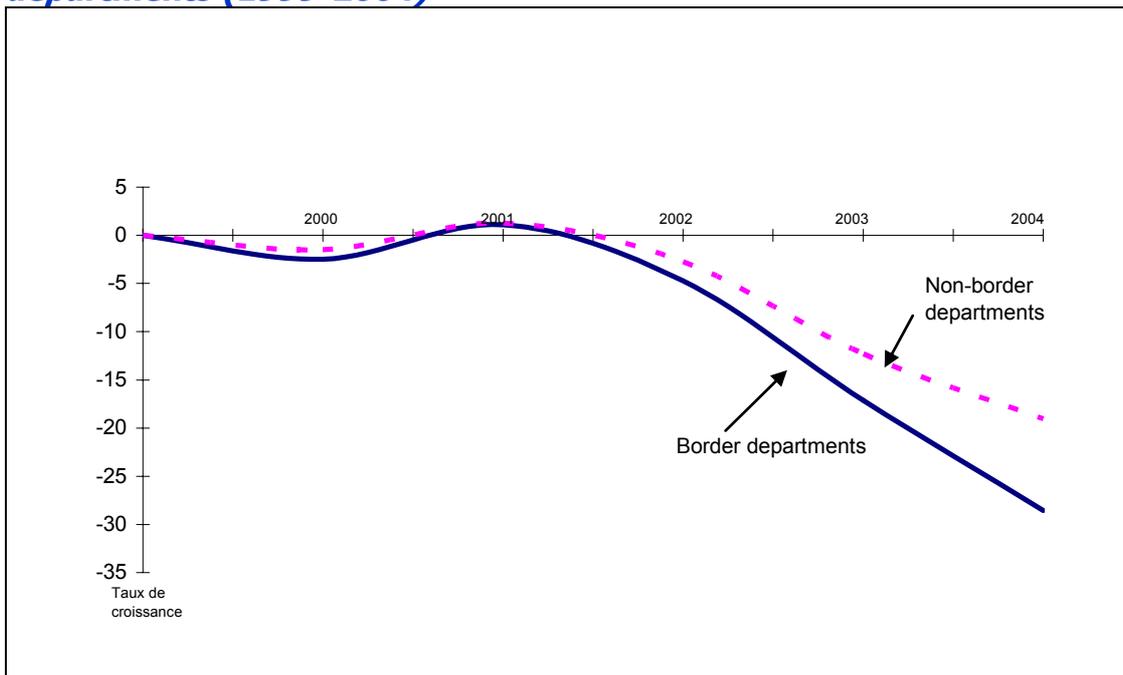
Source: Altadis, OFDT

**Graph 2 – Comparison of the average annual growth rates of cigarette sales of the French border and non-border departments (1999-2004)**



Source: Altadis, OFDT

**Graph 3 – Trends in cigarette sales in the French border and non-border departments (1999-2004)**

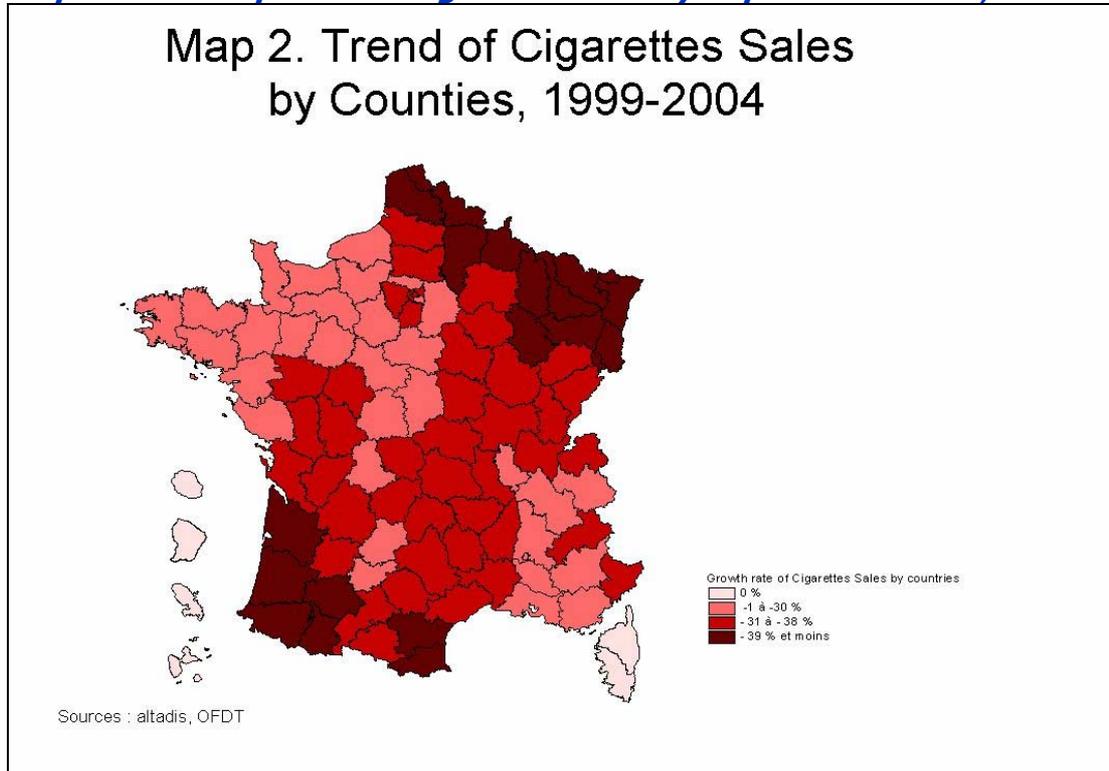


Source: Altadis, OFDT



Map 2, the departmental map, also outlines the different ways in which cigarette sales figures have changed: the further away a department is from the border departments (especially those in the north, north-east and south-west), the smaller the reductions are in cigarette sales. This suggests the geographical dissemination of trans-border purchases.

**Map 2 – Development of cigarette sales by department in %, 1999-2004**



0% to –32%, -33% to –38%, -39% and under.

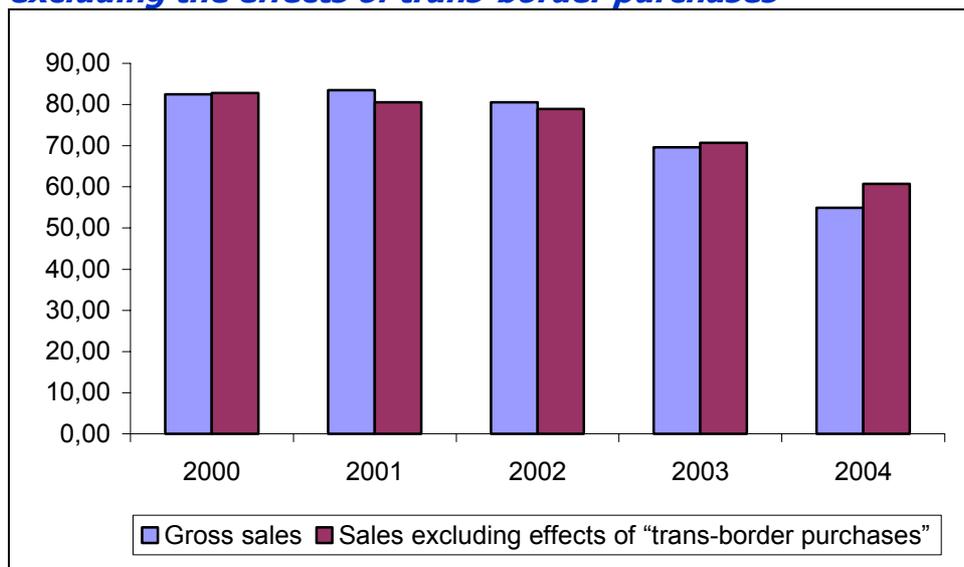
*Source: Altadis, OFDT*

**Estimate of trans-border cigarette purchases**

A simple simulation of tobacco sales has been produced to quantify trans-border cigarette sales. This simulation allows for the subsequent estimation of the amount of tax evasion represented by these sales.

The simulation takes the most significant decrease in cigarette sales across all departments in the period 1999-2004. This department happens to be Côtes d’Armor with a 23.5% fall in cigarette sales. This growth rate is then applied to the cigarette sales of all French departments in 1999. The result is an estimate of cigarette sales in all French departments in 2004, had trans-border cigarette purchases and any other form of tobacco smuggling not taken place, or at least had those forms of contraband been carried out with the same intensity as in Côtes d’Armor.

**Graph 4 – Sales actually observed and estimated cigarette sales in France excluding the effects of trans-border purchases**



Source: Altadis, OFDT

Using this filter, applied firstly to the different years (graph 4) and then to the whole period, it becomes possible to estimate the reduction in total cigarette sales in France excluding the “trans-border purchases” effect.

Graph 4 demonstrates that in 2000, 2001 and 2002 gross sales and sales excluding the “trans-border purchases” effect did not show any significant differences; in fact, sales estimated using the “Côtes d’Armor” filter were lower than gross sales. It would appear that over those three years cigarette sales in the Côtes d’Armor department were lower than in other French departments. However, in 2003 and 2004, the trend was reversed and only the effect on the level of gross sales caused by illegal tobacco purchases can be seen. Those purchases fell significantly lower than sales excluding the “trans-border purchases” effect with discrepancies of 1,099 tonnes in 2003 and 5,790 tonnes in 2004: trans-border purchases have a “watering down” effect on the reduction in cigarette sales across the country as a whole.

Moreover, if for the entire 1999-2004 period, the growth rate in cigarette sales across all French departments had been less than 23.5% - i.e. the rate of Côtes d’Armor – tobacco sales in 2004 would have been 63,559 tonnes. In reality, they were only 54,924 tonnes. Considering that a cigarette weighs 1 gram, the price of a packet of cigarettes (€ 5) and the tax rate (on average, 80% of the sale price), it is possible to assess the tax evasion resulting from trans-border purchases at 1,727 million euros for the year 2004.

## Conclusion

The French border regions and departments have seen their cigarette sales fall much more sharply than elsewhere.<sup>9</sup> Over the 1999-2004 period, cigarette sales expressed in kilograms of tobacco fell by 44% in border departments and by 31% in non-border departments.

It would therefore appear that the significant fall in sales in the border zones can be explained solely by the increase in legal and illegal trans-border purchases. This represents a little over one in six cigarettes for 2004 and, consequently, a considerable obstacle to anti-smoking policies.

<sup>9</sup> A correction in the demographic variations of the border and non-border departments has been made to exclude any possibility that the population growth rate might influence the rate of cigarette sales. It shows that the population growth rate per department has no significant effect on cigarette sales.

## For fuller information

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## Tendances

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