

# **Illicit Trade: Undermining Development**

A report by  
**The Global Initiative against Transnational  
Organised Crime**  
and  
**Black Market Watch**

Commissioned by  
**The Swedish Ministry for Foreign Affairs**

This report is produced ([www.blackmarketwatch.org](http://www.blackmarketwatch.org)) och Global Initiative against Transnational Organized Crime ([www.globalinitiative.net](http://www.globalinitiative.net)), two NGOs based in Geneva, Switzerland, focusing on illicit trade and organised crime.

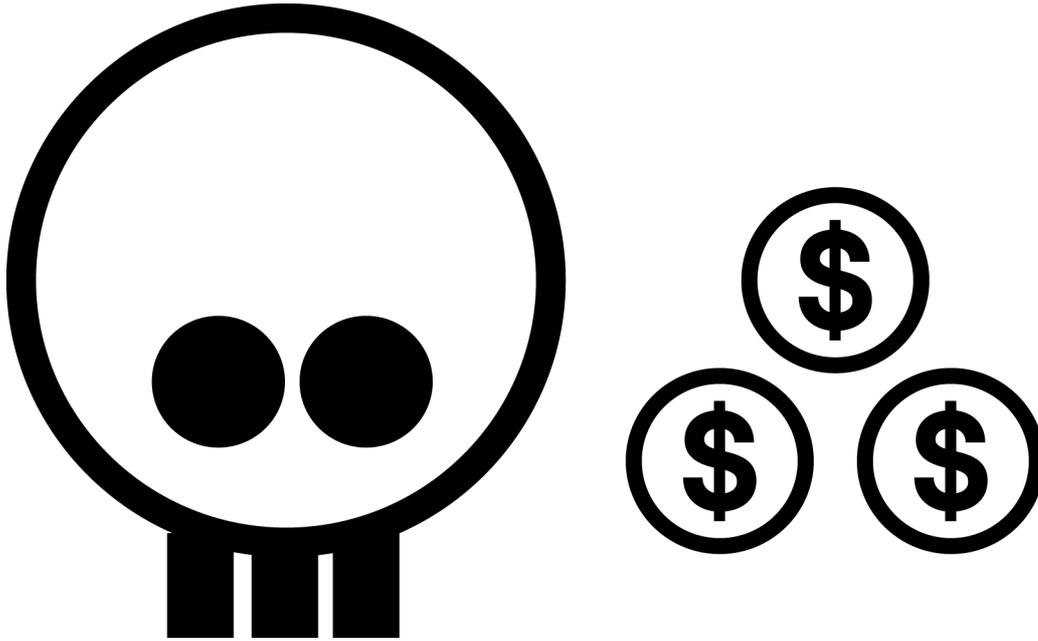
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## Introduction

Trade and development go together. Since the inception of the World Trade Organisation (WTO) in 1995 cross-border trade has more than trebled, lifting more people out of poverty than at any other time in history. Yet there is a neglected underside to the recent expansion in international trade, namely an explosion in illicit trade. The International Chamber of Commerce has projected that the international trade in counterfeit and pirated goods alone could reach up to almost a trillion U.S. dollars in 2015 alone.<sup>1</sup> The smuggling of excise goods, and fraudulent trade of other legitimate goods through the under-declaration of the value of imports further boosts the total scale of illicit trade in “normally licit goods”. These problems are especially prevalent in less developed countries, and they substantially restrict development potential.

This mass scale of different forms of illicit trade poses a number of strategic challenges, which have so far remained relatively unaddressed by the trade and development communities. The implementation of more effective efforts to counter illicit trade would not only boost legitimate economic activity, but also have a positive impact on governance and enhance the effectiveness of global development assistance, and would therefore be of particular help to less developed countries.

That organised crime constitutes a threat to development has been recognised in a number of high profile reports. In 2005, the report of the United Nations (UN) Secretary-General, “In Larger Freedom,” which identified the challenges preventing

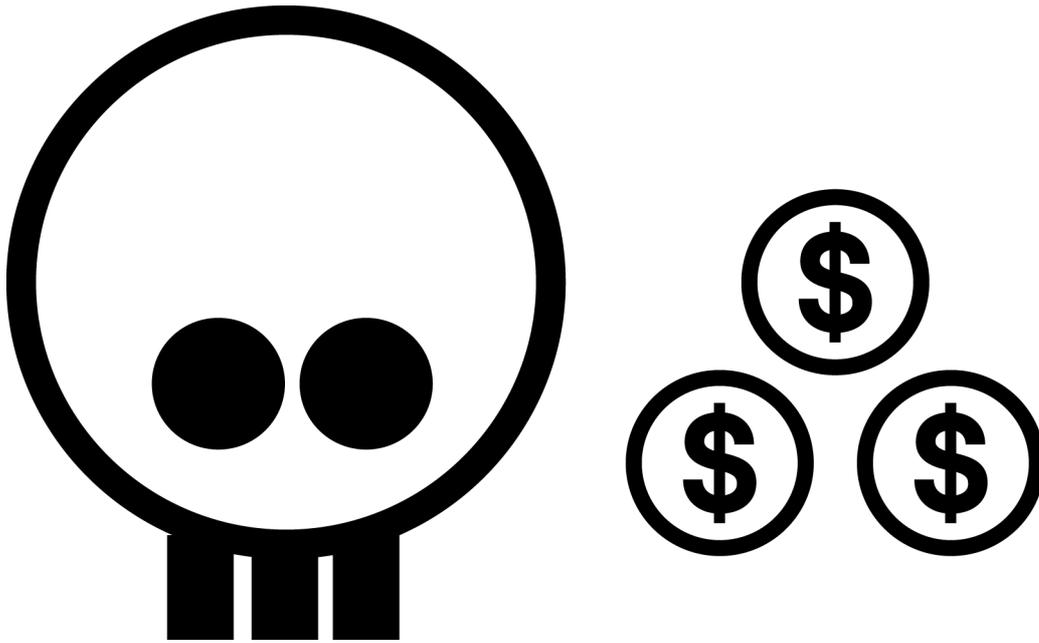


the achievement of the Millennium Development Goals (MDGs), highlighted organised crime as one of the principle threats to peace and security in the 21st century.<sup>2</sup> The 2010 “Keeping the Promise” report of the Secretary-General recognised that in order to achieve the MDGs, there would need to be capacity to respond specifically to organised crime.<sup>3</sup> The World Development Report 2011 concluded that both conflict and organised crime have the same detrimental effect on development, resulting in 20% less development performance.<sup>4</sup> As such, combatting organised crime and promoting greater economic and social resilience to its most deleterious impacts has become an integral part of the 2012 “Action Agenda” of the Secretary-General, as a priority for achieving a stable world.

Addressing the different forms of illicit trade, which constitute the greatest sources of income for transnational organised crime, is consequently recognised as a priority. But in reality the multiple challenges in addressing organised crime and illicit trade, requiring high political prioritisation and effective coordination of multiple stakeholders make this battle a daunting task that has so far seen limited success. Furthermore certain forms of illicit trade, although significant in terms of turnover and their potentially lethal impact, still remain relatively under-prioritised by national law enforcement agencies and the international community.

This paper will take a look at the broader problem of illicit trade, but will focus on the “illicit trade in goods that displace normally legal products” as this remains one of the most underrated and least prioritised organised crime areas despite massive economic turnover and societal impact.





## Fundamental Challenges in Dealing with Illicit Trade

### Data: The Frog-in-Boiling-Water Paradigm

Effectively addressing an issue requires awareness of it. For example, if a preventable disease kills a certain number of individuals every year it is easy to quantify the impact. It is highly visible. With awareness of the problem it is possible to weigh different policy options and assess their relative appropriateness. The problem with certain challenges is that they are not particularly visible, and hence the need for more effective policy responses may be less clear. This is the case with illicit trade. By its very nature the problem has relatively low visibility. The criminals, consumers, affected businesses and governments all have different and compelling reasons not to be open and frank about the challenges posed by illicit activities.

This lack of openness means that we cannot know with precision the extent of the problem of illicit trade and its impact. This makes collecting data a significant challenge, thereby making mobilisation of sufficient political will to prioritise resources for an appropriate response particularly challenging.



## Multiple Actors Sharing Responsibility: The Tragedy of the Commons

Dealing with illicit trade requires coordination between multiple actors. No one single ministry or authority at the national level, or international organisation at the global level, can solve the issue alone. The fact that several entities own part of the responsibility, yet are incapable of solving the problem alone makes it an unattractive issue for anyone to assume ultimate responsibility for. To see it as a law enforcement problem might be politically convenient for some, but it will hardly address the challenge, or help mainstream it as a trade, development, environment and security issue.

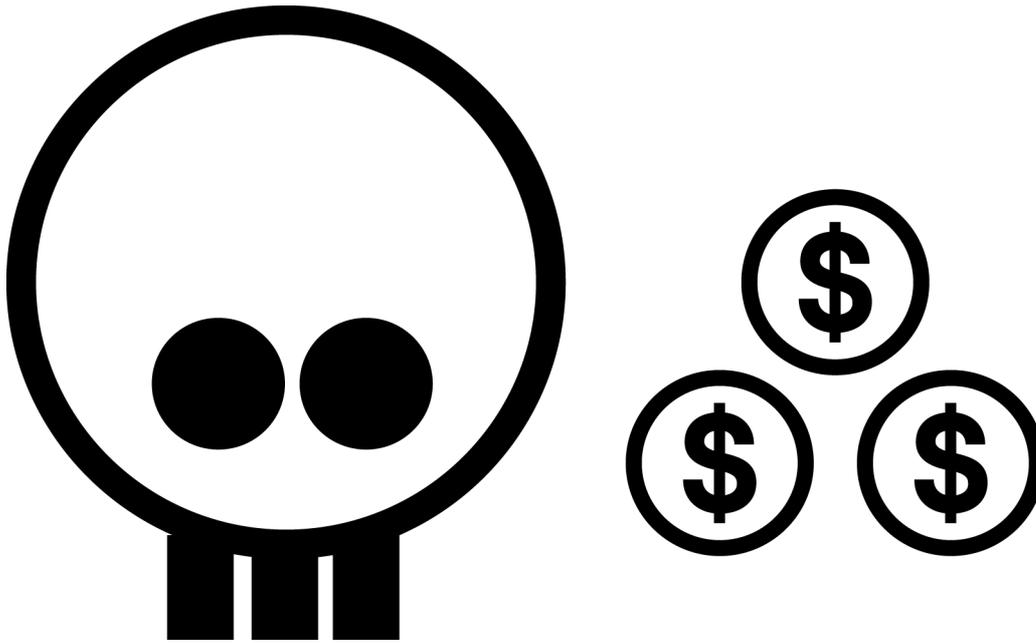
## Long-Term and Indirect Impact: Moving a Mountain One Grain of Sand at a Time

There are other issues that have low levels of transparency and require complex coordination of multiple actors to deal with. Terrorism is one such example. Yet the extreme nature of the potential impact of this problem means that triggering events, such as 9/11 can catalyse an extremely high level of political prioritisation, both at the national and international levels. The clear and present danger of catastrophic attacks terrorism can simply not be ignored.

According to David Luna, Chairman of the OECD Task Force on Charting Illicit Trade: *“As humans, we tend to exaggerate the risks of spectacular events that are extremely rare but that result in many losses immediately — a factory fire, a terrorist attack, a natural disaster. Meanwhile, we underestimate the risks of long-term events that affect us every day in small ways, adding up to a major impact. Illicit trade is one of these risks.”*<sup>5</sup>

The threat posed by illicit trade is more insidious than terrorism. Although the consequences are far worse in terms of lives lost, economic harm, and its corrosive effect on governance and development, but we are unlikely to see the high profile catastrophic incidents that would mobilise political action and force illicit trade onto a global priority pedestal.





## The Big Picture

The opaque nature of the illicit trade, the multitude of actors needed to address it, and the lack of catastrophic high profile incidents explain why the issue has so far received a relatively low level of political prioritisation. But a holistic assessment of the problem shows that this is an unacceptable state of affairs. In an increasingly globalised and interconnected world we need to rethink this approach. Now let us review why this is the case by assessing the scale of the problem and its multitude of impacts.

### The Scale of the Problem

There are some 180 definitions of organised crime.<sup>6</sup> Finding the perfect definition of illicit trade is a similar challenge. Consequently, rather than delve into detailed definitions of exactly what constitutes illicit trade lets us use the common sense approach. "If it looks like a duck, swims like a duck and quacks like a duck, then it probably is a duck." The simplest guiding rule being that if the trade is illegal in a particular jurisdiction then we classify it as illicit trade. For example, this would mean that generic medication when sold in a jurisdiction where it is legal would not constitute illicit trade. On the other hand sale of counterfeit medication would be considered illicit. Prohibited products, such as certain narcotics, will always constitute illicit trade. Most activity of transnational organised crime would consequently constitute illicit trade, whereas purely "domestic" organised crime activity such as extortion, public contracts manipulation and thefts



would not. Some narcotics, counterfeit and illicit environmental trade also remains purely "domestic", although the major flows are transnational.

Measuring the scale of organised crime is fraught with complexities, and putting a number on the scale of the problem has been controversial. A number of estimates of the value of various flows have been made, from conservative to outlandish, but regardless of which you choose, it is clear that the scale of transnational organised crime is a significant part of the global economy.

It is also worth pointing out that the profits from transnational illicit trade play a major role in financing other crimes, both purely "domestic" and transnational. Consequently even seemingly "relatively harmless" forms of illicit trade are not so harmless when they generate significant income for organised crime.

The UNODC has produced an overall estimate of the turnover of transnational organised crime. According to this meta study the global turnover of organised crime was 870 billion US dollars in 2009, representing 1.5 percent of global GDP, close to 7 percent of global merchandise trade, six times official global development assistance budgets. Three of the largest contributing subcomponents used by the UNODC were narcotics (320 billion US dollars), counterfeits (250 billion US dollars), and human trafficking (32 billion US dollars)<sup>7</sup>. Although this UNODC study has not been received without criticism, using its estimate and accounting for economic growth and inflation the annual total turnover of transnational organised crime would now exceed one trillion US dollars.

Last year the United Nations Environment Programme (UNEP) and INTERPOL released a study estimating the total turnover of environmental crime to be between 70-213 billion US dollars<sup>8</sup>, a figure significantly higher than a 2012 OECD study, which estimated the value of international environmental crime at 30-70 billion US dollars<sup>9</sup>. Constituent components include illegal exploitation of natural resources, such as logging and fishing; poaching; toxic waste disposal; and trade in prohibited compounds.

The World Customs Organisation reported that *"In 2012, world container throughput at ports amounted to 601.8 million twenty-foot equivalent container units (TEUs). Organized criminal gangs blend illegal consignments - drugs, precursor chemicals, wildlife, weapons, explosives, etc. - with this huge volume of legitimate trade."*<sup>10</sup> In 2014, for the second year, the World Customs Organisation (WCO) released its Illicit Trade Report (for 2013). It reported increased seizures in all five key areas of illicit items: drugs, environmental, intellectual property infringing goods, excise goods, and security related items.



Counterfeiting is often seen as a relatively victimless crime despite that it arguably constitutes the single largest market for transnational organised crime. The International Chamber of Commerce (ICC) commissioned a study projecting that the value of the internationally traded counterfeit and pirated products would reach 770-960 billion US dollars by 2015.<sup>11</sup> The ICC study is an extrapolation based on customs and trade data assessments done in a previous OECD study, and as such should be taken with some caution. But an industry study interviewing a number of large multinational corporations suggests that counterfeiting has increased globally in the past five years, and that most companies expect the growth trend to continue in the coming years.<sup>12</sup> The UNODC Executive Director Yury Fedotov, noted in 2014 that *"In comparison to other crimes such as drug trafficking, the production and distribution of counterfeit goods present a low-risk/high-profit opportunity for criminals,"* but that *"counterfeiting feeds money laundering activities and encourages corruption, and there is also evidence of some involvement or overlap with drug trafficking and other serious crimes."*<sup>13</sup> Even the most high tech products are not immune from counterfeiting, as confirmed by a year long United States Senate investigation which identified over 1 800 counterfeit electronic parts that had been incorporated into complex U.S. defence systems, including cargo planes, helicopters and surveillance aircraft.<sup>14</sup>

Measuring illicit trade, or illicit activity, is very challenging. Consequently most estimates are open to debate, and the wide range of total estimates itself suggests that they are anything but accurate. However, if we are looking at the developing world as a whole it is safe to assume that the problem of illicit trade in goods that displace legitimate goods (including counterfeit products, contraband excise goods and improperly obtained natural resources) constitute by far the largest category. Certain countries, which are significant producers or transit countries of narcotics or where illegal exploitation of natural resources is very extensive would be the general exceptions. But the biggest markets for narcotics are actually in the developed world, whereas the biggest markets for counterfeit products are outside of the OECD countries.

It is also worth pointing out that the profits from transnational illicit trade plays a major role in financing other crimes, both purely "domestic" and transnational. Illicit trade in counterfeit goods does not operate in a vacuum in relation to other illicit goods. The groups, networks and routes which facilitate one are frequently involved in the other several types of illicit trade. This point has explicitly been made by several law enforcement agencies. Referring to this Interpol has stated *"A clear link has been established between the trafficking of illicit goods and transnational organized crime."* and that *"They use*



*the profits to fund other criminal activities such as drug trafficking, people smuggling and robbery.*"<sup>15</sup> Consequently even seemingly "relatively harmless" forms of illicit trade are not so harmless when they generate significant income for organised crime.

## The Impact of Illicit Trade

At first glance, even a figure such as the UNODC estimate that the turnover of transnational organised crime is equivalent to 1.5 percent of global GDP may not seem that shocking. But the total impact goes far beyond the economic turnover, including:

- The cost of crime diverts development resources. Narcotics use, for example, results in "problem users". These individuals will result in a cost to society not only through their reduced productivity and need for societal assistance but a proportion will also engage in crime to finance their addiction. Loss of human life is also an economic cost, eliminating future economic earnings of the victims. The UNODC estimates that there are between 16 and 39 million problem drug users, and approximately 200 000 drug related deaths annually.<sup>16</sup>
- Key ecosystems and species are irreparably damaged. The cost associated with environmental crime far exceeds the value of the goods traded. The environmental damage caused means that future legitimate earnings of natural resources are eliminated, for very long periods of time, and potentially forever.
- Corruption undermines governance, democracy and the rule of law. As illicit trade generates significant profits for the parties involved, yet exposes them to risk, efforts to buy "insurance" or "protection" from government officials, law enforcement and politicians will occur, perverting governance and democracy in the process.
- Undermining security. Contraband trade provides income for conflicting parties prolonging wars, and serves as important income streams for violent criminal and terrorist groups.
- Diversion of resources to combat criminal entities. The rise of criminal networks controlling illicit trade forces governments to divert focus and resources to law enforcement efforts, at the expense of development. In countries with armed parties profiteering on illicit trade this effect can become particularly extreme.
- Tax revenue losses. When the illicit goods are displacing normally legal products the government is deprived of tax



revenue. This is particularly apparent in the case of excise goods, but applies counterfeits and natural resources too.

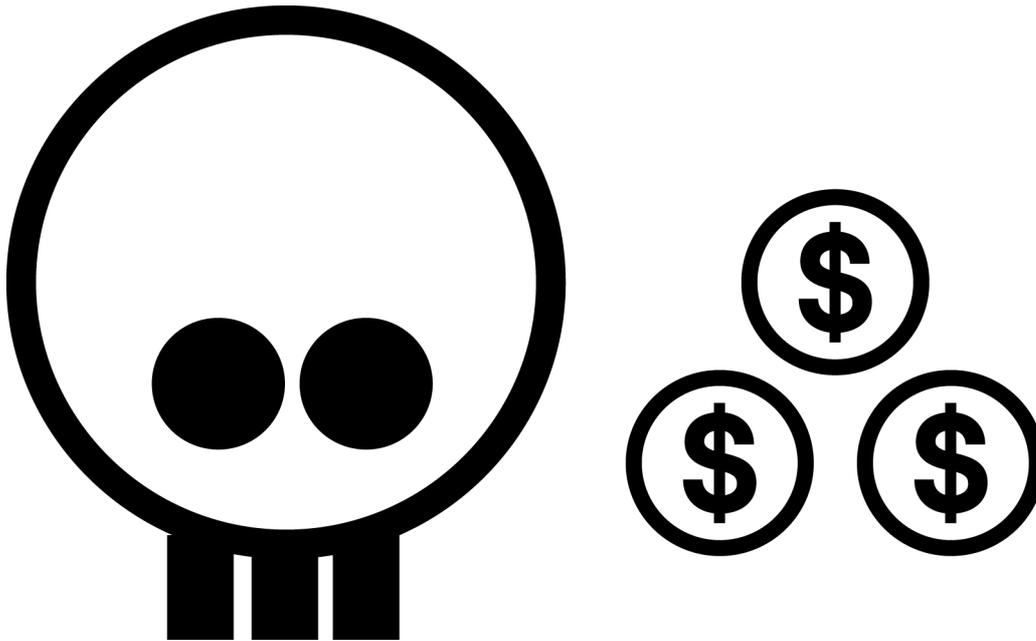
- Undermining public health. Certain forms of illicit trade, particularly counterfeit medicines and foodstuffs, endanger public health.
- Undermining legitimate enterprise and entrepreneurship. The provision of illicit products at prices lower than are possible for legitimate actors results in unfair competition, eliminating legitimate economic actors and negatively affecting investment in the economy. Crime also generates direct costs for business and contributes towards a less conducive business environment.
- Human rights are undermined in a multitude of ways by organised crime activity. From the most extreme direct costs of murder and forced human exploitation, to the indirect costs of depriving millions of people of their freedoms and full potential.

The aforementioned factors contribute to fostering an environment of reduced government functionality and rule of law, reduced revenues, and increased costs. At the same time the economic environment becomes less conducive to economic growth and investments, undermining broader development.

Yet impact is not limited to the country or region affected by illicit trade itself. In an interconnected global system the repercussions are felt beyond national borders:

- Trade with other countries suffers
- Development assistance, depending on programmes, can become less effective
- Instability may be exported elsewhere. Criminal groups and terrorists operating across borders pose a global menace.





## Illustrative Examples of the Scale and Impact of Illicit Trade

The text above has explained the innate challenges in presenting a holistic picture of the scale and impact of illicit trade. To more effectively illustrate the serious challenges illicit trade poses a number of examples highlighting the magnitude and negative consequences of illicit trade are listed below.

### I. Antimalarial Drugs<sup>17</sup>

Anti-malarial drugs constitute 25% of the total drug consumption in malarious countries. Over three billion people are at risk of malaria, which is endemic in over a hundred countries, mostly in the developed world. The most dangerous form of malaria parasite, *Plasmodium falciparum*, kills between 655 000 and 1.2 million people every year, primarily in Sub Saharan Africa and South East Asia.

Poor quality medication results in avoidable deaths and contributes to drug resistance. Falsified drugs are a major problem in this context. In 2012 the Lancet, a leading medical journal, published a review of several studies to determine average rates of false antimalarials. 36% of tested antimalarials in seven South East Asian countries were classified as falsified, as were 20% in 21 sub-Saharan



countries.<sup>18</sup>

Not only can low concentrations of active pharmaceutical ingredients in poor quality antimalarial drugs provide inadequate protection, but can also contribute to the development of drug-resistant parasites. The article concludes that “poor-quality antimalarial drugs are very likely to jeopardise the unprecedented progress and investments in control and elimination of malaria made in the past decade.”

The authors of the study also pointed out that *“No reliable global estimates are available about the frequency of poor-quality antimalarial drugs because of no internationally accepted definitions of different types of poor-quality drugs; no globally standardised or statistically robust sampling schemes, testing protocols, and requirements for drug content; a dearth of funds; and no recognised international forum to provide technical and scientific guidance and oversight.”*

*“A survey of 26 African medicine regulatory authorities indicates a lack of sustainable funding, chronic shortage of qualified staff, and few or no operational resources. Of the 47 malarious countries in Africa, only Kenya, South Africa, and Tanzania have WHO prequalified laboratories that are equipped to chemically analyse antimalarial drugs.”*

*“Production and distribution of counterfeit antimalarial drugs should be prosecuted as crimes against humanity.”<sup>19</sup>*

This problem is not limited to antimalarials, with other studies and public information indicating that most categories of medication are affected by counterfeits with low quantities or no active ingredients likely contributing to treatment failure. Falsified medication is a significant contributor to unnecessary and avoidable morbidity, mortality, drug resistance and loss of faith in the health care systems in low-income countries.

In recent years drug quality testing programmes have been initiated. Yet these programmes do not cover all categories of drugs and all territories.

## II. Law Enforcement Seizures of Counterfeits

Although there are presently no satisfactory methods to measure the prevalence of counterfeit goods law enforcement reporting on seizures does give some indications of the nature of the problem. Interpol and the World Customs Organisation report on some major global seizures, frequently results of coordinated efforts between law enforcement agencies in several countries.

In 2014 Interpol press releases reported a number of law



enforcement operation seizures illustrating the variety and scale of the problem:

- 1 200 tonnes of fake or substandard food and nearly 430 000 litres of counterfeit drinks. Included were 131 000 litres of oil and vinegar, over 80 000 biscuits and chocolate bars, 20 tonnes of spices and condiments, 186 tonnes of cereals, and 45 tonnes of dairy products. Fake whiskey, stock cubes and honey were also seized.<sup>20</sup>
- A factory producing fake cosmetics containing high levels of mercury, which could be toxic to humans. 589 people were arrested, and 37 million US dollars worth of illicit goods were seized.<sup>21</sup>
- Counterfeit products including electrical products failing to meet safety standards, unapproved baby formula, cosmetics containing banned substances, leaky gas cylinders, illicit insecticides.
- The smuggling of narcotics inside counterfeit car and motorbike parts posing a threat to consumers.
- Millions of fake products including television encoders, watches, car parts, food and 2014 World Cup memorabilia seized together with arms and ammunition.<sup>22</sup>

The World Customs Organisation's (WCO) Operation Biyela, a 10 day operation conducted in 23 African countries during 2013, netted over a billion illicit products. Including over 550 million pharmaceutical products including antibiotics, dietary supplements, anti-malarials, anti-inflammatory drugs, pain killers, anti-inflammatory treatments, diabetes treatment, allergy treatment, HIV/AIDS treatment, epilepsy treatment, blood pressure medication, cholesterol and heart treatment, anti-impotence medication, hepatitis medication, and mood stabilising drugs. Over 450 million fake electronic appliances, over 31 million food items, 16 million transportation and spare parts, and over 14 million other items including insecticides.<sup>23</sup>

In 2014 following Operation Biyela 2 in 14 Sub-Saharan countries a WCO press release stated the following: *"The frequency of cases and the size of the batches intercepted by the customs, the increase in types of pharmaceutical products involved (which range from cough medicine to insulin, contraceptives and antibiotics), the 'quality' of the counterfeit products, the ever changing techniques used by drug counterfeiters, and the trafficking routes involved: all of these indicators are in the process of being analyzed – and suggest that far from diminishing, the traffic in counterfeit drugs is in fact increasing steadily.*

*Like all criminal activities, trafficking in counterfeit medications*



*takes root in situations where it is most likely to flourish: namely in places where legislatures are unable, or unwilling to cope with the situation, where legal assistance is non-existent, where population is not well informed, where medications are in short supply, where supply chains are complex, where regulatory and inspection resources are lacking, where corruption is rife, etc. In light of these various factors, it is clear that if action is merely confined to national borders, we have no hope of winning the war against counterfeit medications.”<sup>24</sup>*

### **III. Costs of Crime in Central America**

The World Bank’s report *Crime and Violence in Central America: A Development Challenge* identifies the cocaine flow through the region (estimated to represent 90 percent of US supply) as the single most important factor behind the rising levels of violence in the region.<sup>25</sup> This crime related violence results in significant:

1. Costs: *“Beyond the trauma and suffering of individual victims, crime and violence carry staggering economic costs at the national level. Indeed, some experts estimate these costs at close to eight percent of regional GDP if citizen security, law enforcement and health care are included.”<sup>26</sup>*

2. Reductions in growth: *“Crime and violence also drag down economic growth, not just from the victims’ lost wages and labor, but by polluting the investment climate and diverting scarce government resources to strengthen law enforcement rather than promote economic activity.”<sup>27</sup>*

3. Weakening of the rule of law: *“Existing evidence indicates that drug trafficking increases corruption levels in the criminal justice systems of some Central American countries and tarnishes the legitimacy of state institutions in the public’s mind. On average, victims of crime tend to: (i) have less trust in the criminal justice system; (ii) support taking the law into their own hands in larger numbers; and (iii) believe less strongly that the rule of law should always be respected.”<sup>28</sup>*

The case of the economic consequences of illicit drug flows in Central America is an extreme example. But to some extent illicit flows of all types, around the world, have negative externalities affecting the societies where they feed local crime groups.

### **IV. Illicit Trade Financing Conflict**

In conflicts around the world various forms of illicit trade have played a role in sustaining violence. Military power needs to be sustained by an economic base.



James Fearon of Stanford University assessed civil war data and found that contraband trade had played a major role in prolonging some of the longest running civil wars since the second world war. The mean duration of civil wars with major reliance on contraband trade was found to be 48.2 years, versus a mean length of 8.8 years for conflicts that were not sustained by contraband trade.<sup>29</sup>

The World Bank's World Development Report 2011 states:

*"No low-income fragile or conflict-affected country has yet achieved a single MDG. People in fragile and conflict-affected states are more than twice as likely to be under-nourished as those in other developing countries, more than three times as likely to be unable to send their children to school, twice as likely to see their children die before age five, and more than twice as likely to lack clean water. On average, a country that experienced major violence over the period from 1981 to 2005 has a poverty rate 21 percentage points higher than a country that saw no violence."<sup>30</sup>*

*"The average cost of civil war is equivalent to more than 30 years of GDP growth for a medium-size developing country. Trade levels after major episodes of violence take 20 years to recover."<sup>31</sup>*

*"The death, destruction, and delayed development due to conflict are bad for the conflict-affected countries, and their impacts spill over both regionally and globally. A country making development advances, such as Tanzania, loses an estimated 0.7 percent of GDP every year for each neighbour in conflict."<sup>32</sup>*

In addition to illicit trade financing civil wars several high profile terrorist groups including the Islamic State of Iraq and the Levant (ISIS), al-Shabab, the Real IRA, the PKK, Boko Haram, and Al-Qaida in the Islamic Maghreb have raised significant funding through various forms of illicit trade.

Narcotics and conflict minerals are perhaps the highest profile illicit flows associated with financing conflict, but illicit trade in every day goods such as fuel, food and consumer goods also figure in most conflicts, as well as generating revenues for terrorist groups around the world.

## **V. Synergistic Effects between Illicit Trade and Transnational Threats<sup>33</sup>**

That black markets are the lifeblood of organised crime, and to a large extent terrorism, is clear but the threat of illicit trade goes beyond merely sustaining such groups economically.



Human smuggling, for example, creates a criminal infrastructure that can be used to smuggle terrorists across international borders. Knowledge of certain border weaknesses evolves, such as identifying corrupt border officials, as well as resourceful means of transporting people or products across borders. Supplies of fraudulent documentation (IDs and transportation documentation) catering to large-scale criminal markets are developed. Even the mass-scale trade in relatively “harmless” products such as contraband consumer goods helps develop the necessary “criminal infrastructure”, which facilitates the smuggling of other lower volume but dangerous items such as firearms and explosives. Brian Finally, the Stimson Centre has even pointed out that illicit transportation networks have been leveraged by states to smuggle dual use items useful in developing Weapons of Mass Destruction.<sup>34</sup>

## VI. Net Present Value Loss of Ecosystems

The paper “Global Scale and Impact of Illicit Trade” by Dr. Justin Picard suggests the following step approach to measure the net present value of ecosystem losses due to illicit trade<sup>35</sup>:

Step 1: Value of the ecosystem services

Step 2: Estimate rate of depletion of ecosystem resources

Step 3. Estimate proportion of ecosystem depletion due to illicit trade

Step 4. Use a discount factor per year for future losses on depleted ecosystems to calculate the net present value of total economic losses in the future

In Picard’s example he estimated an annual value of ecosystem services at 115 trillion US dollars, a depletion rate of 0.13 percent, and that 10 percent of this depletion was due to illicit trade, resulting in 14.95 billion US dollars of ecosystem services that are permanently destroyed by illicit trade. Using a discount factor of 3 percent per year for future losses the net present value of the total economic losses in the future were estimated to be 489 billion US dollars.

The actual figure arrived should not in any way considered to be accurate. The critical point being that the true economic losses caused by environmental crime are manifold higher than the economic turnover due to the ecosystem destruction. The illicit trade in many seemingly normal goods contribute to this irreversible damage. The primary goods themselves may have been improperly exploited, parts of manufactured products may have illicit sourcing, or toxic byproducts of



production processes may be illegally disposed of.

## VII. Tobacco Smuggling in Paraguay<sup>36</sup>

Paraguay is a prime example of state duplicity in relation to illicit trade. The President, Horacio Cartes, is also owner of Grupo Cartes which includes the country's largest cigarette manufacturer Tabacalera del Este (Tabesa). Tabesa's cigarettes are the most smuggled in Latin America.<sup>37</sup>

The Framework Convention on Tobacco Control (FCTC) places a number of binding requirements upon its parties to reduce illicit trade. Yet Paraguay's 2014 FCTC implementation report indicates that the country has not taken any measures to reduce illicit trade, over a decade since the country signed and ratified the treaty.<sup>38</sup>

The illicit trade in tobacco products has major impact on public health, as it undermines the effectiveness of government smoking related policies. According to the World Health Organisation (WHO) illicit trade *“undermines price and tax measures for tobacco control; thereby increases the accessibility and affordability of tobacco products.”* This in turn has *“adverse effects on public health and well-being, in particular of young people, the poor and other vulnerable groups.”* And this has *“disproportionate economic and social implications on developing countries and countries with economies in transition.”* The WHO identifies tobacco use one of the biggest public health threats the world has ever faced, killing nearly six million people per year.

Essentially the problem is that smuggled tobacco is much cheaper than legitimate and taxed tobacco, which boosts consumption amongst price sensitive groups: typically those in the developing world. At the same time this diversion into illicit markets also reduces government revenues for service provision and other governance priorities.

According to the WHO estimates 9-11 percent of the global cigarette market is illicit and governments could stand to gain at least 30 billion US dollars if it were eliminated. The tobacco industry estimates that over 600 billion cigarettes consumed every year are illegal.<sup>39</sup> Criminal diversion of legitimate cigarettes remains the largest problem, but counterfeiting and undeclared production are also problems.

Paraguay is by no means the only country with indications of state complicity or corruption in relation to the illicit tobacco trade. Zimbabwe is a significant source of smuggled cigarettes in Southern Africa, Belarusian state manufactured cigarettes are present in several countries where they have no legitimate market, and North Korea, where little economic activity takes



place without government assent, is considered to manufacture very high quality counterfeit cigarettes according to industry sources.

## VIII. Undeclared Imports in the Philippines

A study by Global Financial Integrity found that over the past decade 25 percent of the value of all imports into the Philippines went unreported to customs officials.<sup>40</sup> Such extensive import under-invoicing is generally driven by a desire to reduce or eliminate the costs of customs duties and tariffs.

Taxes on international trade constitute 22 percent of total tax income in the Philippines. Over the period 1960-2011 trade misinvoicing relative to total trade increased on average by 3 percent per annum.

Other studies by Global Financial Integrity suggest that trade misinvoicing is an enormous problem in the developing world as a whole. Furthermore a study conducted by a Presidential task force in Ghana estimated that fraudulent activities of importers resulted in annual revenue losses to the state of 36 billion Cedi. Although this would appear to be an overestimate, considering that Ghana's GDP in 2014 was 113 billion Cedi, it illustrates the presence of an enormous problem.<sup>41</sup> It is also worth bearing in mind that Ghana enjoys relatively low corruption and good governance indicators in the West African context, suggesting that that other countries in the region are likely to be affected by similar problems.

## IX. "Oil Bunkering" in Nigeria<sup>42</sup>

Nigeria is Africa's largest oil producer, and oil generates over 70 percent of government revenues. According to a 2013 report by Chatham House an estimated 3 - 8 billion US dollars of Nigerian oil are stolen annually, and largely sold on the international market. The Chatham House report suggests that the problem is growing. To compound the problem further the Nigerian National Petroleum Corporation is riddled with corruption. In 2006 the country's former anti-corruption police chief claimed that elites had 'stole or wasted' \$380 billion over four decades. Between 2003 and 2007, Nigeria's Economic and Financial Crimes Commission (EFCC) probed eight of the delta's nine state governors for grand corruption. In 2014 Lamido Sanusi, the central bank governor, warned that the Nigerian National Petroleum Corporation might have short changed the government to the tune of 20 billion US dollars over a 19 month period alone (January 2012 - July 2013) through fictitious fuel subsidy expenses and bogus trade swaps.<sup>43</sup>



Beyond high level corruption reducing government revenues from the nations oil wealth organised crime groups, cults and militias are making money by stealing oil directly from pipelines. By the mid-2000s, non-state armed groups and their backers were making inroads into the stolen oil business. Well-connected local ‘militants’ provided security for theft rings or set up protection rackets around them. Beyond the oil diversion itself such groups also imposed further costs on the nation: between 2007 and 2009, one government study found, attacks on oil infrastructure by Niger Delta militant groups shut down nearly half of Nigeria’s onshore oilfields. These attacks slashed the country’s oil exports, costing the state at least \$24 billion in the first eight months of 2008 alone. From 2010 to 2012 the Nigerian National Petroleum Corporation spent 2.3 billion US dollars on pipeline security and repairs. Significant oils spills and leaks resulting from oil theft pollute water and soil, impacting human health, livelihoods, and food stocks.

At the height of the Niger Delta Conflict there were an estimated 1000 deaths each year (not all directly related to oil theft). Beyond instability and violence the criminal groups behind oil bunkering have also been involved in kidnappings and bank robberies, and some “warlords” are now receiving lucrative government contracts to guard the same infrastructure they previously attacked.

Nigeria is rather unique in terms of the magnitude of oil theft, with only Russia suffering a comparable scale of the problem. But oil theft has been a source of revenue for militant groups in other parts of the world. Islamic State of Iraq and al-Sham (ISIS) was estimated to 1.5 million US dollars a day on the sale of petroleum products in 2015.<sup>44</sup>

## **X. The Broader Impact of Illicit Trade: The Example of India**

Reviewing the above information, which is itself not comprehensive, makes it quite clear that illicit trade is a much greater problem than the sum of its individual parts. The UNODC estimate that transnational organised crime has a turnover equivalent of 1.5 percent of global GDP, however accurate or inaccurate, does no justice whatsoever to the magnitude of the multiple negative impacts caused by illicit trade. Income criminal and terrorist groups, destabilisation and corruption of states, public health threats, reduced economic growth and destruction and pollution of ecosystems.

India can serve as an illustrative example.<sup>45</sup> In 2013 the Federation of Indian Chambers of Commerce (FICCI) published estimates for seven business sectors, suggesting that a quarter of fast moving consumer goods, a quarter of



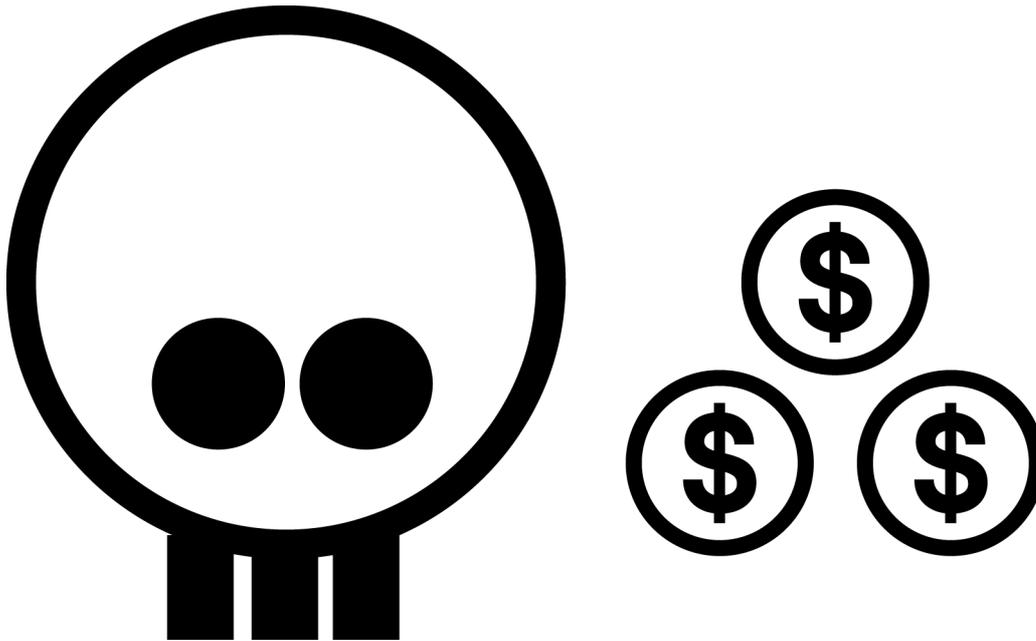
computer hardware, and a third of automotive components are from the grey sector - that is undeclared and largely counterfeit. The seven analysed sectors alone are estimated to deprive the legitimate economy of over 720 billion rupees in sales, and resulting in tax losses of 260 billion rupees.<sup>46</sup>

Looking at this economic loss is far from sufficient in judging the overall negative impact, the impact on human safety is of much greater concern. Around 20 percent of total road accidents in India—causing 25,400 deaths and more than 93,000 injuries a year — are estimated to be directly or indirectly attributable to the use of counterfeit automotive parts. Of even greater concern is that according to FICCI 23 percent of packaged food consumed is counterfeit or not sold in compliance with legislation. A study by Nielsen found that 30 percent of Fast Moving Consumer Goods were counterfeit, with 80 percent of consumers believing they were buying originals.<sup>47</sup>

One source of illicit flows of Chinese counterfeits to North Eastern India is via Myanmar. The illicit trade routes also bring illicit drug from Myanmar — heroin, opium and amphetamines. Perhaps not coincidentally the drug addiction rate in the border state Manipur is the highest in all of India. Myanmar is also a source of illicit weapons for separatist movements in North East India. The total sum of the flows, just from Myanmar, has multiple impacts on North East India: income for organised crime and insurgents, armaments for the separatists, drug addiction, health risks for the general populace due to the threat posed by counterfeits, all whilst the legitimate economy and government is deprived of income.

The broader perspective taken on India can of course be applied to a multitude of other countries facing the dual challenges of illicit flows and insurgency movements.





## Anti-Illicit Trade Actors in the International System

Both the national and international institutional frameworks have evolved to deal with the challenges of the past. The revolutionary changes that have taken place since the end of the Cold War (and earlier) have opened up most of the world to accelerated international trade and interdependence. Yet these very positive developments which have lifted unprecedented numbers of people out of poverty have also been accompanied by an explosive development in illicit trade. Not only are most states ill equipped to deal with this new challenge, but so too is the international system.

Below are some reflections regarding the role of some of the key actors in the international system concerning illicit trade. The list is by no means exhaustive.

### Nation-States

States remain the key actors within the international system. Not only are they responsible for core tasks such as law enforcement, but they are also the "shareholders" capable of influencing the agenda of international and multinational organisations and agreements. Development assistance is also largely dispensed by nation states, implying that developed states' can play an important role in addressing illicit trade through supporting capacity building efforts to reduce illicit flows in developing countries.



Tomas Ries, the former director of the Swedish Institute of International Affairs and senior lecturer at the Swedish National Defence College, says that in the old security paradigm the protection of national borders was the primary focus. In today's globalised world managing international flows are at least as crucial to security and well being. This requires both supporting desired flows and filtering undesired flows. Illicit flows undermine economic development, corrupt societies, generate income for criminal and non-state actors, as well as contribute to environmental degradation. One challenge is that our institutions are largely developed to meet yesterday's territorial threats, rather than global challenges such as illicit trade. Globalisation results in growing interdependence with trade partners which lack effective government administration and are characterised by extensive corruption. Dr. Ries sees the maintenance of efficient and secure trade flows as a core precondition for the flourishing of modern globalised society. He also sees that synergies between illicit trade and other threats, such as international revolutionary movements, together create a threat complex that is greater than the sum of the individual parts.<sup>48</sup>

Developing countries generally, and less developed countries in particular, are frequently characterised by weak state capacity. The bureaucracy is both inefficient and generally lacks resources. So called "failed states" provide the most extreme examples, such as Somalia, but even states with more functioning institutions may not exercise full control of all territory. Such "black holes" provide particular challenges. But even more functioning developing states may face challenges in dealing with illicit trade that do not fit well with the general "enlightened" assumption that the state is the solution to fighting organised crime. Key actors within the state may have interests contrary to the national interest, and profiteer on illicit flows (of course this problem is not exclusively limited to the developing world even though it is more prevalent there). Guinea Bissau, where there have been indications complicity in narco-trafficking at the very highest level of the state, is a well known example but is far from a unique example of political and military elites being key stakeholders in transnational organised crime.

Challenges presented to the nation state consequently impact the capacity for multi-lateral action, when states are no longer necessarily acting in the interests of their citizens. The recognised illicit trade expert, Moisés Naim, coined the term "mafia states", describing the phenomena in a 2012 article: *"Across the globe, criminals have penetrated governments to an unprecedented degree. The reverse has also happened: rather than stamping out powerful gangs, some governments have instead taken over their illegal operations. In mafia states, government officials enrich themselves and their families and friends while exploiting the money, muscle, political influence, and global connections of criminal syndicates to cement and expand their own power. Indeed, top positions in some of the world's most profitable illicit enterprises are no longer filled only by professional criminals; they now include senior government officials, legislators, spy chiefs, heads of police departments, military officers, and, in some extreme cases, even heads of state or their family members."*<sup>49</sup>



The challenges at the national level are manifold. Where there is conflict and instability peace needs to be achieved before the problem of illicit trade can begin to be addressed. Where there is peace institution building can be supported. But in order for institutions to be truly effective good governance and rule of law needs to be developed, which is a very long term endeavour. However, as Naim's article also points out, the perversion of the nation state also weakens multi-lateral endeavours, as the interests of the state no longer align with those of the population, but instead are directed to protect personal revenue streams and in some cases illicit interests.

## **The WTO and the World Trade System<sup>50</sup>**

A review of international trade law, conducted by the Trade and Investment Law Clinic of the Graduate Institute of International and Development Studies in Geneva, found that the World Trade Organisation (WTO) lacks effective mechanisms to deal with illicit trade, and practically even limits the capacity of individual member states to implement measures countermeasures to limit the problem.<sup>51</sup>

In effect illicit trade is not recognised as a serious barrier to trade. All members of the WTO, (other than LDCs that are subject to different requirements) are bound by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) which requires minimum standards to prevent trade in counterfeits and intellectual property infringing goods. Yet despite this illicit trade continues to flourish. It is effectively impossible for states, or corporations, to claim damages from other states that do not take effective measures to prevent illicit trade (either in terms of production or market prevalence), despite the fact that this seriously undermines the benefits of trade.

The United States filed the "China-IP Rights" case with the WTO. Although the case may have had its weaknesses it is telling that the WTO Panel actually praised China for having "a level of protection higher than the minimum standard required by the TRIPS Agreement." In this context it must be noted that China is the originator of the majority of the world's counterfeit products.

On the positive side bilateral and regional trade agreements do provide some scope for including measures to prevent illicit trade and protection of intellectual property rights over and beyond TRIPS - but this is based on the mutual willingness of the parties concerned to agree to do so. The recently concluded negotiations of the Trans-Pacific Partnership trade agreement serves as a major example in this context.

International investment law may also provide some opportunities - although this is only applicable where foreign investments in a country can be shown to suffer from illicit trade. Swedish based investors have brought a case to the World Bank's International Centre for Settlement of Investment Disputes in 2014 that could — if successful — potentially set an interesting precedent. An investment was made in an alcohol facility in the Romania. Since the



investment was made the illicit trade in alcohol increased significantly. The investors are claiming that their investment was damaged, as the government did not take adequate measures to prevent illicit trade, and are demanding compensation.<sup>52</sup>

The World Intellectual Property Organisation (WIPO) cooperates with the WTO on IP related matters, and also conducts some awareness raising work in relation to the problem of IP infringement. WIPO's Advisory Committee on Enforcement (ACE) is the forum within which WIPO Member States discuss intellectual property (IP) infringements, how to enforce IP rights (IPR) and what other measures to take to build respect for IP. ACE sessions have focused on measuring the impact of counterfeiting. The simplified summary of the papers presented within ACE is that no one single methodology is yet deemed sufficient for quantifying this problem.

The Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) is the international community's means of controlling trade in animals and plants and the Convention has 179 Parties at present. Whilst its appendices list significant numbers of fauna and flora species (30,000+), the Convention does not apply to all wildlife and its focus is one of sustainable regulation of transnational trade. Although Parties are legally bound to penalize violations of CITES, the Convention was drafted in 1973 and, hence, its wording does not reflect the existing significant and serious levels of sophisticated and organized trafficking. It is acceptable, for instance, for Parties to respond to violations by way of administrative, as opposed to criminal, penalties. Studies have shown that a good deal of this law is outdated, was initially intended to regulate hunting or penalize subsistence harvesting, and is inadequately-framed to combat organized wildlife trafficking. Although many Parties to CITES have enacted legislation to better equip them to implement the Convention, little of it is intended to enable enforcers and prosecutors to respond to serious criminal exploitation of fauna and flora.<sup>53</sup>

### **International Organisations with a Focus on International Law Enforcement Coordination and Support**

The WCO and Interpol help law enforcement agencies share information and coordinate certain activities. Yet they are in not international law enforcement agencies themselves, and as such have a limited role to play in addressing illicit trade. The burden on enforcement still rests on nation states. The WCO also has trade related responsibilities unrelated to illicit trade, and beyond Interpol's work on counterfeiting and other illicit trade it also focuses on several other types of crime not considered illicit trade.

The United Nations Office on Drugs and Crime (UNODC) is the lead UN agency on crime matters. It runs a broad range of programmes, and relating to border security coordinates together with WCO and Interpol the EU funded Airport



Communication Programme (AIRCOP)<sup>54</sup> and with the WCO the Global Container Control Program<sup>55</sup>. These programmes are designed to facilitate information sharing and to build the capacity of local law enforcement through training and assistance.

The UNODC consolidated budget for the biennium 2012-2013 was US \$576.7 million, or US \$288 million per annum if split in half, and the majority of this is voluntary funding.<sup>56</sup> This does not enable the kind of long-term sustained engagement that is genuinely required to build capacity or arguably, to mobilize significant policy shifts that are not immediately seen to be in the interests of key member states. Interpol's operating revenue for 2013 was 78 million Euro. Fairly limited budgets for organisations addressing such a broad range of issues and considering the scope of the multiple issues they deal with.

## OECD

The OECD High Level Risk Forum took the initiative of creating a Task Force of Charting Illicit Trade, which had its first meeting in 2013. The Task Force *"aims to co-ordinate international expertise in the quantification and mapping of illicit markets to enable a fuller understanding of the connections between different forms of trafficking, and underpin analysis of the public policies that successfully increase economic and societal resilience to this threat."*<sup>57</sup> So far the work has primarily focused on consolidating existing data to create a more holistic view of the problem of illicit trade. An OECD study on counterfeiting, based on extrapolations from customs seizure and trade data has also been commissioned. Essentially this will be an update to the former OECD study on counterfeiting conducted in 2008. The task force will also present policy recommendations on how to address the problem of illicit trade. As such supporting the task force presents an opportunity for OECD member states concerned by illicit trade as an international phenomenon. What is rather unique about the Task Force on Charting Illicit trade is the holistic perspective it takes on illicit trade, whereas the dominant approach so far has been to focus on specific categories or aspects of the "mega-problem" that is illicit trade.

The OECD's Development and Cooperation Directorate's Anti-Corruption Task Team has also shown interest in illicit trade as a related development issue, and has amongst other things commissioned a study relating to illicit flows in West Africa that is expected to be published in early 2016. The OECD's Trade and Agriculture Directorate has also exhibited interest in illicit trade, publishing a study on Illicit Trade in Environmentally Sensitive Goods in 2012.

## The International Chamber of Commerce

The ICC created Business Action to Stop Counterfeiting and Piracy (BASCAP), which a platform for the private sector to engage with international organisations and governments on counterfeiting and piracy. BASCAP coordinates industry views



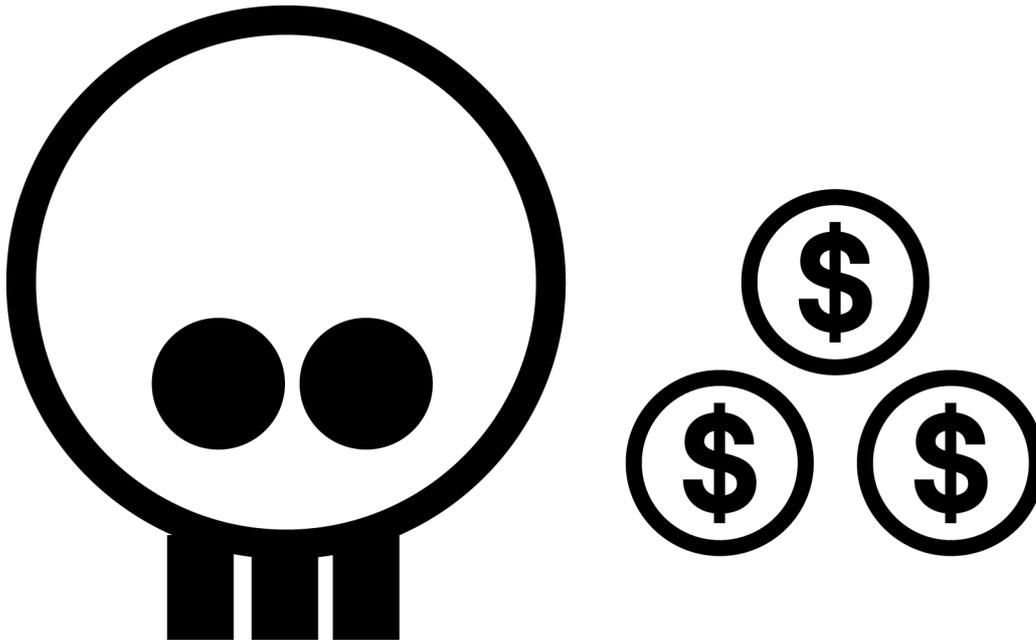
and commissions relevant research to shed light on IP infringement. Although a number of leading international companies are paying members of BASCAP more corporations facing severe problems with counterfeiting and piracy could become involved in its efforts.

## Think Tanks, NGOs and Research Organisations

In terms of improving the understanding of illicit trade several think tanks and academic institutions have conducted research relating to illicit trade, but most of this research tends to be focused on particular aspects of illicit trade, rather than taking a more holistic perspective. There are a number of NGO initiatives directed at specific aspects of illicit trade, for example counterfeit medicines, but few which address the challenge holistically.

- The Stimson Center's Managing Across Boundaries Programme stands out as a pioneer in terms of taking a more innovative and holistic approach integrating broader development and security dimensions of illicit trade.
- The preeminent international security think tank, the International Institute of Strategic Studies, has established a Security and Development Programme which includes a focus on illicit trade and organised crime.
- The World Economic Forum, although not a think tank in the classic sense, created a so called "Global Agenda Council" on Illicit Trade a few years back. The council has since been restructured a couple of times, and now has a "meta council" focusing on the Shadow Economy.
- The Swiss NGOs Black Market Watch and the Global Initiative against Transnational Organized Crime have partnered to create a joint programme dedicated specifically to enhancing knowledge concerning illicit trade.
- Global Financial Integrity has done novel work on attempting to quantify illicit financial flows and losses incurred from trade misinvoicing, which has some benefits for awareness raising and advocacy on the scale of the problem.





## Considerations for Improving Global Anti-Illicit Trade Efforts

So far most focus in terms of preventing illicit trade has been placed on countering narcotics, with high profile issues such as human trafficking and weapons also benefiting from relatively high prioritisation. A likely reason for the preeminent focus on these issues is that the wealthy developed world has been a key target of these illicit flows, and the repercussions with drug addiction, public health implications and crime mobilise a strong public opinion to focus on these visible problem. The problem with illicit trade in "normally legal goods" is quite different as the extent and visibility of the problem is much more apparent in the developing world than in the developed world. Consequently the states most able to deal with this type of illicit trade, and assist in capacity building, are not as concerned by these problems themselves. This leads to a number of problems. As the issue is not considered of primary importance the efforts to quantify the problem and measure its impacts have not been as robust as in the drugs space. This relative lack of data again creates a problem, as it becomes politically very hard to set an appropriate level of prioritisation of a problem when there is a shortage of data.

If the "hard reality" is that the rich developed world has engaged on the illicit trade sub-categories of narcotics, human trafficking and weapons because it has a seemingly clearer



self interest in doing so then part of the solution to increasing focus on other areas of illicit trade must lie in awakening "enlightened self-interest" amongst the wealthier countries in addressing broader illicit trade challenges. A prerequisite to achieve this must be new qualitative and quantitative data illustrating the impact of illicit trade from a holistic perspective, effectively presenting the issue as the "mega problem" it is.

Intellectual property infringement and the negative environmental impact of non-compliant goods do not respect national boundaries, an international coordinated response to the challenges is required. Below are listed some considerations that may be relevant in this context:

### **Gathering Data and Enhanced Private Sector Cooperation**

The Japan Patent Office has conducted an annual survey on losses suffered by Japanese companies due to counterfeiting since 1996. The 2014 survey suggested that 21.8 percent of responding companies suffered due to counterfeiting in 2013<sup>58</sup>. As a world leading exporter of IP intense goods the presence of underlying statistics indicating that a significant proportion of Japanese companies are affected by counterfeiting has created a knowledge base for Japan to formulate a policy response upon. Consequently Japan is a major supporter of WIPO, the World Customs Organisation, as well as bilateral efforts to enhance customs capacity building in other countries.

EU efforts through OHIM and the External Action Service to create a better understanding of intellectual property related challenges faced by European business are consequently welcome.

Novel approaches to collecting illicit trade data are also necessary. The traditional approach of looking at a problem within national territories is of limited value, particularly relating to intellectual property related crimes. The major market of products may be global, and production spread across several jurisdictions. The Swedish Confederation of Enterprise has consequently tried a novel approach of assessing how leading multinational corporations listed on the NASDAQ OMX Stockholm Index are impacted globally by counterfeiting and other forms intellectual property theft. The data provided by individual firms was anonymised and aggregated for the entire index in order to encourage companies to share otherwise very sensitive information. As the data collected, although global in scope, relates specifically to the national interest of a particular state it is more likely to influence the political decision making process of that country.

A key challenge in quantifying the problem of intellectual



property related crimes is the reluctance of corporations to openly share information due to concerns of frightening consumers as well as shareholders, as well as damaging trade marks. Yet with indications that this is a growing issue governments and international organisations need to become much better at engaging with the business community to extract an accurate picture of the problem. Commissioning studies like the ones carried out by the Swedish Confederation of Enterprise or the Japan Patent Office should be standard operating procedure for states, not the exception.

The fact that corporations have interests in addressing illicit trade, particularly to reduce unfair competition, threats to their trade marks, and to generally foster more positive economic development and conducive business environments makes them natural partners in addressing this challenge. Partnering with the private sector within the development context is not novel in itself, the Swedish International Development Agency (SIDA) for example has a Business 4 Development initiative. Including specific illicit trade related projects of both public and private sector concern would make sense in this context.

### **Increased Focus on Countering the Illicit Trade in "Normally Legal" Goods**

Other than narcotics, which has already received mass scale law enforcement focus, the other major category of illicit trade -- the illicit trade in goods that displace normally legal products -- such as counterfeits and contraband excise goods has on the other hand received relatively little law enforcement attention in proportion to the magnitude of its turnover.

Considering the comparatively low law enforcement prioritisation of the illicit trade in "normally legal goods", in relation to narcotics, this would appear to be an area with strong potential for improvement. The present situation is characterised by weak legislation and limited dedicated law enforcement resources. Improvements to reduce the current "high profit - low risk" perception enjoyed by this category of crimes could likely be achieved at relatively low costs. So working to enhance law enforcement prioritisation of this category of crime internationally should be a priority, to be complemented by broader efforts to reduce the incentives for these types of illicit trade.

### **Trade Policy as a Tool to Reduce Illicit Trade**

Trade is a driver of global wealth creation, lifting unprecedented numbers of people out of poverty in the developing world. Consequently ensuring smooth and efficient trade flows is a major global priority. Yet contagion of these trade flows by illicit trade poses a challenge. Presently the capacity to prevent abuse of legitimate trade flows to hide



illegitimate trade is severely limited.

The existing WTO framework has limited capacity to take countermeasures against illicit trade, and states' measures to counter illicit trade have on occasion been struck down by the Technical Barriers to Trade Committee. Furthermore plurilateral approaches to establishing new approaches to illicit trade may be of limited value due to the fact that the "troublesome" states are unlikely to want to participate in such initiatives. Even efforts at sharing best practises in relation to TRIPS have historically met challenges, and certain states have emphasised that it is up to each member states how they implement the TRIPS requirements. Consequently the most likely avenue for success in terms of enhancing protection of intellectual property rights will come out bilateral or regional trade agreements with developing countries. As mentioned earlier, the Trans-Pacific Partnership trade agreement is the most recent and significant example of this.

Trade and investment agreements that offer market access should be utilised to place requirements on developing countries that go over and beyond TRIPS as well as ensure capacity building against illicit trade. Such trade agreements with developing countries could be complemented with foreign development assistance dedicated to help achieve these objectives.

Another area of promise might be the Transatlantic Trade and Investment Partnership (TTIP). With the failure of ACTA the European Union and the United States could use TTIP to establish new standards relating to intellectual property and other forms of illicit trade with an ambition that these could become future global standards that could be exported further afield.

## A Broader Coordinated Approach

Professor Louise Shelley, director of the Terrorism, Transnational Crime and Corruption Center (TraCCC) at George Mason University points out the need for a much broader coordinated response involving multiple actors:

*"Rather than a grand strategy, the international community needs a holistic approach. American officials assert that to address crime and terrorism, we need a whole-of-government approach integrating military, law enforcement, and financial countermeasures with development assistance. But this is too narrow a response for the entangled problem of crime, corruption and terrorism, which requires much more than a state response.*

*A whole-of-society approach is needed by both North America and Europe that must work together more closely to address these problems by identifying the trajectory of these current problems. Yet these problems cannot be left to governments*



*alone. They require the participation of multilateral organizations, international and local business, consumers, religious and secular civil society, journalists and international online communications (which have replaced much print journalism), researchers, and educational institutions. Without the participation and cooperation of different communities outside of government forming strategic partnerships, it will prove impossible to counter the corrosive impact of crime, corruption and terrorism.*<sup>159</sup>

The illicit trade driven by transnational organised crime is a global phenomena consisting of enormous numbers of networks intertwined with the legitimate economy and co-opting state actors, even at the very highest levels. There is no global system or institutional framework to deal with this problem from a multifaceted perspective.

The dominant approach has been law enforcement focused. As the war on drugs has shown this has been utterly insufficient, if not counter-productive, in dealing with the problem without supporting programmes addressing the socio-economic incentives underpinning the crimes, and providing protection for its victims. Illicit trade needs to be visualised in such a way as to mobilise multiple actors working in different spaces including amongst other things; trade, development, health, environment, labour standards, and security.

The coordination of these multiple stakeholders with an interest in addressing illicit trade, and their communication needs to be improved. The Ebola crisis in West Africa, and the United States response has raised concerns amongst some within that country over the ability of the "health" and "security" communities to communicate and cooperate effectively with one another. Exactly the same challenge exists relating to illicit trade. Development professionals and law enforcement professionals have completely different experiences, tools and perspectives -- getting them to speak a common language and understand each others objectives is not a natural process. The same applies to the health, trade, security and other communities that need to be engaged in addressing illicit trade.

## **Breaking Silos and Fostering a Network Approach**

At a Global Initiative meeting on Development Approaches to Transnational Crime in November 2014<sup>60</sup>, the German Federal Ministry of Economic Cooperation and Development (BMZ) presented their work to prevent ivory and rhino trafficking in Southern Africa as an example of an approach that draws on the competencies of different German line ministries under one coordinated and integrated programme. The German government invests €500 million annually for the



decade spanning 2010-2020 to protect biodiversity. In the Kavango Zambezi (KAZA) region spanning five southern African countries, Tanzania (Serengeti and the Selous national parks) and Central Africa they see this initiative being entirely undermined by virulent poaching. It was further noted that poaching and the increasing militarisation of both the poachers and the wardens was impacting the tourist trade, with significant impact on local economies and sustainable livelihoods.

In order to address this, the BMZ has invested in a “polifund” project that brings together the competences of different German line ministries in complementary fields of action, based on their own mandates, know-how and specific interests. This innovative integrated programme examined the criminal economy chain of the ivory and rhino trafficking to identify the necessary actions that would need to be taken to sustainably end the practice. It was recognised that strategic interventions would be needed to:

- Strengthen and support the national capacity for management and governance of the protected areas, including through the use of technology;
- Provide alternative livelihoods and incentives for local communities to engage in preventing poaching;
- Work across borders to ensure a uniform and collaborative approach to protect the conservation areas;
- Build the capacity of a range of security actors, from wardens to law enforcement, the police and the judiciary to uphold CITES and national environmental law;
- Address corruption facilitating the poaching and transportation of illegally sourced environmental commodities;
- Raise awareness and attempt to address demand in the main market countries in Asia consuming ivory and rhino products, based on analysis of the factors driving demand;
- Support international cooperation and dialogue between the affected African and Asian countries.

The German Federal Ministry of Economic Cooperation and Development (BMZ) plans to support “polifund” projects in other areas relating to illicit trade. This holistic approach looking to address not just law enforcement issues but also the underlying drivers of illicit trade, working collaboratively with multiple stakeholders, and across borders and continents is an approach to serve as inspiration for other donors.

## Looking Beyond Immediate and Measurable Results

Measuring the impact of anti-illicit trade and corruption



programmes is challenging. Firstly there is a general lack of reliable indicators and data relating to many of the aspects of illicit trade. And secondly, longer term indicators of successful development such as improvements in the Transparency International Corruption Perception Index or the World Bank Ease of Doing Business Ranking may initially suffer as a consequence of focus on anti illicit trade activities. This is neatly illustrated by the high profile efforts to crack down on corruption in China, causing increased awareness and focus on corruption, actually resulting in the country slipping significantly, from 80th place in 2013 to 100th place in the 2014 Transparency International's Corruption index ranking. In the longer term, however, there should however be a pay-off to such efforts. In a slightly different way efforts to reduce illicit financial flows and certain criminal activities may actually have a directly negative impact, at least in the short term, on the World Bank's Ease of Doing Business rankings.

So as results are hard to measure, and certain efforts to address illicit trade and corruption may actually generate apparently negative impact in the short term, it remains key to maintain a long term perspective (which is of course politically more challenging).

## **Mainstreaming Illicit Trade**

As a multifaceted approach addressing the multiple incentive structures relating to illicit trade (law enforcement capacity and policies relating to trade, agriculture, intellectual property, health, defence, taxation, enterprise, etc) is most effective mainstreaming illicit trade as a topic to be considered in the general policy making process would be of significant value. This applies equally to the national policy approaches as well as engagement from international organisations and donor countries.

Individual donor countries should ensure that their development assistance programmes, trade engagement and security & defence cooperation take illicit trade into consideration and that all agencies involved in a particular country coordinate and cooperate on illicit trade.

Several of the UN's Sustainable Development Goals will be hard, if not impossible, to achieve without addressing illicit trade and organised crime. For example; target 3.3—"By 2030 end the epidemics of AIDS, tuberculosis, malaria, and neglected tropical diseases and combat hepatitis, water-borne diseases, and other communicable diseases"—cannot be achieved without sharply reducing the mass trade in false and substandard medication. Likewise targets relating to protecting the marine and terrestrial environments will not be achieved without effectively tackling environmental crimes. The proposed peace and governance goal specifically mentions targets including reduction of deaths and violence,



ending the trafficking of children, significantly reducing arms flows and combatting all forms of organised crime, reducing bribery and corruption, and the development of transparent institutions at all levels. Several other proposed goals will also fail to be met, or be much harder to meet, without generating significant political will to combat illicit trade and organised crime. Consequently as a part of their commitment to reaching the Sustainable Development Goals UN member states must commit to clear and concrete proposals to fight illicit trade.<sup>61</sup>

Another aspect of mainstreaming illicit trade would be to ensure that resource rich organisations targeting issues of public interest address illicit trade challenges threatening their objectives. Malaria provides an interesting example. As has been pointed out by Gaurvika Nayar in the Lancet, fake medication threatens to undermine public health objectives relating to malaria<sup>62</sup>. As a response to this threat the Gates Foundation has funded the establishment of the Counterfeit Drug Forensic Investigation Network to facilitate forensic analysis of suspected poor quality antimalarials. Many NGOs and foundations operating in diverse fields could become better at furthering their objectives by also addressing illicit trade related issues.

## Investment for the Future

Expenditure to reduce crime and illicit flows should not be seen as an expense, but rather an investment to increase tax revenues, reduce costs of crime and improve the return on government expenditure which can then be used for socio-economic investment and other development objectives.

Considering that the European Union and its member states contribute the majority of global development assistance, it is noteworthy that the Commission's Instrument contributing to Stability and Peace (IcSP) is dedicating relatively limited resources towards long term capacity building against organised crime, and those are predominantly focused again on drug control, or on terrorism related transnational organised crime. Considering that the EU's budget for external relations (including development assistance) and the 11th European Development Fund together exceeds €80 billion for the period 2014-2020, a lot more could be done.

Within the ambit of the EU's Trade directorate and investments in developing economies, significantly more could be spent on capacity building dedicated to reducing illicit flows, and the scope should be expanded to cover broader categories of crime, particularly including the massive illicit trade in counterfeit and excise goods.

Considering the current situation, with the Southern EU states under significant fiscal pressure coinciding with significant instability in the EU's immediate neighbourhood resulting in increased illicit flows of commodities and human smuggling



across the Mediterranean, there should be a strong political interest in reducing illicit flows into the EU. This evident self interest in addressing illicit flows could serve as a facilitating argument in convincing the EU and its member states to escalate their efforts against international illicit flows and exporting relevant capacity abroad. In this context it is noteworthy that illicit flows across the Mediterranean often originate further afield.

### **Limiting Illicit Financial Flows**

The International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation have been endorsed by over 180 countries. Yet according to the OECD publication *Measuring OECD Responses to Illicit Financial Flows from Developing Countries*, published in 2013, average compliance amongst OECD states leaves significant room for improvement.<sup>63</sup>

This implies that there is an onus on the OECD countries to get their own house in order, which is a prerequisite for being able to place stronger pressure on developing countries to improve their own compliance.

### **Technological Opportunities and New Global Standards**

With the advent of new and low cost technological solutions to ensure supply chain track and trace capacity, product authentication and traceable digital transactions much more can be done to raise the barriers to illicit trade, particularly of normally licit goods. The possibility of states to collectively set new standards, which may one day become global standards, provides an opportunity that must not be neglected. For the EU and the US the ongoing Trans-Atlantic Trade and Investment Partnership (TTIP) negotiations may present an opportunity in this context.

The Framework Convention on Tobacco Control Protocol to Eliminate Illicit Trade in Tobacco Products will make track and trace requirements down to individual pack levels on tobacco products obligatory. Should the new requirements prove effective in reducing illicit trade it could make sense to expand similar requirements to other categories of products subject to extensive contraband trade.

A key area to watch in terms of future technology is the digital arena. Changes in online trade have had revolutionary consequences for legitimate commerce, but also for illicit trade. And the replacement of physical products with digital content has had even more far reaching implications for the affected sectors, something which is likely to affect more and more areas as 3D printing takes off. The growth of the so



called dark web and increasing use of cryptocurrencies will also require countermeasures to prevent their abuse in order to facilitate illicit trade.

Beyond the online arena it will also be important to assess standards both for other private sector services that can be leveraged for illicit trade purposes, as well as core trade infrastructure such as ports and airports.

## **New Global Requirements Regarding Counterfeits**

Firstly, there is no global system for mandatory reporting, assessment and dissemination of information on several types of counterfeit products. Secondly, many countries do not have legislation requiring industry to inform the relevant regulatory authorities of counterfeit products which pose a risk to human health or safety. Thirdly the extradition and prosecution of criminals trading in counterfeits, even if posing potential danger to users, is extremely difficult as it is not an international crime. All of these three problems apply to pharmaceuticals and several other sectors where fakes can have deadly consequences. The international community should consider addressing the aforementioned shortcomings in areas where there are potential dangers associated with counterfeit products. Additionally increased penalties for counterfeiting, especially when risk to human health may result, could be pushed as a higher priority on the global agenda.

## **Capacity Building Assistance**

Facilitating international cooperation is certainly desirable, but national capacity to deal with illicit trade nonetheless remains critical. Hence focus needs to lie on enhancing state capacity to deal with illicit flows. The dilemma being that the states least resilient to illicit flows are the ones worst affected. A part of the solution is for other, more capable states, to export illicit flow resilience to where it is needed, either directly through bilateral assistance, through multilateral organisations and/or through other states or organisations.

For such assistance to be effective it requires that the recipient state is genuinely interested in addressing the problem, and that the approach taken is broad enough to take into consideration all incentive structures in place (such as the legal framework, law enforcement capacity, trade policy, excise regimes, agricultural and environmental policies, public health, and the broader security environment). A robust law enforcement capacity is relatively ineffective as long as there remains strong incentive structure in place enticing illicit trade. For example if policies distort market prices and create significant price differentials across borders it will inevitably

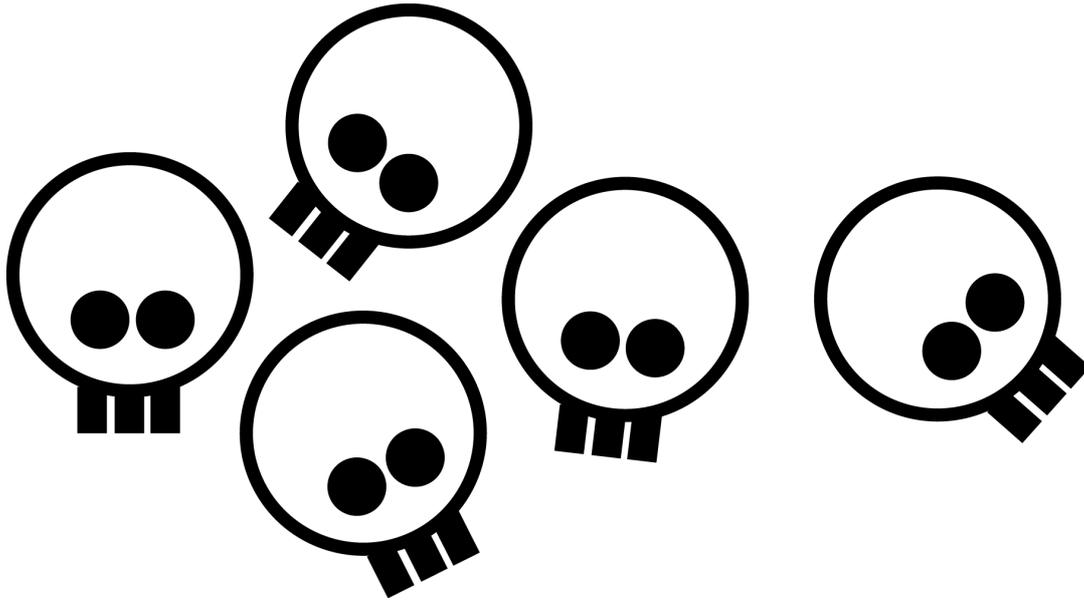


create illicit trade, in a comparable way to which prohibition incentivises the narcotics trade through the possibility of earning super normal profits.

### **A Two-Pronged Approach: Pick the Winners and Use Civil Society to Keep Them in Line**

The reality in large parts of the world is that elite complicity is driving illicit trade. Consequently development assistance intended to build capacity against illicit trade is likely to be most effective where there is a genuine political will to address the problem. It also means that the approach of building state capacity needs to be complemented by building robust civil society platforms that will contribute to ensuring long term public awareness and political will against corruption and illicit trade. Strong NGOs and independent investigative journalists who act as whistleblowers will help ensure a genuine and lasting will to address illicit trade by increasing the political costs of corruption.





## Conclusion

It is apparent that expenditure of effort to reduce illicit trade is very low in proportion to the destructive impact the phenomenon has on security and development. Yet as illicit trade is so multifaceted, individual states wishing to address it need to select specific areas of focus. Within international fora the distribution of specialised national focus areas could perhaps be coordinated, in order to avoid duplication of efforts and to ensure a holistic coverage of the broad range of different forms of illicit trade that exists.

As this report points out one of the opportunities presenting itself as “low hanging fruit” is to address illicit trade in goods that replace normally licit goods. The turnover of this trade is enormous, yet the current legal frameworks and law enforcement prioritisation make this a low-risk/high-profit proposition for organised crime. Consequently focusing efforts on this form of illicit trade is likely to yield relatively more significant results, as the starting point is so low, compared to other forms of illicit trade. In addition, addressing this problem would beyond the direct benefit to the concerned developing states also indirectly benefit potential donor states, which have a self interest in targeting counterfeiting which hurts their export industries. Rather than seeing this self interest as something negative it should be seen as an asset by the development community, enabling it to mobilise broader support in its efforts to address an important obstacle to development. Furthermore the synergies existing between different forms of illicit trade, would mean that greater focus on the illicit trade in “normally legal goods” would also benefit broader law enforcement and security concerns in terms of



“higher priority” forms of organised criminal activity.

Irrespective of the chosen focus areas, and type of response to illicit trade, it is clear that there is not a shortage of new potential initiatives to redress the neglect that this important policy space has been subjected to.



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