

ILLICIT TRADE FLOWS

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HOW TO DEAL WITH THE NEGLECTED ECONOMIC AND
SECURITY THREAT

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HOW TO DEAL WITH THE NEGLECTED ECONOMIC AND SECURITY THREAT



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- Illicit trade flows generate massive costs for the EU, yet the countermeasures have been inadequate. A shortage of data, the tendency to look at different forms of illicit trade as separate phenomena, and the complexity of the problem have led to an under-prioritisation of illicit trade among policymakers.
- Globally, the illicit trade in products that replace those that are generally licit (such as counterfeit goods and contraband excise goods) represents the biggest monetary turnover and hurts government and corporate revenues directly. Still, it is particularly under-prioritised.
- Synergistic effects for smuggling different items relate to the fact that there are over one thousand international poly-crime groups operating in the EU, the same smuggling routes can be used for different commodities, and the same corrupt officials or purveyors of false documentation can deliver their services to multiple “operators”.
- Illicit trade also makes the EU more vulnerable to terrorist attacks. It finances terrorist organisations, and well-established smuggling routes make the borders more porous.
- To address the problem, better data need to be generated showing its extent and impact. Taking a holistic view of the various aspects of illicit trade is important to facilitate coordination among the relevant authorities. The costs of this work represent investments which – beyond enhancing security – will generate income by boosting tax revenues, reducing crime, creating jobs and driving economic growth.

The Global Security research programme
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Global illicit trade has exploded over the last 20 years. The UNODC estimated in 2009 that the turnover of transnational organized crime was about USD 870 billion, but accounting for global economic growth and inflation the figure should now exceed one trillion, which can readily be compared with the global licit trade figure of about USD 18 trillion. Illicit trade is thus not just the ugly underbelly of the global economy, but a significant part of it. Globalisation has not only helped accelerate this illicit trade, but the interdependence it has brought about also makes societies more vulnerable to its harmful effects, even when it involves activities on the other side of the globe. For the EU, these illicit trade flows not only incur massive costs for the economy and member-state tax revenues, but also give rise to major social ills, environmental degradation and potential security risks.

Yet, despite the negative consequences of illicit trade, surprisingly little has been done to address the challenge. Illicit trade has simply not been a priority for policymakers. There are several explanations for this, including a shortage of solid data, a tendency to look at different forms of illicit trade as separate phenomena (despite overlaps), and the complexity of the problem. Taken together, these factors make it hard to prioritise illicit trade in the political arena. To complicate the situation further, addressing the problem requires the effective coordination of multiple authorities, in both the national and international arenas – something that will not happen as long as the phenomenon remains poorly understood.

The purpose of this paper is to provide a holistic perspective on the different aspects of illicit trade, focusing primarily on how it affects the EU, and to provide some recommendations on how to deal with this global phenomenon.

The scale of illicit trade

Illicit trade comprises both the trade in illegal goods and services, as well as instances when normally legal goods are traded illegally. These activities affect almost all aspects of the global economy. Its components include narcotics, counterfeiting and different forms of intellectual property crimes, substandard consumer products and foods non-compliant with safety standards, human trafficking, the smuggling

of excise goods, environmental crimes (including illicit logging, fishing, poaching, and toxic waste disposal), and the contraband trade in weapons and potentially dangerous dual-use technologies.

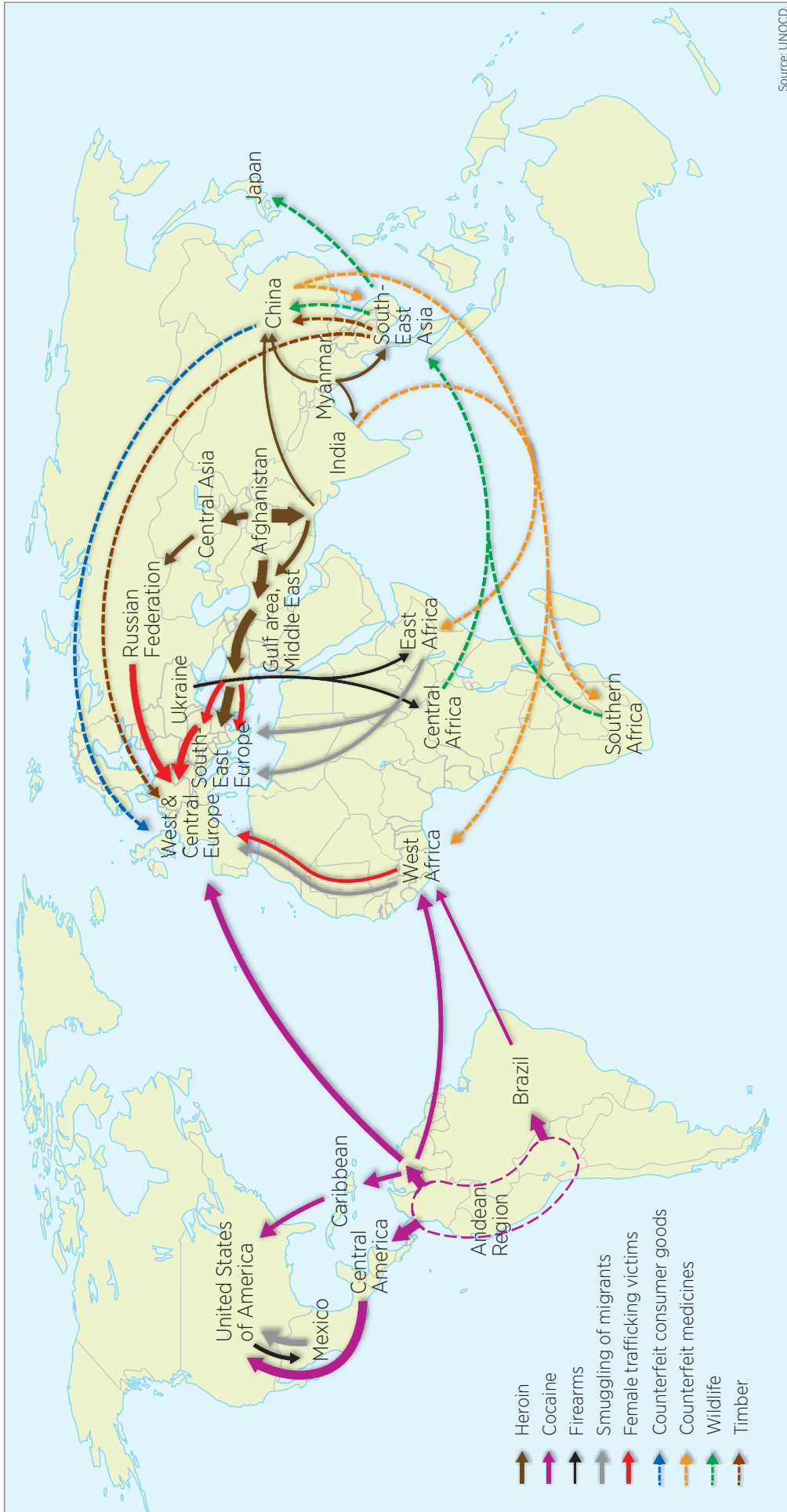
Counterfeit goods

The trade in counterfeit goods has not featured high on the global policy agenda, but it is one of the most lucrative illicit markets. According to Jeff Hardy of the International Chamber of Commerce (ICC), “The potential profit margins are very attractive, yet the legal consequences are lower than for other crimes. Every sector is affected. Almost any product you can imagine is being counterfeited, from anti-malaria medication to aircraft components”.¹ Yet, the scale of the problem has not been well documented. The ICC estimates that the global illicit trade in counterfeit goods was worth USD 455–650 billion in 2008, causing 2.5 million job losses in the G20 countries alone. According to the ICC forecast, the market for counterfeit and pirated goods will continue to expand rapidly, reaching USD 1.2–1.8 trillion by 2015. This figure has been criticised as excessively high, but even assuming it is an overestimation, it is clear that counterfeiting is a problem of considerable proportions.

Europe is a major destination for counterfeits, and the number detected at the European borders has increased markedly in recent years. In 2002, the annual number of registered IPR infringement cases with EU customs authorities was 7,553. By 2012, this figure had increased to 90,473. Anecdotal evidence collected by the authors of this paper would suggest that most national governments in the EU are ineffective at preventing this illicit trade, and appear to fail to understand its importance, consequently giving it insufficient political prioritisation. However, for all forms of illicit trade that essentially substitute goods for existing legal goods – such as counterfeited/pirated products and contraband excise goods – it is clear that the government loses tax revenues. The counterfeiting of European intellectual property also incurs huge costs for the European economy. As Benoît Battistelli, President of the European Patent Office, explains: “One in three jobs in the EU today is created in industrial sectors with an above average use of IP rights. These sectors account for almost 40% of the GDP and 90%

¹ Personal communication, 27 November 2013.

Main global illicit flows



Map 1. Main global illicit flows. Map: Kauko Kyöstiö.

of exports of the EU. They are a pillar of the competitiveness of the European economy at the global level. It is necessary, therefore, to improve and strengthen the use of IP rights not only in Europe, but also internationally.”²

In terms of pirated and counterfeited consumer goods (not subject to excise tax), the total black market turnover is likely significantly higher than excise goods, but the tax loss to the state is proportionately lower (although possibly higher in total). Goods infringing IP rights seized by customs at the EU border in 2012 had a total retail value of around one billion euros, according to the European Commission, but this gives little indication of the scale of the problem, as interception is difficult due to the problems entailed by customs in determining the illegality of what appears to be legitimate consumer goods.³ Europol states it is a relatively low-risk activity involving high profits, and will as such increasingly attract organised crime groups previously involved in other criminal activities.

Naturally, economic losses incurred by the EU are not only due to the sale of counterfeit goods inside the Union. As a large number of the world’s leading global trademarks and patents are owned by European companies, there are also significant losses incurred by the extensive illicit trade in counterfeit goods in Africa, Asia, Eastern Europe and the Americas. Such figures have not been quantified at present – which makes it hard for policymakers to adequately take this into consideration.

Health is also put at serious risk by counterfeits in a range of sectors. Of particular concern are foodstuffs and medicine. Over 1,200 tonnes of fake or

substandard food and 430,000 litres of counterfeit drinks were seized in one single Europol-Interpol operation conducted in December 2013 and January 2014. The illicit medicine market in the EU is estimated by Pierre Delval of the OECD Task Force on Charting Illicit Trade to exceed USD 1.6 billion annually, and over USD 47 billion globally.

Narcotics

Along with counterfeiting, there is a huge black market for narcotics, worth globally around USD 320 billion per year. Of this, the value of the global cocaine market is estimated at USD 88 billion. In Europe, the growth of this market has been rapid, up from USD 14 billion in 1998 to USD 34 billion, almost on a par with the US market. Over the same time period, the number of European users has doubled to around 4.1 million, consuming approximately 124 tons of cocaine. The cocaine enters Europe from South America mainly by sea routes, with Venezuela in particular emerging as a key transit country, together with Brazil and the West African region. This contrasts with the smuggling of heroin into Europe, which still seems to be transported by land from the “Golden Crescent” (i.e. Afghanistan, Iran and Pakistan) via Turkey and through South-East Europe. The European Monitoring Centre for Drugs and Drug Addiction estimates the value of the Western European heroin market at USD 20 billion, with 87 tons of heroin fuelling the habit of approximately 1.4 million individuals. The social and economic costs to Europe of this flow of illicit drugs include crime, drug-induced deaths, health costs, drug treatment, and the cost of enforcing drug offences. In 2011, at least 1.2 million people received treatment for illicit drug use, and EU drug intervention costs were estimated at eur 34 billion. This estimate does not include the broader social impacts of drug-related crime and misuse.

Human trafficking

One of the most repugnant illicit trades flourishing today is that of human trafficking, the figures for which are without precedent in history and growing rapidly.⁴ In 2005, the ILO estimated that between

2 Personal communication with EPO, 25 November 2013.

3 It was estimated at USD 8.2 billion per year by the UNODC a few years ago based on consumer surveys. However, respondents in consumer surveys are likely to under-report their own illegal or unethical behaviour. Additionally, consumers of counterfeit goods are frequently unaware that they are buying an illegal product. Regarding seizure statistics for counterfeits, it should be borne in mind that in relation to other illicit goods they are not prioritised, and distinguishing between legitimate and counterfeit consumer goods is frequently a very difficult task for customs. Consequently, the real figure for counterfeiting in Europe is likely significantly higher than the UNODC estimate.

4 The authors do not intend to equate human trafficking with illicit trade in physical commodities, but several different types of illicit trade are included, as the aim of this paper is to show how the different aspects of illicit trade are often interconnected and better viewed from a holistic perspective.

1995 and 2004 there were 12.3 million people in forced labour situations, of which 2.4 million were trafficked internally or internationally. Annual earnings from this trafficking were estimated at USD 32 billion. Seven years later, in 2012, the ILO updated the estimate of global forced labour to 20.9 million. This estimate also includes victims of human trafficking for the purpose of sexual exploitation. Assuming that the proportion of victims stays constant, the number of trafficking victims could be estimated at 4.2 million persons, providing a total annual turnover of USD 66 billion in 2012.⁵

Human trafficking knows no geographical boundaries with respect to sources or destination markets. In the period 2007–2010, victims of 136 different nationalities were detected in 118 countries across the world. Yet, from these flows crisscrossing the globe some more general patterns can be discerned. Generally, victims are trafficked from relatively poorer areas to more affluent ones, with Western and Central Europe serving as a key destination for these flows. The UNODC estimates that there are 140,000 trafficking victims in Europe, suffering on average two years of exploitation, which suggests around 70,000 new entries every year, generating an estimated gross annual income of USD 3 billion.

In 2012, the ILO estimated that close to a million people are working in forced labour in the EU, of which about 30 per cent are involved in prostitution. Many of the victims are from outside the EU, or from the poorer member states. The EU's Clandestino project estimated that back in 2008 there were between two and four million "irregular foreign residents". Other estimates put the figure of irregular migrants at 8 million, but there are no estimates of the annual flows of irregular migrants crossing the border illegally.

The above figures do not include the market for people who willingly pay to illegally enter another country through smuggling. Eurostat reported that there were over 300,000 asylum applicants in the EU in 2011, many of whom would have been illegally smuggled into the Union. On top of this there are, of

course, many immigrants who are neither trafficked nor apply for asylum, but who have illegally entered the Union and live an undeclared existence. The result is a significant market for human traffickers and smugglers. The present instability in the EU's immediate neighbourhood, fed by the fallout from the Arab Spring, is boosting this ever-increasing demand further. Both Syria and Libya are key factors. The instability and collapse of state authority in Libya has "re-activated" this country's role as a major transit point for human smuggling. At the same time, the civil war in Syria has increased the demand for clandestine entry into Europe.

Firearms, excisable goods and environmental resources

Other illicit trade includes firearms, excisable goods and environmental resources. The global black market for firearms is estimated at between USD 170–320 million per year according to UNODC. There are no comprehensive estimates for the turnover of illicitly traded excise goods (primarily tobacco, alcohol, and petroleum products), but the annual global tax losses on tobacco alone are estimated at USD 40–50 billion, representing hundreds of billions of illicit cigarettes.

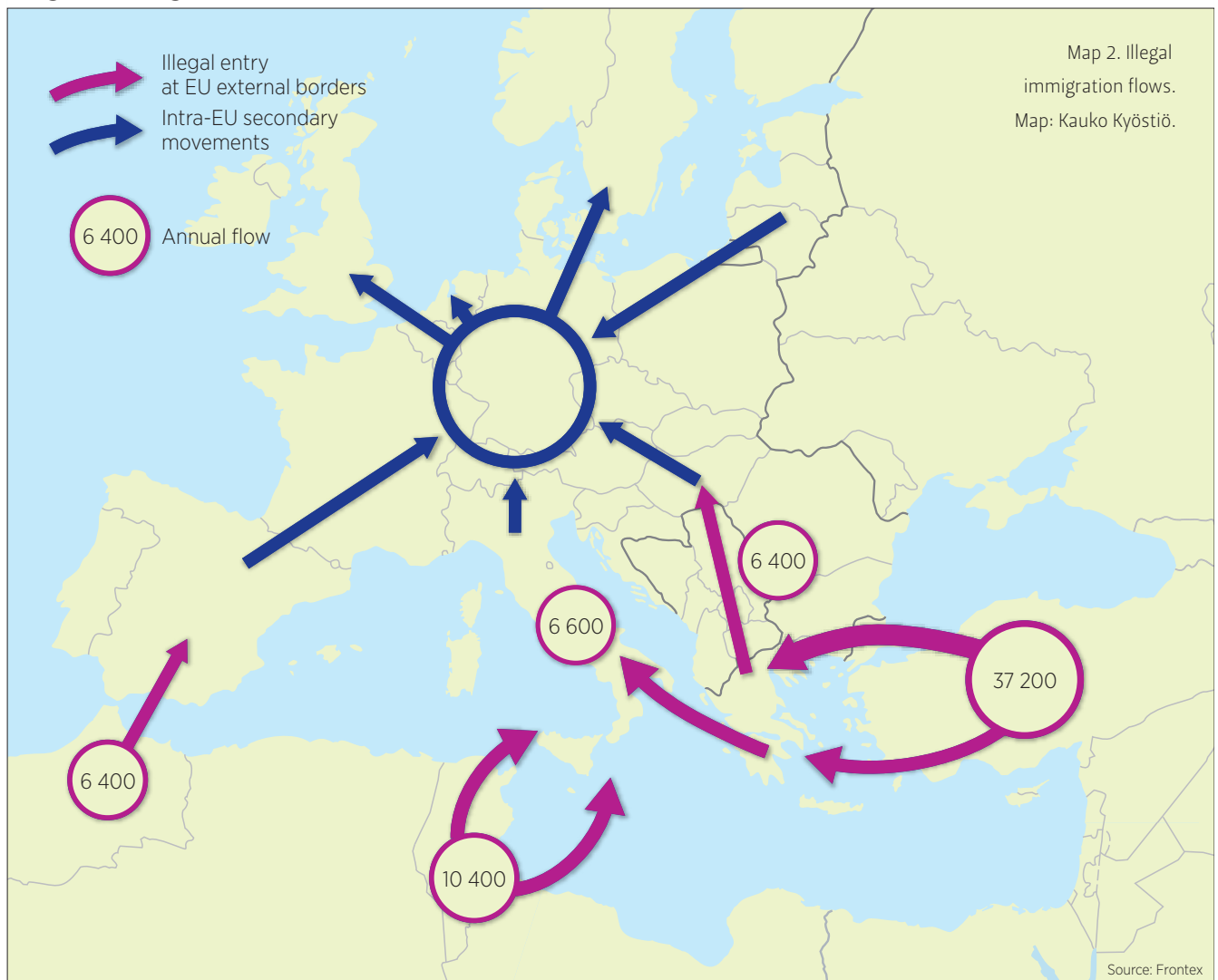
The significance of the illicit petroleum trade is best illustrated by the extreme example of Nigeria. The annual value of diverted oil in Nigeria alone is estimated at USD 3–8 billion, funding criminals and militants that are also involved in piracy, kidnapping, the drugs trade and arms trafficking.⁶ The illicit trade related to hazardous waste as well as to the illegal harvesting of natural resources, particularly timber and fish, has been aggregated in a recent paper to give a turnover of approximately USD 50 billion per year.⁷ The impact of this form of illicit trade is particularly serious as ecosystems are negatively affected for a very long period of time. For example, the mass-scale dumping of toxic waste, reportedly by the Camorra, in the area around Naples is expected to have an impact for generations

5 Based on the authors' calculation from ILO figures and factoring in USD inflation. ILO Facts & Figures available at: <http://www.ilo.org/global/topics/forced-labour/lang--en/index.htm>. Date accessed: 11 March 2014.

6 Christina Katsouris and Aaron Sayne (2013): *Nigeria's Criminal Crude: International Options to Combat the Export of Stolen Oil*. London: Chatham House.

7 Justin Picard (2013): 'Can we Estimate the Global Scale and Impact of Illicit Trade?' *Convergence: Illicit Networks and National Security in the Age of Globalization*. Washington DC, National Defense University Press.

Illegal immigration flows



to come. Disentangling licit from illicit in this area is often difficult, as the legality of shipments is based on paperwork that can often be fraudulently obtained from corrupt officials.

KPMG's Project Star estimates that in 2012 the EU member states lost 12.5 billion euros in excise revenue due to illicit tobacco alone. The WHO estimates that approximately 13 per cent of EU alcohol consumption is unregistered, and based on this and the national excise data from the European Commission, it generates tax losses exceeding 4 billion euros on alcohol tax alone. This figure will be much higher if VAT is included. Petroleum products are another commodity type subject to excise taxation. The Frontex 2013 Annual Risk Analysis ascertained that this trade is concentrated on the EU's Eastern borders with the former Soviet Union and Yugoslavia. In Bulgaria, it has been estimated by the Centre for the Study of Democracy that 11 per cent of the

turnover from organised crime in the country comes from illicit trade in petroleum products.

In addition to the lost tax revenue, a further critical factor is that consumers are exposed to health risks through dangerous products. One example is the counterfeited rum containing methanol which recently killed 30 people in the Czech Republic. There are also studies indicating that counterfeit cigarettes are even more harmful than regular ones. The illicit trades in tobacco and alcohol are also major sources of income for criminal and terrorist groups operating in Europe and beyond.

Calculating the total economic impact of all illicit trade is "mission impossible" considering the lack and unreliability of data. However, an attempt to do so has been made by Justin Picard. By assessing five major categories of illicit trade, estimated (conservatively) to have an economic turnover of

approximately USD 300 billion, the impact was estimated at USD 1.5 trillion – five times higher.⁸ This “impact factor”, and the fact that all forms of illicit trade have not been covered above, should be borne in mind when considering the effect of illicit trade on the EU and other economies.

Illicit trade and security

According to David Luna, Chairman of the OECD Task Force on Charting Illicit Trade, 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.” As black markets are the lifeblood of organised crime, and to a large extent terrorism, it is also clear that illicit trade poses a grave threat to the security of the EU.

According to Frontex, over 100,000 illegal border crossings are detected every year in the EU. The massive scale of this illicit movement of people provides profitable opportunities for organised crime groups and helps establish criminal routes and routines. It also heightens the risk of terrorist attacks in Europe. 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.

Europol estimates that of the 3,600 international criminal organisations operating in the EU, over a thousand are so-called poly-crime groups, suggesting that synergies exist in trading different illicit items. The UNODC states that poly-crime groups involved in trafficking in persons are often linked to drug trafficking and other smuggling, and

Frontex has for example reported that humans and tobacco have been smuggled together. In addition, there are law enforcement suspicions that boats smuggling humans into the EU also carry narcotics. The 700-metre-long tunnel equipped with its own narrow-gauge railway under the Slovak-Ukrainian border, discovered in 2012 with millions of smuggled cigarettes, could clearly be used for other goods, as well as people. Beyond such direct synergies, profits generated from smuggling can also finance the expansion of completely separate, and potentially much more violent, criminal activities. This also applies to terrorist organisations. Be it cocaine shipped to Europe, generating revenues for the FARC movement, Taliban attacks against ISAF troops indirectly financed by European heroin addicts, or the Real IRA’s earnings from tobacco smuggling and fuel laundering, terrorists often use criminal networks for logistical support and funding. The Madrid bomb attacks in 2004, which were funded by money obtained from drug trafficking, underlined the crime-terror nexus as a growing security concern for the EU.

Illicit trade networks may also facilitate the proliferation of weapons of mass destruction (WMDs) explains Brian Finlay, managing director at the Stimson Center:

“Although we have yet to see the widespread evidence of a common clientele between WMD items and other contraband, increasing participation of criminal actors in proliferation networks demonstrates that the supply chain connecting dual-use producers to dual-use recipients does share common pathways with other illicit items. North Korea, for instance, has developed a significant non-nuclear covert smuggling capability that has also aided in the transfer of sensitive items into and out of the country. Similarly, despite significant economic sanctions, the Government of Iran has managed to rely upon similar networks to obtain critical technologies for their uranium enrichment program. And while drug smugglers are never likely to become nuclear terrorists, the illicit transportation networks that they have built have been unwittingly leveraged in support of state-based proliferation programs.”⁹

8 See Picard: ‘Can We Estimate the Global Scale and Impact of Illicit Trade?’

9 Personal communication, 24 January 2014.

Illicit trade is inextricably linked to corruption, the absence of the rule of law, and a lack of development. The UN General Assembly recognises that organised crime and illicit drugs are a major impediment to the achievement of the Millennium Development Goals, and that both illicit trade and the corruption it causes can have an excessively destabilising effect on post-conflict or economically fragile states. Consequently, the UN recognises that countering such crimes must form a central pillar of the development agenda. Research also suggests that civil wars where belligerents are fuelled by high-value contraband trade last significantly longer than such wars on average. Afghanistan, a country where Western nations have been significantly involved since the early 2000s, is a case in point – extreme, but far from unique. Addressing illicit trade must be central to any solution to the situation in the country, where the value of the opium trade alone has been estimated to constitute one third of GDP, although this problem is further compounded by other illicit trade activities.

Conclusions

Illicit trade is nothing new, but its significance is growing, and it has been under-prioritised for too long. Three underlying causes explain this systemic under-prioritisation. Firstly, as it concerns secret activities, the available data are limited – it is hard to prioritise something that we do not have information on. For the losses incurred by business, the problem is compounded by the fact that companies that are victims of counterfeiting are reluctant to speak openly about their problems, as it may reduce customer confidence in their products. Secondly, a number of actors share the responsibility for dealing with various aspects of illicit trade, meaning that no one assumes overall ownership of the issue. To compound this, the aforementioned lack of data makes it far easier not to acknowledge responsibility. Thirdly, illicit trade is dealt with as numerous separate issues (human trafficking, contraband tobacco, narcotics, food safety, corruption, proliferation, etc.) as opposed to being seen holistically as an interconnected mega-problem. Several component aspects of illicit trade – such as non-lethal counterfeit goods – will logically never be prioritised unless viewed from a holistic perspective through which their economic significance and interconnectedness with other more dangerous phenomena becomes clear.

At the international level, the first meeting of the OECD Task Force on Charting Illicit Trade in 2013 is a testament to the growing appreciation of the need for a holistic perspective on the problem. At the European level, the European Parliament's initiation of the 18-month "Organised Crime, Corruption and Money Laundering" committee in 2012 also indicates a gradual awakening to the problem in Europe. Yet, concrete action also needs to be taken at the national level in order to shed light on these black markets and facilitate a holistic perspective.

This paper suggests three initiatives to this end. First, the business impact of illicit trade should be measured or quantified. In terms of turnover, the largest form of illicit trade by certain estimates is counterfeiting and intellectual property theft. Yet, this is one of the least understood problems, with poor data and little awareness of the macro impact at a national level. The Japan Patent Office publishes an annual Survey Report on Losses Caused by Counterfeiting. Over 4,000 companies provided responses in 2012, with 23.4 per cent indicating that they suffered losses due to counterfeiting. These are very elementary data, but they do provide an indication of the commercial magnitude of the problem. Consequently, the Japanese government has the underlying information empowering it to prioritise the fight against counterfeiting – which it also does.

The EU lacks comparable data and consequently there is no appreciation of the scale of the problem. Present efforts by the EU Observatory on Infringements of Intellectual Property Rights to conduct a survey targeting companies in the EU are hence very welcome. There are however concerns that a simple questionnaire will generate only a limited response. A more productive approach might be to target a smaller number of companies for in-depth interviews concerning losses due to illicit trade. Constituent companies of leading stock market indices would be the logical targets. Collected data would be kept anonymous to encourage information sharing in order not to hurt the trademarks or other interests of individual companies. The data from the constituent companies of the index would then be aggregated to provide a total assessment for an entire index. Such a project has been presented to the OECD Task Force on Charting Illicit Trade and is planned using the Stockholm OMX 30 stock index as a pilot market. The project could be replicated on a larger scale across other indices.

Second, national illicit trade reports should be compiled. Aggregated reports on the different forms of illicit trade in a jurisdiction will provide an overall picture of the black market situation in a country. Such a report should consist of numerous short chapters assessing illicit trade, its impact, and possible solutions compiled by relevant government authorities, business associations, consumer organisations, trade unions and civil society organisations – and edited from a holistic perspective. The report would help national policymakers contextualise the multifaceted problems of illicit trade and empower adequate prioritisation.

Third, a study of illicit trade scenarios ought to be conducted. Shedding light on the implications of novel technologies and scientific developments for illicit trade is critical to adequately prioritise for the future. How could developments lead to new ways of conducting and combating illicit trade, and create new illegal products and services? Looking beyond the horizon to identify threats and opportunities ahead is essential to pre-empt novel future challenges. The traditional law enforcement approach of reactively responding to new crime problems will be too costly considering the rapid pace at which illicit trade has evolved in recent years. Shedding light on the possible illicit trade scenarios is a prerequisite for both national governments and the international community to be able to mobilise ahead of the problem.

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