UNCTAD Illicit Trade Forum

3rd to 4th February 2020

Room XXVI, Palais des Nations, Geneva

Background Note

Illicit trade significantly endangers achievement all of the United Nations Sustainable Development Goals (SDGs). It creates a triple threat to the financing of development: crowding out legitimate economic activity, depriving governments of revenues for investment in vital public services and increasing the costs of achieving the SDGs by eroding the progress already made.

For these reasons, UNCTAD will host the Illicit Trade Forum, in collaboration with the Transnational Alliance to Combat Illicit Trade (TRACIT).

The Forum will be held over two days, featuring four session intended to set out the main reasons why governments should prioritize actions to combat illicit trade and convey the importance of intergovernmental leadership to coordinate resources, share expertise, establish guidelines and promote international enforcement cooperation among United Nations Member States.

Session 1: Understanding the size and shape of illicit trade

Criminal networks actively engage in illicit trade on every continent and in every major economy, with adverse economic, social, environmental and even political impacts that are detrimental to sustainable development. Industries suffer lost business and governments lose out on job opportunities and much needed tax revenues, which has a negative impact on the quality of public services. The effects of illicit trade are also felt in the costs of law enforcement, incarceration and rehabilitation. Over the longer term, illicit trade also undermines trust in government and contributes to a declining trust in public institutions, undermines the rule-of-law, erodes human capital, deters foreign investment and deteriorates public health. To mitigate this global risk, governments need a firmer understanding of the magnitude and nature of illicit trade's impacts on economic activities, and a clearer understanding of the conditions that enable it.

By its very nature, illicit trade is difficult to both identify and quantify. It is hard to estimate with precision an activity that is intentionally conducted in a clandestine manner, and an even greater challenge to measure its socio-economic and environmental impacts. Other challenges include agreeing on a common set of definitions on what "illicit trade" is, let alone the metrics to quantify the damages. However, without this information it is difficult for appropriate policies to be designed and implemented to tackle this scourge.

While data on illicit trade is relatively scarce, there is mounting evidence of the economic, social and environmental losses it can cause. Several international organizations have measured the proceeds of organized crime for different product classes and according to different methodologies, often resulting in a range of estimates on the monetary value of illicit markets. These figures, although only approximations, provide a broad indication of the extent and magnitude of the threat.

- According to the World Economic Forum, economic leakages from illicit trade create an annual drain on the global economy of US$2.2 trillion – nearly 3% of the world's economy. If illicit trade was a country, its economy would be larger than Brazil, Italy and Canada – and as large as Mexico and Indonesia combined.
- Illicit flows resulting from transnational crime – such as arms, tobacco or pharmaceuticals smuggling – are valued at an average of US$1.6 trillion to US$2.2 trillion annually, according to Global Financial Integrity (GFI),[1] which is nearly the size of the United Kingdom's gross domestic product (GDP).[2]

Even when looking at the problem on a purely sectoral basis, the size and values are staggering.

- According to the OECD and the European Union's Intellectual Property Office, the trade in counterfeit goods has intensified to unprecedented levels, reporting a 154% increase from US$200 billion in 2005 to US$509 billion in 2016. Trade in counterfeit and pirated goods now stands at 3.3% of all global trade.
- The International Labour Organization (ILO) and the Walk Free Foundation (WFF) estimate that 24.9 million people are victims of forced labor globally.[3] According to the ILO, trafficked forced laborers produce a total illicit profit of US$150 billion per year.[4]
- INTERPOL reports that the trade in illegally harvested timber is between US$51 billion and US$152 billion annually, making it the world's most profitable natural resource crime.[5] This figure does not take into account the reduction in legal timber prices caused by illegal logging, which is estimated to be between 7% and 16%.[6]
- Illicit trade in tobacco represents 10 to 12% of global tobacco consumption, with an estimated illicit volume of up to 600 billion illegal cigarettes.
- According to Euromonitor's 2018 Global Study on Illicit Alcohol, 1 in 4 alcohol bottles are illicit, representing 25.8% of all global consumption.[7] These findings correspond to World Health Organization (WHO) estimates that unrecorded alcohol accounts for 25.5% of total worldwide adult alcohol consumption and is projected to increase to 27.7% in 2020.[8]

While figures on the size of illegal markets are elucidating, the hidden nature illicit trade nonetheless means that the current metrics for estimating them usually involve proxies that depend on indirect information gathered from customs seizures, industry reports, law enforcement actions and court decisions. Differences in measurement valuation methodologies presents challenges for comparative analyses of illicit markets. Focusing solely on the capital that illicit trade generates for criminal networks also disregards negative externalities on economic stability, social welfare, deterioration of public health and public safety and environmental degradation. Further, gathering and sharing data under appropriate frameworks requires the investment of significant resources by member States and stakeholders.

This session will discuss the different ways in which illicit trade impacts different countries and stakeholders. By drawing attention to the scope of illicit activities and the interconnections between them, the intergovernmental community can also help countries focus and co-ordinate efforts to drive criminal entrepreneurs and illicit networks out of business. Evidence-based research allows policy makers to make informed decisions on ways to address gaps and develop more effective tools to combat illicit trade.

Session 2: The impacts of illicit trade on achieving the SDGs

From smuggling, counterfeiting and tax evasion, to the illegal sale or possession of goods, services, humans and wildlife, illicit trade is compromising the attainment of economic and sustainable development goals in significant ways, crowding out legitimate economic activity, depriving governments of revenues for investment in vital public services, dislocating millions of legitimate jobs and causing irreversible damage to ecosystems and human lives. Most importantly, illicit trade undermines good governance, erodes trust in government and the rule of law. It threatens political stability as its economic actors use bribery and undue influence to deflect unwanted attention, protect their illegal market share and undermine public sector integrity.

A dark side to globalization has been the alarming emergence of illicit trade, which significantly endangers all aspects of the SDGs. Based on the research undertaken by the Transnational Alliance to Combat Illicit Trade (TRACIT), the socio-economic impacts of illicit trade significantly impair the achievement of all 17 SDGs. For example:

- Medicines with no active ingredient and toxic illicit alcoholic beverages set back progress on SDG 3's goals for good health and well-being.
- Food fraud, commodity smuggling, and illegal agrochemicals undermine sustainable farming, limit crop yields and jeopardize delivery of fair, safe and sustainable food supplies, slowing progress on SDG 2's goal for zero hunger.
- Illegal logging destroys the carbon sink capacity of forests and restricts achievement of SDG 13's goal to end climate change.
- Illicit wildlife trade is almost entirely responsible for pushing some of the world's species to the brink of extinction and robs countries of their natural heritage, undermining SDG 15's goals to preserve life on land.

Illicit trade creates a triple threat to the financing of development by crowding out legitimate economic activity, depriving governments of revenues for investment in vital public services and increasing the costs of achieving the SDGs by eroding the progress already made. This is especially important in the light of the 2019 Financing for Sustainable Development Report, which warns that mobilizing sufficient financing remains a major challenge in implementing the 2030 Agenda and that investments that are critical to achieving the SDGs remain underfunded.

The sweeping, negative impacts of illicit trade on the SDGs point to a wide range of challenges for governments. A holistic approach is needed to address the significant number of interdependencies and overlapping problems relating to multiple forms of illicit trade. The impacts of illicit trade cannot be examined effectively in isolation of other sectors, nor can they be addressed in isolation of the SDGs.

Although each form of illicit trade has its own characteristics and drivers, there are also important commonalities. The same criminal groups are often exploiting the same trade routes, the same means of transport and the same concealment methods behind multiple forms of illicit trade.

While several governments have taken concrete steps to curtail illicit trade, the approach has often been siloed, precluding an understanding of the interconnected nature of the problem and the commonalities and points of convergence across sectors. The result of this has been a disjointed international response, with little cross-cutting work on shared resources or shared recommendations addressed to national governments.

To remain on track towards meeting the SDGs, countries must prioritize efforts to reduce the deterrent forces of illicit trade and plug the fiscal leakages associated with it. Collaboration between countries to address the networks that facilitate illicit trade across borders is also critical. Removing the economic drags of illicit trade can improve the efficiency and effectiveness of policies and actions to stimulate growth, employment and investment to achieve the SDGs. A comprehensive approach to combatting illicit trade must also explore how to reduce consumer demand for prohibited and illicit goods.

This session brings together knowledge from governments, international organizations, non-governmental organizations and industries whose bottom lines are affected by illicit trade. This multi-stakeholder discussion enables a fuller understanding of the connections between different forms of illicit activities and how they impact the SDGs. Panelists will explore the main reasons why governments should prioritize actions to combat illicit trade and convey the importance of intergovernmental leadership to coordinate resources, share expertise, establish guidelines and promote international enforcement cooperation among United Nations Member States.

Session 3: Illicit trade and illicit financial flows

Illicit trade is part of a broader problematic known as illicit financial flows (IFFs). UNCTAD and the United Nations Office on Drugs and Crime (UNODC) define illicit financial flows as all financial flows crossing international borders that are illicitly generated (e.g., originating in criminal activities or tax evasion), illicitly transferred (e.g., violating currency controls) or illicitly used (e.g., for financing international terrorism).

IFFs is therefore a broad term that encompasses a wide variety of activities. These flows originate in different sources, they are transferred abroad through a diversity channels and for many purposes. Countries' challenges with IFFs differ: while some countries may be most concerned by the illicit trade of wildlife products, others could be more affected by undeclared trade of mining products or by companies exploiting legal loopholes to reduce their tax payments. The methodologies to identify and monitor IFFs, as well as the actions required to reduce them, must therefore be adapted to the specific situation of each country.

In general, the trade of illicit goods, proceeds of crime, goods and services mis-invoiced at customs, stolen assets, profits avoiding taxes and other forms of illicit financial flows are channelled abroad every year, often to financial havens. These flows weaken state institutions by fuelling corruption and violence, and undermine the rule of law. They discourage public and private investment and deprive the licit economy from resources that are needed for sustainable development along all its dimensions. In addition to diverting resources for development, they also hamper structural transformation and sustainable economic growth.

The risks and the harmful impact of IFFs have been recognized in the 2030 Agenda for Sustainable Development, especially in SDG target 16.4 that calls for, "[b]y 2030, significantly reduce illicit financial flows and arms flows, strengthen the recovery and return of stolen assets and combat all forms of organised crime". The Addis Ababa Action Agenda on financing for development also calls for a redoubling of efforts to substantially reduce IFFs by 2030, with a view to eventually eliminate them.

However, to date there was no international agreement on adequate methodologies for measuring IFFs. This lack of statistical indicators on IFFs reduces clarity about how large these flows are, where they originate from and what consequences they have on development. It also hampers policy action to reduce the main sources and channels of IFFs. To this end, UNCTAD and UNODC, acting as joint custodians of SDG indicator 16.4.1, which aims at monitoring the "total value of inward and outward illicit financial flows", are developing common statistical methodologies and guidelines that national statistical authorities can apply to estimate the size and channels of the main types of IFFs.

This session will frame illicit trade within the broader discussion on IFFs. It will also present the latest developments in relation to SDG indicator 16.4.1 and the different methodologies available to measure and monitor IFFs and their economic and institutional impact. The panellists will cover the following questions:

- What is the relationship between illicit trade and IFFs? Is illicit trade a specific type of IFF? Or is it a channel through which other types of illicit flows are conducted?
- What are countries' main priorities and concerns when dealing with illicit trade as a form of IFF? Which sectors are most affected? Who are the actors involved? What is the impact on development and institutions?
- What are the cross-border difficulties that could be addressed to make measurement and curbing of IFFs more effective?
- What efforts have been made to measure illicit trade and other types of IFFs? What do the results show? What are the main statistical challenges in developing indicators to monitor IFFs?
- What policy actions have been taken to curb different types of IFFs? Is there evidence of their effectiveness in reducing these flows?

Session 4: The role of the private sector in combatting illicit trade

The private sector has a vital interest to ensure that illicit trade does not compromise the integrity of legitimate markets or jeopardize the well-being of consumers.

Because illicit traffickers do not comply with often costly environmental, health and safety standards and often employ underpaid or exploited labor, they act as "free riders," putting legitimate businesses at a severe competitive disadvantage. This has the effect of significantly reducing market shares and turnover for law-abiding companies, causing a decrease in recruitment opportunities for local workforces and reduced tax revenues for governments. The challenge is particularly acute in developing countries, where unemployment rates are often high and cash-strapped governments struggle to provide basic social services.

In addition to harming consumers, the entry of fake products and sub-standard materials in supply chains negatively affects consumer perception of a corporation’s social responsibility performance. Where proliferating illicit trade creates socio-economic instability, it dampens private sector investment, holds back research and development and discourages technology transfer.

However, while private sector’s entrepreneurship and dynamism is undeniably affected by illicit trade, businesses can fight back and proactively contribute to shaping the response to illicit trade.

An effective way of doing so is through the implementation of stringent due diligence and “know your customer” policies. Due diligence mechanisms are used to identify suspicious suppliers and supply chain partners, with a view to working with them to improve trade practices or discontinue the business relationship altogether. The task of monitoring supply chains is often a complex one, considering that, for example, harmful counterfeit pharmaceuticals or adulterated food products have been traced back to suppliers several tiers removed from the ultimate reseller and unwittingly passed through the supply chain.

Businesses can also mobilize key tools and resources to assist governments in the disruption of trafficking networks. At the general level, SDG 17 calls for inclusive partnerships with the private sector as necessary tools to achieve a successful sustainable development agenda. In particular, governments and law enforcement should leverage the private sector’s expertise and resources by forging strong and lasting collaborative relationships against illicit trade.

The cooperative role that businesses and governments can play has many facets, drawing from the private sector’s first-hand understanding of local market circumstances, illicit trade dynamics and the way in which traffickers exploit supply chain vulnerabilities, institutional weaknesses and regulatory gaps.

Many private sector actors are able to provide law enforcement with pivotal intelligence not only on general trends in terms of techniques and routes used by perpetrators, but also incident- or case-specific information to trigger new illicit trade related investigations. Private sector information is also an indispensable ingredient to drive effective risk-management by customs administrations.

Public-private partnerships (PPPs) can also be leveraged for capacity building purposes, starting from brand owners explaining to customs how to distinguish between genuine and fake goods, to businesses’ sharing of “red flags” used in their own supply chains to develop training modules for law enforcement. Another important area to collaborate relates to developing traceability systems which contribute to enhancing the transparency on the origin of the raw material and encourage the sharing of information and knowledge among value chain actors[9].

At the same time, effective PPPs are predicated on nurturing a mutual sense of trust between public and private sector authorities. Due to its potential sensitivity, a little discussed issue in the context of public-private cooperation is the extent to which private sector actors should receive feedback on how operational information provided by them to law enforcement authorities has been instrumental in advancing investigations. Feeding non-sensitive information back to private sector stakeholders may contribute to consolidating existing partnerships based on shared interests and incentivize the further sharing of information.

This session explores the commitment of the private sector to achieving the SDGs. It presents examples of business’ own efforts to deter illegal trade across industrial sectors, addressing vulnerabilities in the supply chain, reporting criminal activity, promoting sustainable resource management and protecting against forced labor and other human rights abuses.

Notes

[1] Channing May, "Transnational Crime and the Developing World," March 27, 2017, *https://gfintegrity.org/report/transnational-crime-and-the-developing-world/*.
[2] The World Bank put United Kingdom GDP at US$ 2.6 trillion for 2017, see for example *https://data.worldbank.org/country/united-kingdom*.
[3] Alliance 87. (2017). Global Estimates of Modern Slavery: Forced Labour and Forced Marriage. Geneva: ILO / Walk Free Foundation.
[4] ILO. (2014). Profits and Poverty: The Economics of Forced Labour. Geneva: International Labour Organization. Available at: http://www.ilo.org/global/publications/ilo-bookstore/order-online/books/WCMS_243391/lang--en/index.htm
[5] https://www.interpol.int/en/content/download/5149/file/Global%20Forestry%20Enforcement%20Prospectus%202019-web.pdf
[6] https://fas.org/sgp/crs/row/IF11114.pdf
[7] Euromonitor International. (2018). *Size and Shape of the Global Illicit Alcohol Market*.
[8] World Health Organization. (2018). *Global status report on alcohol and health 2018.* Available at: http://apps.who.int/iris/bitstream/handle/10665/274603/9789241565639-eng.pdf?ua=1
[9] For example, UNCTAD has collaborated with CITES Secretariat and other stakeholders on studies and workshops regarding traceability systems for selected CITES-listed species, including medicinal and ornamental plants, and python skins. The studies are available at UNCTAD's BioTrade Initiative: https://unctad.org/en/Pages/DITC/Trade-and-Environment/BioTrade.aspx