



Size and Shape of the Global Illicit Alcohol Market

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Introduction

Alcoholic beverages are deeply ingrained in most societies worldwide, with global consumption in 2017 generating US\$1.6 trillion in legally registered sales¹ of 222.8 million hectolitres of pure alcohol (“hectolitres of alcohol equivalent”, or HL LAE). However, despite the efforts of policy-makers, law enforcement officials, and legitimate alcohol manufacturers, illicit alcoholic beverages still account for a significant share of the total volume of alcohol consumed in many countries.

This white paper explores critical issues affecting the problem of illicit alcohol in today’s global alcohol industry. To this end, the paper analyses research conducted in 24 countries in Latin America, Africa, and Eastern Europe,² and examines the major factors shaping their illicit alcohol markets. Illicit alcohol is prevalent in these countries: Of the 42.3 million HL LAE of total alcohol consumed each year, approximately 25.8% is illicit. In other words, nearly 10.9 million HL LAE of illicit alcohol is consumed annually in these 24 countries alone. This suggests they represent an effective sample for exploring this important topic.

Illicit alcoholic beverages are defined as those not complying with the regulations and taxes in the countries where they are consumed, resulting in serious health risks to consumers, revenue loss, and brand degradation for legitimate manufacturers, as well as reduced tax revenue for governments. These products are responsible for hundreds of cases of death and illness due to accidental methanol intoxication, millions of dollars used to fund other criminal activities, and the fiscal loss of billions of dollars in unpaid taxes. Health risks affect the poorest and most vulnerable consumers by contributing to widening health inequalities.

The most significant risks and costs for each country depend on the characteristics of the local market for illicit alcohol. The landscape of illicit alcohol is varied and complex, ranging from homemade artisanal beverages sold without the proper sanitary permits to legitimately branded bottles of alcohol smuggled illegally into a country. However, although market characteristics differ across countries, the problem of illicit alcohol exists in every region, in developed and developing countries, urban and rural areas, and higher-income and lower-income neighbourhoods alike.

Governments, businesses, and civil society organizations — all stakeholders with vested interests in curbing illicit trade — have responded to this problem from many angles. The approaches are as varied as the markets themselves, but have often been partial or ineffective, especially due to rapid adaptation of illicit businesses to new regulations and restrictions.

This white paper analyses and summarises findings that may help stakeholders better understand the illicit alcohol trade. In particular, the paper identifies five themes that are shaping the global illicit alcohol trade and affecting the stakeholder initiatives intended to reduce it.

Five Themes that are Shaping the Global Illicit Alcohol Trade



STRONG CONSUMER PERCEPTIONS & LOW AWARENESS

Consumer perceptions and awareness affects demand for illicit alcohol.



HIGHER AFFORDABILITY OF ILLICIT ALCOHOL

The price gap between licit and illicit alcohol has a major influence on alcohol-related purchase decisions, and that gap is affected by taxes and other factors.



INADEQUATE OR EXTREME REGULATORY & LEGAL FRAMEWORK

The regulatory and legal approach that governments take when governing the production and sale of alcohol can leave the door open for the illicit alcohol market — or even unintentionally stimulate it.



LACK OF ENFORCEMENT & COLLABORATION

In some countries, alcohol-related regulations are poorly enforced. They are sometimes rendered ineffective by corruption as well as by the lack of collaboration between government agencies and the public, private and civil society sectors.



POORLY REGULATED DISTRIBUTION CHANNELS

Illicit alcohol players take advantage of underregulated or weakly controlled distribution channels to buy raw ingredients as ethanol and to reach consumers, including informal outlets, duty-free areas, and e-commerce platforms.

Source: Euromonitor International



Key concepts

Illicit alcoholic beverages are sold commercially and do not comply with the relevant regulations and taxes in a country. They are often sold in informal channels that do not pay taxes or follow local regulations, such as open markets, street stalls, or small independent stores that under-declare their sales in order to pay less in taxes. However, illicit alcoholic beverages are sometimes sold in formal channels as well, such as supermarkets.³

Illicit alcoholic beverages are generally divided into the five categories and four subcategories listed below.

Categories and Subcategories of Illicit Alcoholic Beverages

Smuggling

Smuggling (also known as contraband) covers both ethanol (which can be used as a raw ingredient for spirits production) as well as finished products that have been brought into a country for commercial purposes without paying required import tariffs duties, and fees.

Smuggled ethanol as raw material

Smuggled ethanol is imported illegally without paying the import tariffs duties or fees required by the country. It is often used as the base for illicit spirits.

Source: Euromonitor International

Smuggled finished products	Alcoholic beverages that are brought into the country illegally without paying the import tariffs, duties, or fees required by the country.
Counterfeit and unregistered brands	This category includes both fraudulent imitations of legitimate (legally registered) branded beverages as well as industrially manufactured beverages that are either unbranded or sold under unregistered brands.
Substitution / refill	Counterfeit alcoholic beverages that violate the trademark rights of legitimate brand owners in one of two ways: illicit beverages sold as if belonging to legitimate brands (substitution), or empty bottles of licit beverages that are filled with cheaper alcohol (refill).
Industrial manufacturing of illicit products	Industrial manufacturing of unbranded products or of illicit (unregistered) brands.
Illicit artisanal alcohol	Alcoholic beverages produced following artisanal practices, including home production. Artisanal alcoholic beverages are considered illicit if they are produced for commercial purposes, and if their production and / or sale violate local law. Known as illicit homebrew in Africa.
Tax leakage	Alcoholic beverages legally manufactured in the country, but for which required taxes have not been paid.
Surrogate	Alcohol not meant for human consumption but diverted to the market for alcoholic beverages. Examples include pharmaceutical alcohol, mouthwash, and perfume.

Source: Euromonitor International

Overview of market drivers and enablers

At a high level, the illicit alcohol trade is driven by the same general market forces as the legal one: Consumers look for good deals and products that meet their needs, while sellers look for revenue and profits. As long as consumer demand for illicit alcohol is strong and the illicit alcohol trade remains a profitable business, illicit players will find ways around regulations and enforcement. Developing effective strategies to reduce the size of the illicit market therefore requires addressing both supply and demand.

Specific, interrelated factors enable the supply and demand for illicit alcohol to flourish. These factors can be related to consumer preferences, such as consumers' tendency to seek out lower-priced products, convenient shopping locations, and aspirational brands. Market drivers or enablers can also come from the business environment, where there may be excessively high taxes that incentivise players to maximise profits by entering the illicit market. The illicit alcohol market can be unintentionally stimulated by other government initiatives as well, including some that are intended to curb illicit activity but end up undermining that objective. Although each individual market has its own local nuances, the table below summarises the main factors that drive and enable the global trade of illicit alcohol.

Main Drivers and Enablers of the Illicit Alcohol Trade

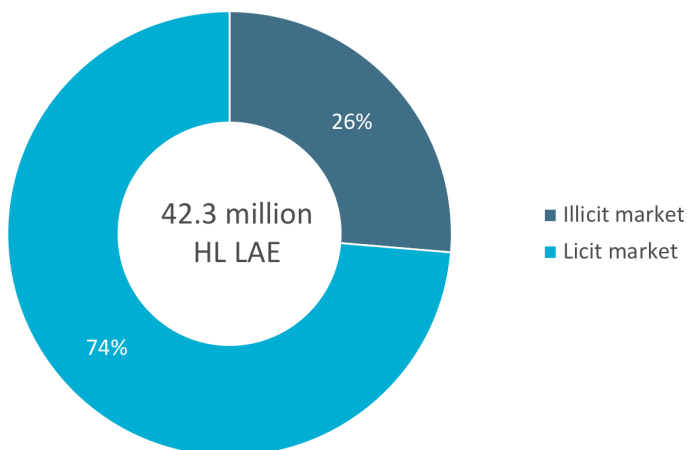
Consumers	Business environment	Government
<ul style="list-style-type: none"> ▪ Lower-priced products ▪ Greater availability or more convenient locations of illicit alcohol ▪ Aspirational access to premium brands ▪ Social acceptability of illicit trade ▪ Limited knowledge about the risks of illicit alcohol and how to identify illicit beverages ▪ Local customs and traditions, especially involving artisanal alcohol 	<ul style="list-style-type: none"> ▪ Price gap between licit and illicit alcoholic beverages ▪ High excise taxes and excessive restrictions on licit alcoholic beverages ▪ Availability of production inputs for alcoholic beverages 	<ul style="list-style-type: none"> ▪ Inadequate or partial regulations and laws about alcoholic beverages ▪ Excessive regulations and restrictions on licit alcoholic beverages ▪ Ineffective enforcement ▪ Low penalties for activities related to illicit alcohol ▪ Corruption

Source: Euromonitor International

Global Illicit Alcohol Landscape

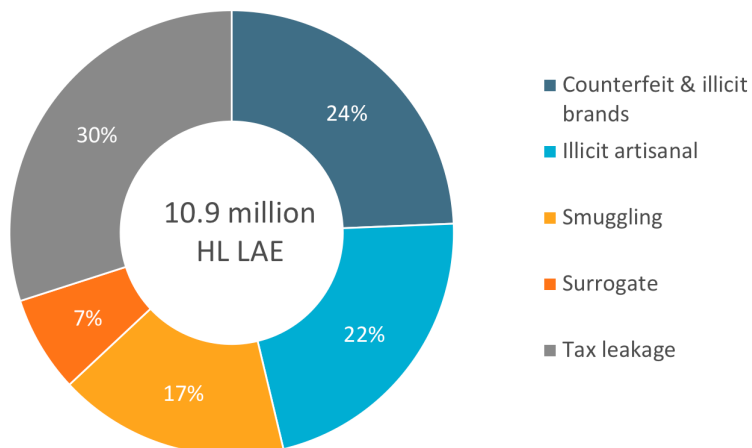
In total, 42.3 million hectolitres of pure alcohol (HL LAE) are consumed each year across the 24 countries under review. Illicit alcoholic beverages account for 25.8% of this volume and generate more than US\$19.4 billions in sales. The average person in these countries consumes 5.9 LAE of alcohol each year, and 1.5 LAE of that is illicit. The illicit beverages that consumers drink are most likely to be counterfeit / unregistered brands and illicit artisanal beverages, although this differs significantly by geography.

Licit vs. Illicit Alcohol Volume Consumed (HL LAE, Latest Year)



Source: Euromonitor International

Illicit Alcohol Volume Consumed by Category (HL LAE, latest year)

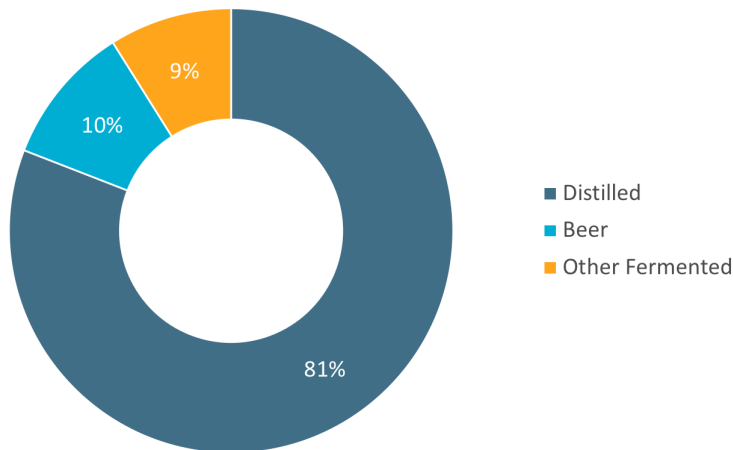


Source: Euromonitor International

Across regions, consumers drink more illicit distilled spirits than illicit fermented beverages such as beer or wine. This is true even when fermented alcoholic beverages are more popular in the overall market. Distilled spirits are more common in the illicit market because spirits have higher alcohol content and tend to be more expensive, providing an even greater incentive for those who sell illicit spirits to increase their profits. There is also a greater incentive for price-conscious consumers, who have fewer inexpensive licit options when purchasing spirits.

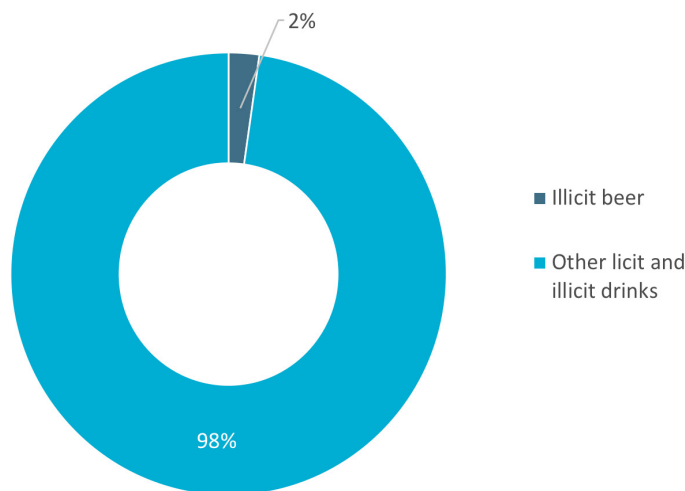
Beer accounts for 52.9% of licit alcohol consumed (LAE) globally, however it only represents 10.2% of the global illicit alcohol consumption (LAE). Overall, beer is the least likely type of drink to be illicit, being 2.3% from total (licit and illicit) alcohol consumption.

Illicit Alcohol Consumption by Drink Type (HL LAE, Latest Year)



Source: Euromonitor International

Consumption of Beer from Total Alcohol Consumption (HL LAE, Latest Year)



Source: Euromonitor International

Health and fiscal risks

During the past seven years of research, Euromonitor has identified two primary types of risk that are associated with the illicit alcohol consumption:

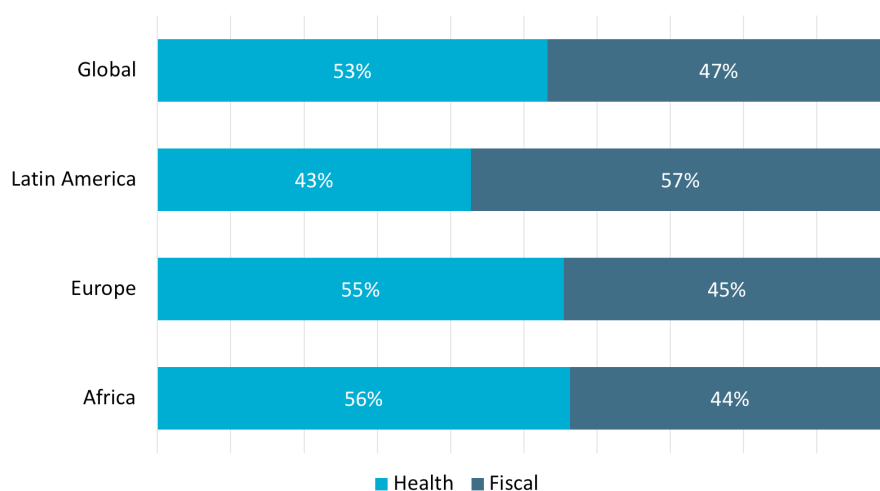
- **Consumer health risks** given the lack of controls and sanitary standards in the illicit alcohol production, also from accidental methanol intoxication, which can lead to illness or even death;
- **Fiscal risks** due to the loss of tax revenue that governments would have otherwise been able to invest in their societies.

Prevalence of health or fiscal related risks is a result of the illicit market shape in each region. Although both types of risks are present in all markets, its prevalence varies as shown in the chart below.

Health risks are more prevalent in countries where illicit alcohol consumption is focused on artisanal beverages, counterfeit / unregistered brands, and surrogate products. The methods of producing these categories of illicit beverages are much more likely to lead to health problems for consumers: the facilities are beyond the reach of health and safety inspectors, and production methods can result in dangerously high levels of methanol. On the other hand, fiscal risks are higher in countries with a greater presence of tax leakage or smuggling.

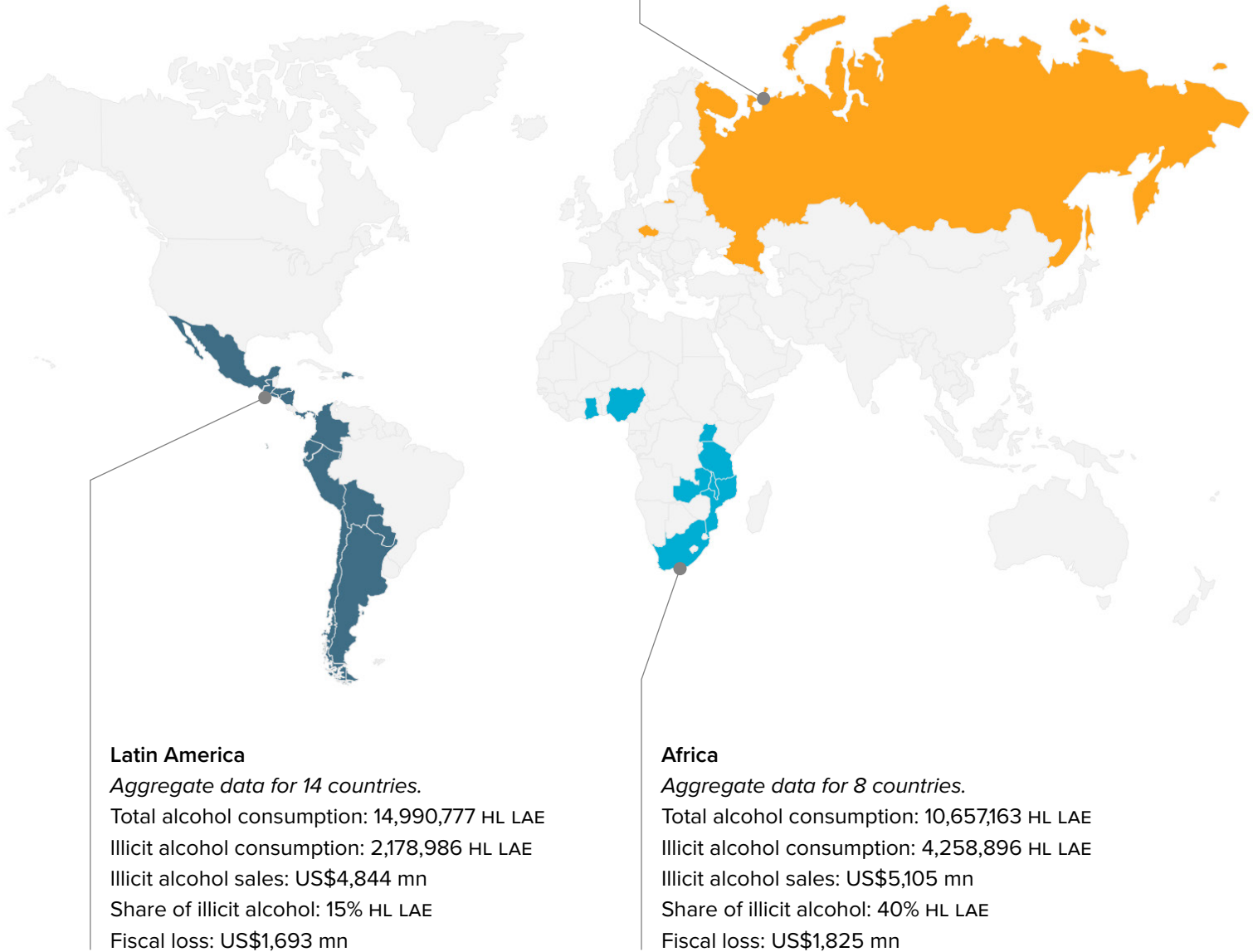
Examining the LAE volume shares of these two illicit alcohol categories may help stakeholders focus their efforts on areas presenting the highest risks.

Prevalence of Health and Fiscal Risks by Region



Source: Euromonitor International

Overview of Global Alcohol Trade

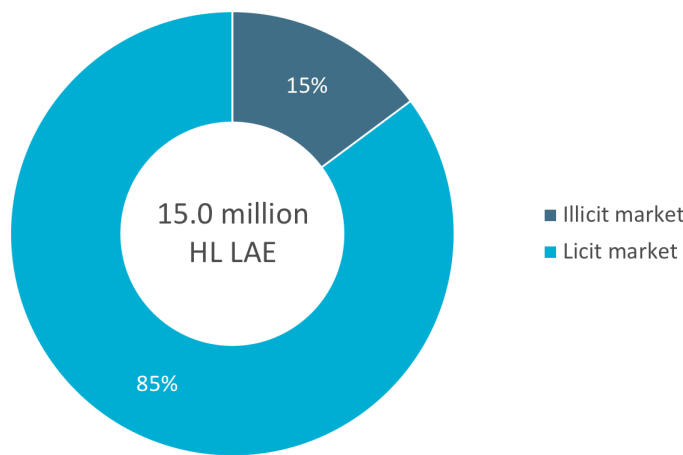


Source: Euromonitor International

Illicit Alcohol in Latin America

Of the 15.0 million HL LAE of alcohol (LAE) consumed each year across 14 markets in Latin America, 14.5% is illicit.⁴ It generates more than US\$4.8 billion in annual revenue for illicit businesses, and more than US\$1.7 billion in fiscal loss for governments.

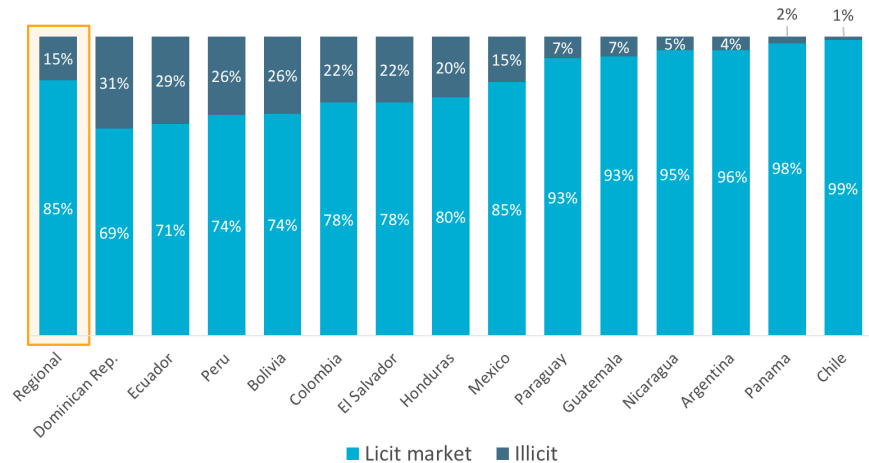
Licit vs. Illicit Alcohol Volume Consumed in Latin America (HL LAE, Latest Year)



Source: Euromonitor International

Regional highlight: Illicit alcohol has the highest presence in the Dominican Republic since it has the highest share of illicit alcohol from the total alcohol consumption in volume (30.8%) while Chile has the smallest (1.2%).

Share of Licit and Illicit Alcohol Out of Total Alcohol Consumption by Country (HL LAE, Latest Year)

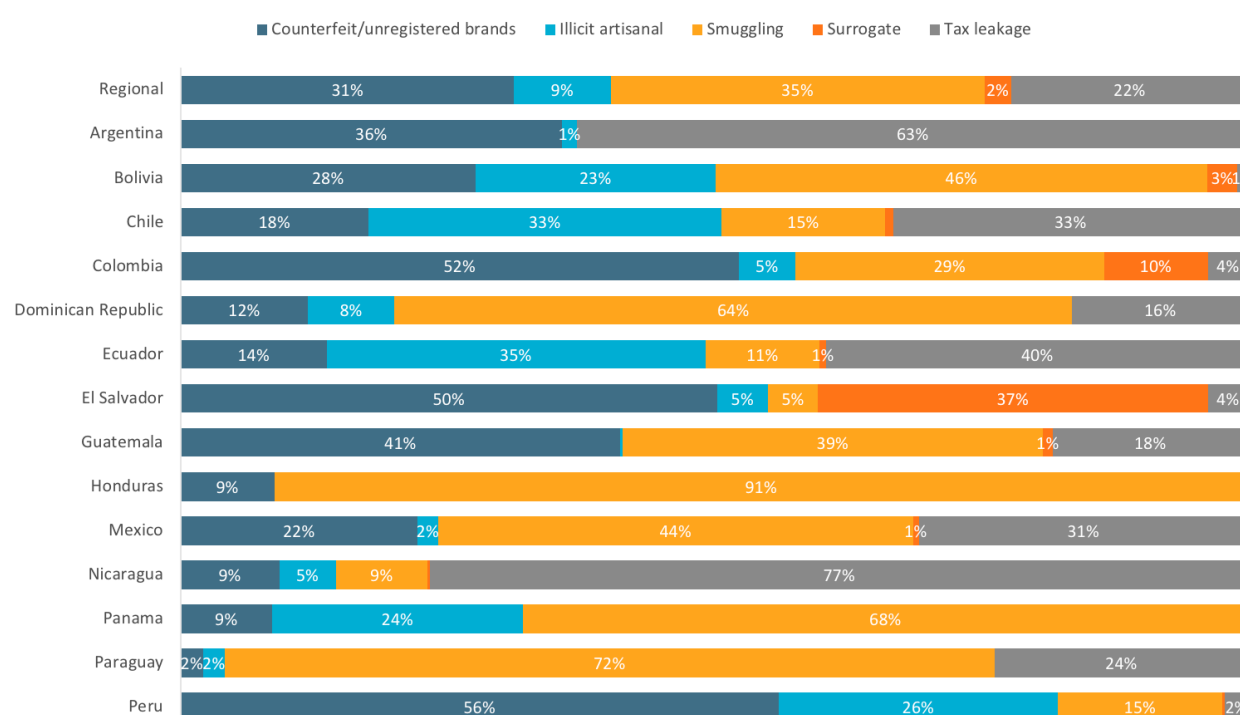


Source: Euromonitor International

Illicit alcohol in Latin America is driven by smuggling and counterfeit / unregistered brands

Smuggling accounts for the greatest share of illicit alcohol volume (LAE) in Latin America, largely driven by its prevalence in Mexico, the region's largest illicit alcohol market in volume. However, the specifics of individual markets vary significantly, as shown below.

Illicit Alcohol Volume Consumed in Latin America by Category (HL LAE, Latest Year)



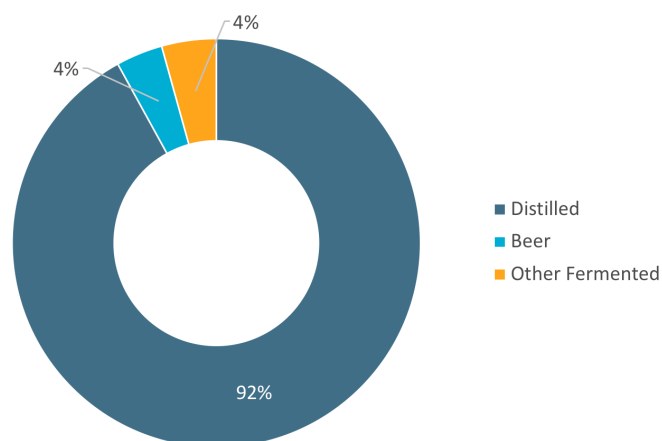
Source: Euromonitor International

Beer is the least likely beverage to be illicit in Latin America

Most of Latin America's illicit alcohol is distilled: 92.0% of illicit alcohol volume in LAE terms.⁵ Distilled spirits such as whiskey, rum, etc. have higher alcohol content and tend to have higher prices in the licit market, which makes them more easily susceptible to illicit sales, as illicit producers look to avoid high taxes and consumers seek more affordable options. In addition, adulterating or producing illicit spirits can be as simple as mixing ethanol, colouring, and flavouring.

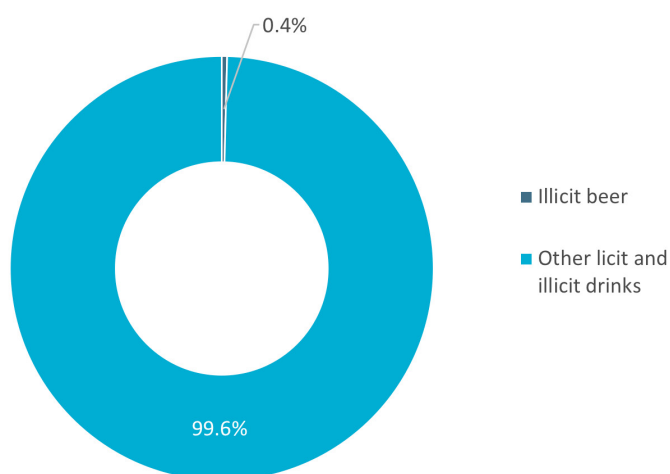
In contrast, Latin America's licit alcohol market is dominated by fermented beverages. Beer is the most popular alcoholic drink in the region and accounts for 63.1% of licit alcohol consumed (LAE). However, only 3.7% of the illicit alcohol (LAE) that Latin American consumers drink is beer. Beer is the alcoholic beverage least likely to be illicit in Latin America — only 0.4% of total (licit and illicit) alcohol consumed (LAE).

Illicit Alcohol Consumption by Drink Type (HL LAE, Latest Year)



Source: Euromonitor International

Consumption of Beer from Total Alcohol Consumption (HL LAE, Latest Year)

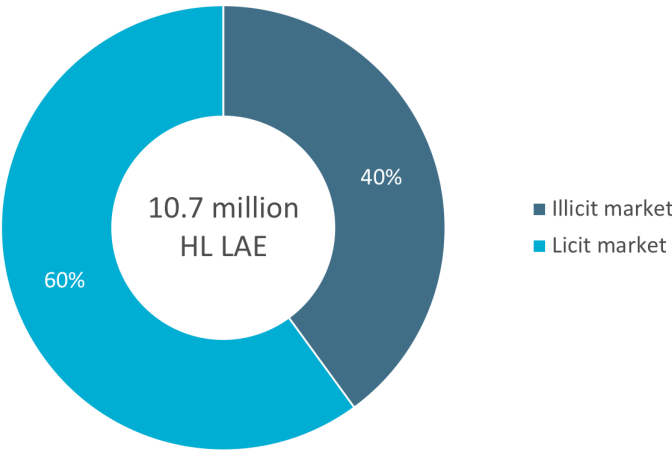


Source: Euromonitor International

Illicit Alcohol in Africa

Of the nearly 10.7 million HL LAE consumed each year in the eight researched markets in Africa, 40.0% is illicit. The illicit alcohol trade generates US\$5.1 billion in annual sales revenue for illicit players, and represents a combined annual fiscal loss of more than US\$1.8 billion for the governments involved.⁶

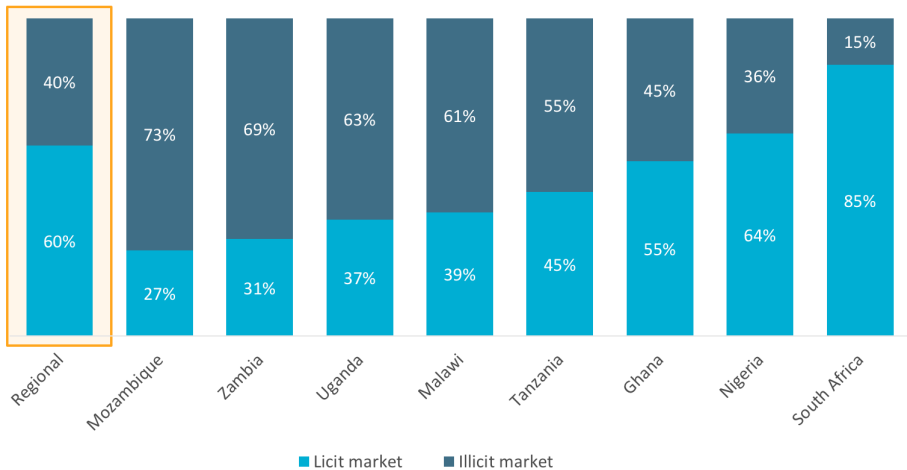
Licit vs. Illicit Alcohol Volume Consumed in Africa (HL LAE, Latest Year)



Source: Euromonitor International

Regional highlight: Illicit alcohol has the highest presence in Mozambique since it has the highest share of illicit alcohol from the total alcohol consumption in volume (73.0%) while South Africa has the smallest (14.5%).

Share of Licit and Illicit Alcohol Out of Total Alcohol Consumption by Country (HL LAE, Latest Year)

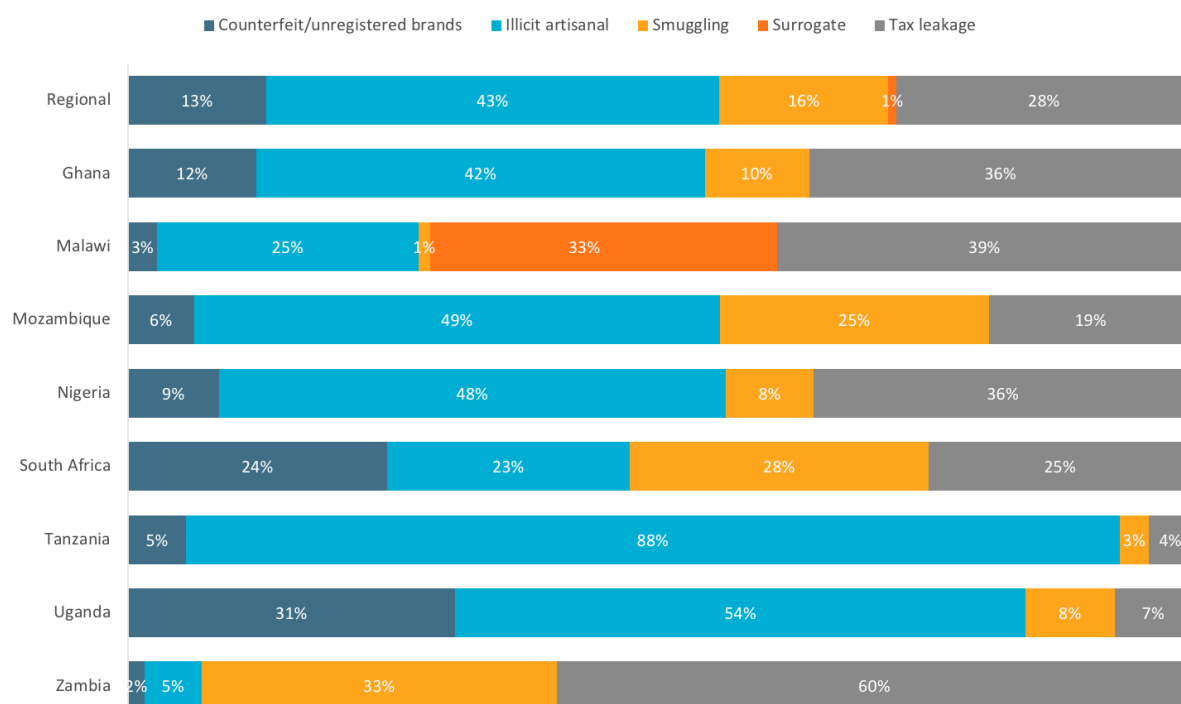


Source: Euromonitor International

Illicit alcohol in Africa is driven by artisanal beverages

The illicit alcohol markets in Africa are more similar among them than the markets in Latin America. Illicit artisanal alcohol (locally referred to as illicit homebrew) is a regional mainstay, accounting for 42.6% of the region's illicit alcohol volume in LAE terms and emerging as the largest category in five of the eight researched markets. Whether distilled or fermented, illicit artisanal alcohol is widespread: Although it is particularly prevalent in rural and low-income areas, it is consumed across all income levels.

Illicit Alcohol Volume Consumed in Africa by Category (HL LAE, Latest Year)



Source: Euromonitor International

Clear beer / lager is the least likely beverage to be illicit in Africa

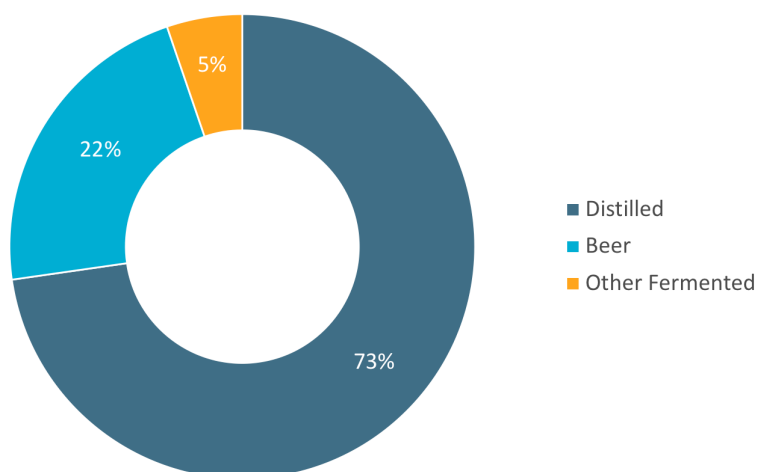
As in Latin America, illicit alcoholic beverages in Africa are largely distilled (72.6% illicit volume in LAE terms)⁷, but the licit alcohol market is dominated by fermented beverages, especially clear beer / lager. Of the nearly 3.2 million HL LAE consumed of clear beer / lager, only 1.2% is illicit. There are sufficient options of low-cost beers available to consumers, and initiatives to supply more affordable licit options have further reduced incentives for consumers to seek out illicit beer.

In Africa, several other products are referred to as “beer” that have very different profiles: “opaque beer” made from sorghum or millet, and “traditional African beer”, which is a fermented homebrew. These types of beverages have a very high share of illicit activity and represent a significant share of the total illicit alcohol volume (LAE) in the region.

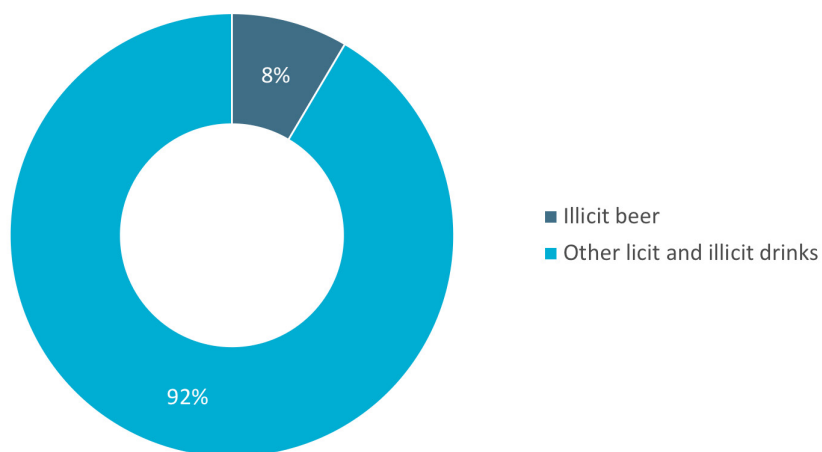
- **Traditional African beer** is a type of fermented homebrew and is traditionally prepared for ceremonial and traditional cultural events. It is made from fruits, grains, bread, and sorghum, using local recipes handed down through families.
- **Opaque beer** is unique to the region and is typically produced by mixing commercially made powder with water. Opaque beer comes in two forms:
 - » **Low-cost licit opaque beer** is made from sorghum or millet. Several countries have included affordable licit opaque beer as part of a strategy to reduce illicit alcohol consumption among people of low income.
 - » **Illicit unpackaged powdered opaque beer** is made when the powdered ingredient is diverted from the legitimate production facilities. It is popular only in Uganda and Zambia.

In Africa, beer (including all products referred to as “beer”) is also the alcoholic beverage least likely to be illicit, accounting for 8.3% of total (licit and illicit) alcohol consumed (LAE).

Illicit Alcohol Consumption by Drink Type (HL LAE, Latest Year)



Source: Euromonitor International

Consumption of Beer from Total Alcohol Consumption (HL LAE, Latest Year)

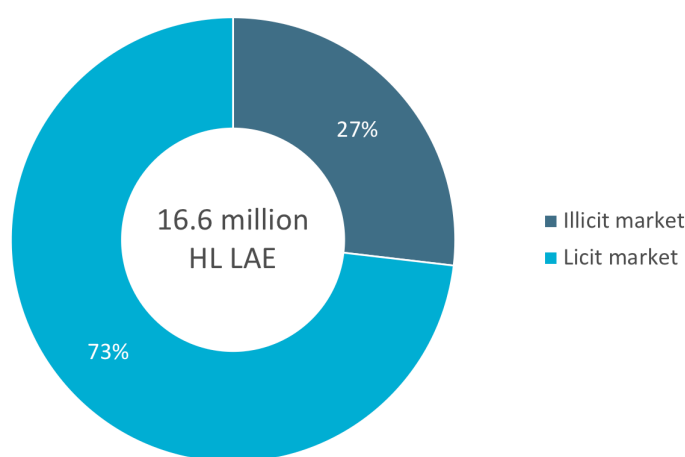
Source: Euromonitor International

Regional highlight: For example in Mozambique, Impala beer made from cassava, a local smallholder crop, is a low cost beer alternative to illicit alcohol. The government of Mozambique designed a specific excise regime that allows the local brewer to sell this beer at two-thirds the price of a regular mainstream lager, making it an affordable option. This not only makes for safer drinking for consumers, but provides the government with gains from increased tax revenue.

Illicit Alcohol in Eastern Europe

Of the nearly 16.6 million hl lae consumed each year in Russia and the Czech Republic, 26.8% is illicit. The illicit alcohol trade generates US\$9.4 billion in annual sales revenue for illicit players, and represents a combined annual fiscal loss of more than US\$98.6 million for the governments involved.⁸

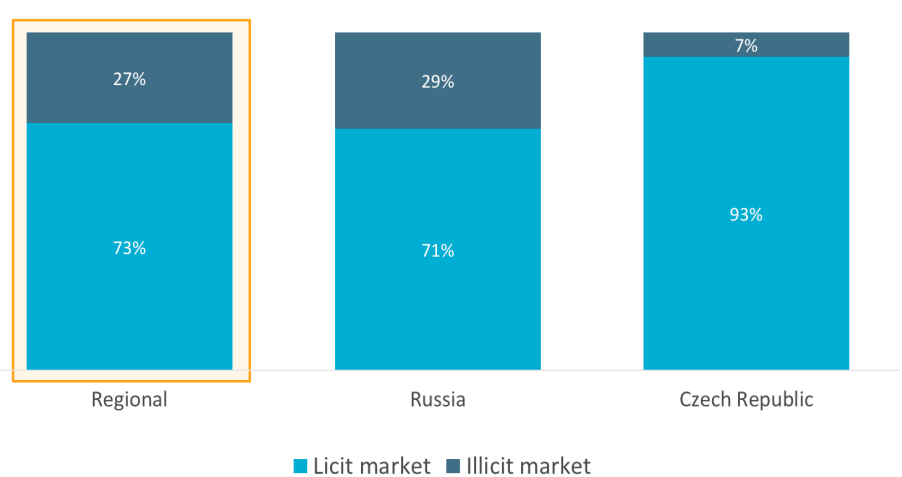
Licit vs. Illicit Alcohol Volume Consumed in Eastern Europe (HL LAE, Latest Year)



Source: Euromonitor International

Regional highlight: Illicit alcohol has a higher presence in Russia, representing 28.5% of total alcohol consumption while it represents 7.1% in the Czech Republic.

Share of Licit and Illicit Alcohol Out of Total Alcohol Consumption by Country (HL LAE, Latest Year)

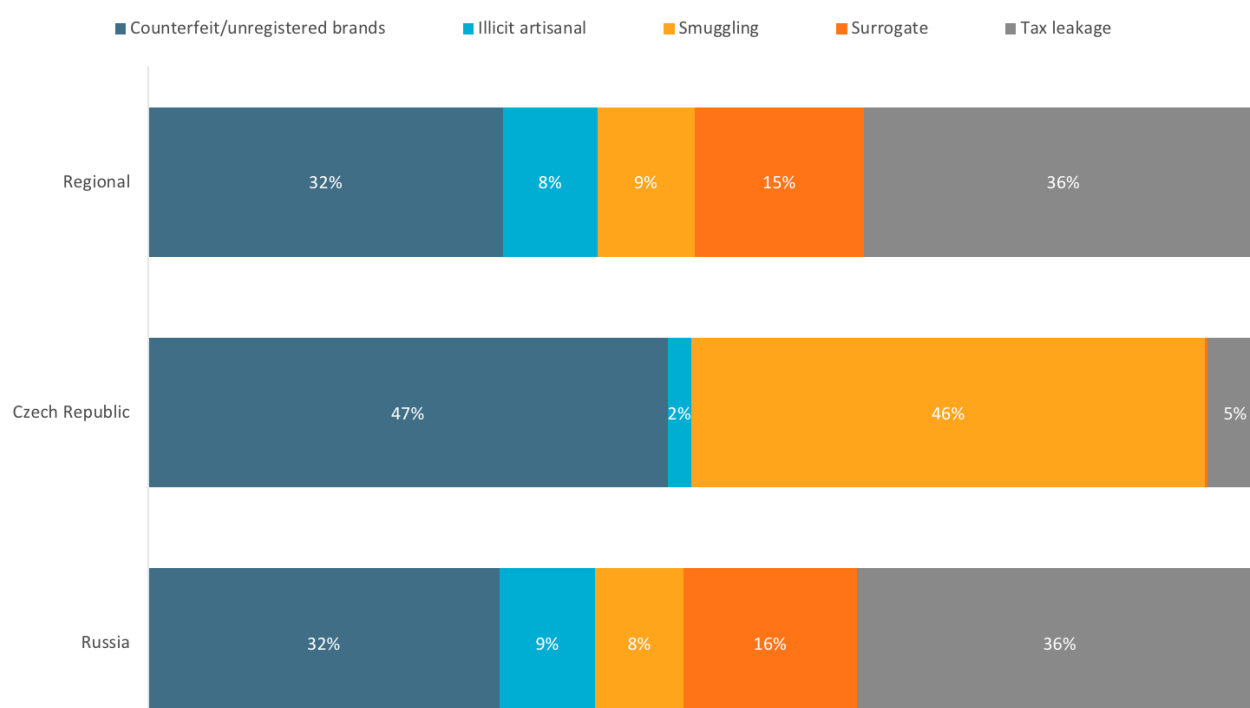


Source: Euromonitor International

Illicit alcohol in Eastern Europe is driven by tax leakage and counterfeit / unregistered brands

Consumption of illicit alcohol in Russia and the Czech Republic is driven by the availability of more affordable prices compared to its licit counterparts. Tax leakage accounts for 35.8% of the region's illicit alcohol volume in LAE terms, followed by counterfeit / unregistered brands that accounts for 31.9%.

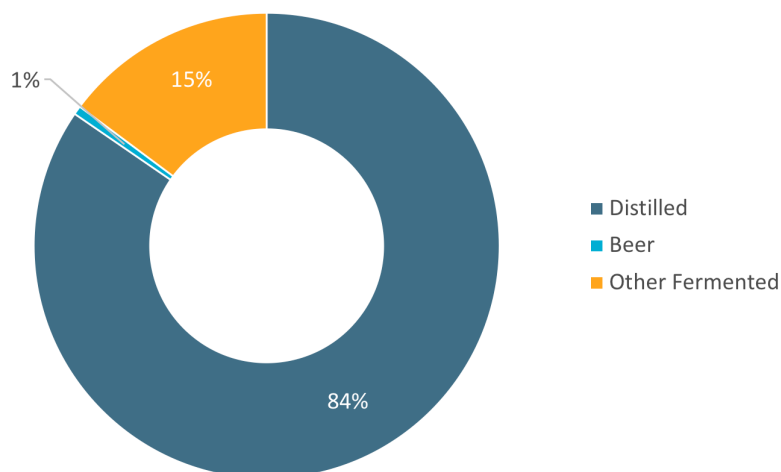
Illicit Alcohol Volume Consumed in Eastern Europe by Category (HL LAE, Latest Year)



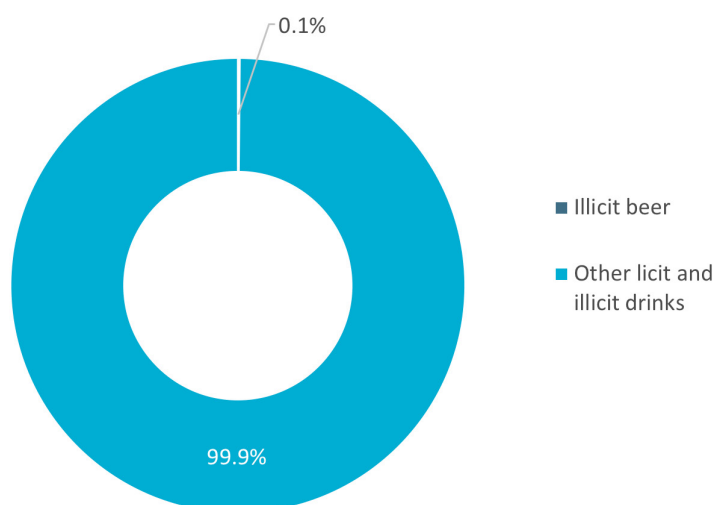
Source: Euromonitor International

Beer is the least likely beverage to be illicit in Eastern Europe

Similar to Latin America and Africa, illicit beer consumption represents a small share of total illicit alcohol consumption (0.6% HL LAE). Beer is also the alcoholic beverage least likely to be illicit in Eastern Europe — only 0.1% of total (licit and illicit) alcohol consumed (LAE).

Illicit Alcohol Consumption by Drink Type (HL LAE, Latest Year)

Source: Euromonitor International

Consumption of Beer from Total Alcohol Consumption (HL LAE, Latest Year)

Source: Euromonitor International

However, the Czech Republic does not follow the pattern found in Latin America and Africa. The Czech illicit alcohol market is largely comprised of fermented beverages, accounting for 73.0% of illicit alcohol volume (LAE). Wine is the most popular illicit beverage (64.9% of total distilled and fermented beverages), followed by spirits (27.0%). The prevalence of illicit wine in the country is due to poor government controls over wine — there is zero excise tax on wine and thus less incentive for the government to improve controls.

Even in the Czech Republic, where fermented beverages make up the majority of illicit alcohol, beer is still largely a licit product. Beer accounts for 41.4% of licit alcohol in the country but only 7.9% of illicit alcohol. Czech consumers have affordable licit beer options, so there is little incentive to purchase illicit beer.

Key Global Themes

As discussed above, the global illicit alcohol trade is complex, and each region or individual market has distinct characteristics that affect how policy-makers, enforcement officials, and legitimate businesses respond. However, identifying similarities across markets can help stakeholders collaborate and better understand the possible consequences (often unintended) of their actions. Euromonitor has identified five key global themes that are influencing discussions about how to reduce the size of the illicit alcohol market.



Strong consumer perceptions and low awareness

When analysing consumer demand for illicit alcoholic beverages, reports tend to focus mostly on the lack of consumer awareness regarding the health risks involved. Although this is indeed an important issue, consumer perceptions and awareness of illicit alcoholic beverages is much more complex. In many cases, consumers are also unaware of the illicit nature of the products, do not perceive a difference in quality, and / or consider consumption of these products to be socially acceptable.

Consumers are often uncertain about legality of a product

Consumers do not always know when they are purchasing an illicit alcoholic beverage or how to identify one. Some licit alcohol manufacturers and other organizations have invested in communications campaigns to help consumers learn about the characteristics that may indicate a beverage is illicit (e.g. unusually low prices, damaged labels or seals, dirty bottles, cloudy liquid, etc.).

To make matters more difficult, vendors often sell a mix of licit and illicit products. In addition, illicit players use various methods to make products appear legitimate, such as refilling bottles of legitimately branded beverages with cheaper illicit alcohol, or counterfeiting packaging labels and fiscal stamps.

Consumers perceive low risks and health implications

Consumers may perceive consuming illicit alcohol to have few risks or health implications. For example, consumers might not perceive a noticeable difference in quality between illicit and licit products. In some countries, illicit alcoholic beverages can be of “not bad” to “good enough” quality, such as in Colombia,



where counterfeit products are hard to distinguish from authentically branded ones. Besides being satisfied with the quality of illicit products, consumers who believe they are drinking an authentic product do not realize the possible health implications of their purchase.

Even when consumers are able to identify that the product they are consuming is illicit, they might be unaware of or underestimate the health risks involved, or the penalties if caught.

Illicit trade is often socially accepted

In many countries, consumers do not consider buying illicit alcohol to be a serious crime. On the contrary, many consumers around the world perceive these purchases to be “good deals”. In these situations, there is insufficient social pressure to dissuade them from participating in the illicit alcohol trade. Consumers in countries with widespread corruption may be particularly willing to purchase illicit products they know full well are illicit because they are so accustomed to illicit activity being a part of their society.

Illicit products often offer consumers aspirational status

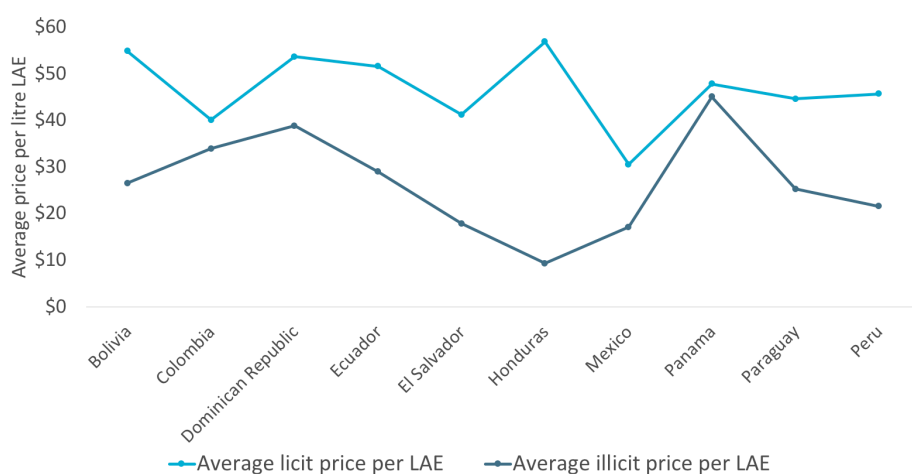
There is often an aspirational component to illicit purchases. Since illicit alcoholic beverages have lower prices than their licit counterparts, consumers are able to afford premium products (or what they believe to be legitimate premium products) that would otherwise be unaffordable. The desire to gain access to products consumed by people of higher socioeconomic status is common across countries, and affects a wide range of illicit products, including alcohol.



Higher affordability of illicit alcohol

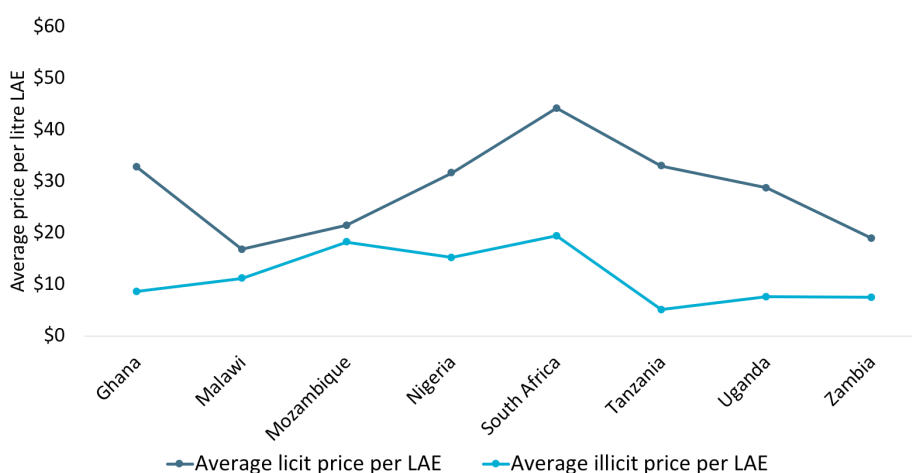
Consumers at all income levels purchase illicit alcohol for various reasons, but the commonality between them is that the illicit products they buy tend to have lower prices than their licit counterparts. The importance of affordability is especially strong among low-income consumers with more restricted purchasing power, such as youth, students, and people living below the poverty line.

Average Per Litre LAE Prices of Licit and Illicit Alcoholic Beverages in Select Countries in Latin America (US\$, Latest Year)



Source: Euromonitor International

Average Per Litre Prices of Licit and Illicit Alcoholic Beverages in Africa (US\$, Latest Year)



Source: Euromonitor International

The price gap between licit and illicit alcoholic beverages is affected by many factors, including macroeconomic and regulatory conditions as well as the pricing strategies of alcohol players. Moreover, the price gap has varying effects on illicit alcohol consumption across countries, although in general there have been changes in illicit alcohol consumption following adjustments to taxes, import tariffs, and inflation, restrictions, all of which affect prices. Price typically has a more pronounced impact on consumption when consumer purchasing power is further constrained because of high unemployment or slow economic growth.

The two examples below shed light on how conditions that alter prices can affect the illicit alcohol landscape.

The unintended effect of taxation

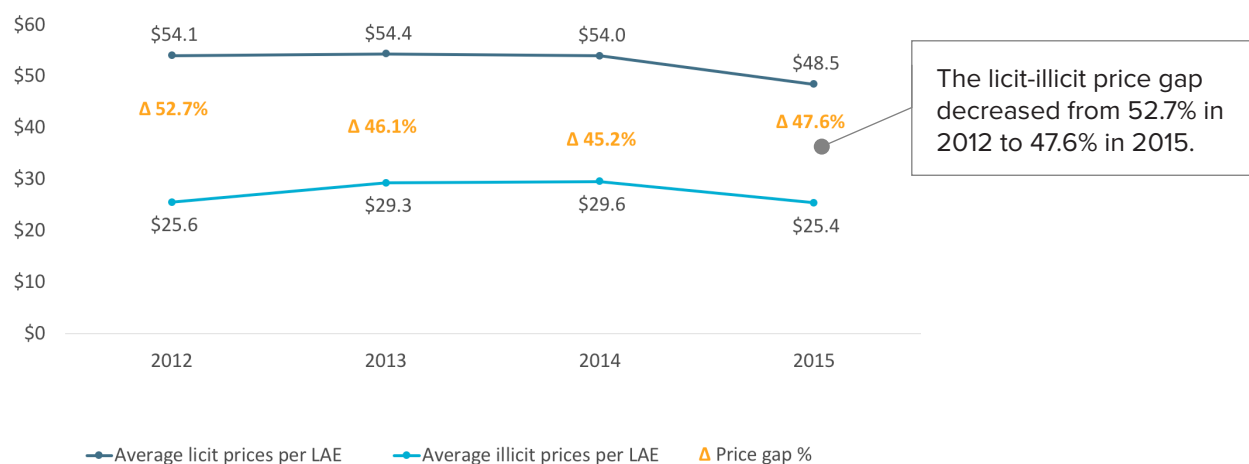
Taxes on the production and sale of licit products drive up the prices that consumers must pay. Excise taxes have a particularly important effect on the alcohol market, since they are applied to the sale of specific products such as alcohol. Governments often try to maximize their revenue and moderate consumption by setting high excise rates. However, excessively high taxes can be counterproductive if they stimulate demand for illicit products.

Differences in excise and other taxes between neighbouring countries have the additional effect of increasing the likelihood of smuggling, something discussed in further detail below.

Latin America's narrowing price gap

The difference between the prices of licit and illicit alcoholic beverages in Latin America has narrowed over time. Illicit players have been forced to increase their retail prices during the past few years, as their costs have been affected by many factors: for example, improved enforcement by local authorities have made production and distribution logistics more complex, stricter controls over ethanol supply in some countries has reduced the residual volumes available. Also, as retailers and consumers become more aware of the issue with illicit alcohol, they are increasingly suspicious of brands with very low retail prices. As a result, illicit players can no longer offer extremely low-priced alternatives to licit brands without risking being caught.

Historic Average Per Litre Prices of Licit and Illicit Alcoholic Beverages in Latin America⁹



Source: Euromonitor International



Inadequate or extreme regulatory and legal framework

Governments employ a variety of regulatory and legal mechanisms to control harmful consumption of alcohol and to combat illicit alcohol, with differing degrees of success. Many national frameworks are ineffectively designed, offer only partial solutions, or are inadequately enforced or resourced. Some mechanisms may even unintentionally boost illicit alcohol consumption by making it more difficult for consumers to access or afford licit beverages. Other mechanisms may be such stringent restrictions on licit businesses that they incentivise illicit activity.

To be effective, regulatory and legal frameworks must be designed with a full understanding of the size, shape and dynamics of the illicit alcohol market. There must also be well-resourced agencies monitoring, intercepting, and deterring illicit activities throughout the entire supply chain.

Holistic regulatory and enforcement frameworks aim to monitor and control the entire alcohol supply chain. They can include initiatives such as:

- Regulating and controlling the supply of raw materials, particularly ethanol
- Monitoring production sites, and requiring health and sanitary permits for manufacturers
- Strengthening national borders and law enforcement departments to identify and prevent illicit activity

- Strengthening penalties for illicit activity to increase their deterrent effect
- Improving a country's overall business environment to encourage businesses to operate legitimately
- Raise level of awareness of the threat of the illicit trade and its consequences.

Growing use of fiscal marking for alcoholic beverages

Fiscal marking has become a regulatory approach for reducing the illicit alcohol market, with around 50 countries currently using this method for spirits. Only a few countries around the world (less than 5) apply fiscal marking to beer. Countries such as Ecuador have already implemented fiscal marking on alcoholic beverages, and others including Uganda and Zambia are considering its adoption.

Fiscal marking, or tax stamps, has historically been issued by governments to indicate that a tax, duty, or fee has been paid. However, many governments have adopted alcohol-related fiscal marking for other reasons as well, such as product authentication and tracking. These governments believe that fiscal marking will reduce counterfeit, smuggling, and tax leakage.

Despite these goals, the actual effectiveness of fiscal marking in reducing the illicit alcohol trade remains uncertain, as different countries using this system have seen a range of outcomes. The results are affected by five factors.

First, in many countries where fiscal marking is implemented, it is applied in a generalized way, even to product categories that do not experience significant illicit activity. This is because governments do not know or have a full understanding of the size and shape of the illicit market. Consequently, licit players are negatively affected.

Given limited government resources, this generalized approach tends to stretch monitoring and enforcement resources too thin, with disappointing results. Instead, a more targeted approach focusing on the products with the most illicit activity would be more efficient and have a greater impact.

Second, fiscal marking design has a strong influence on effectiveness. The stamps are often easy to counterfeit; in fact, counterfeited stamps may actually help illicit products avoid raising suspicion among consumers. Regulators adopt specialized technology and update designs regularly to prevent this, but illicit players often react rapidly and counterfeit the new designs. In addition, the more advanced the technology and the more it is updated, the more expensive it is for the government, which diminishes the system's intended revenue benefits. Moreover, legitimately stamped bottles are often refilled with cheaper or illicit alcohol.

Third, government initiatives that increase the cost of licit alcoholic beverages can be counterproductive if they increase prices of licit alcohol, which drives consumers to seek cheaper options. The effect on cost is especially significant for products with high-speed packaging lines and low profit margins.

If there is an illicit alcohol threat and it is mainly non-compliance by domestic producers (such as tax leakage due to different levels of excise in the country), marking may be effective in tackling it. In these circumstances, a well-designed tax stamp / marking system eases the competitive disadvantage faced by compliant producers. Even then, tax stamps may not be the best solution. If the revenue authorities improve their capability and capacity to audit excise producers, they may achieve the same or better results in terms of increased tax receipts, but at lower cost than a tax stamp regime.

Fourth, fiscal marking will not help consumers identify illicit products unless consumers use the stamps, or care about the legality of the products in the first place.

Lastly, fiscal marking will be an incomplete and ineffective system if it is adopted as an isolated policy without support from a broader monitoring, control, and enforcement strategy.

Moreover, the cost-effectiveness of fiscal marking should be compared to that of alternative policies which could be included in the strategy, such as higher penalties for illicit activities.

Some fiscal marking systems can be cost-effective for governments and manufacturers depending on the market context; for example, a comparison with other possible initiatives may reveal that they would be more cost-effective and impactful. Applying a tax stamp will only protect revenue if it is only aimed at the products where loss is taking place. This may seem obvious but applying tax stamps to the wrong category of products (such as to a fully compliant sector) will not increase tax revenue, so this approach fails to get at the root of the problem. In brief, excise tax controls are positive when they are reasonable, effective, targeted, and proportionate.

The Case of Ecuador's Fiscal Marking

Ecuador recently adopted fiscal marking in the form of QR codes under a system called SIMAR. In 2017, SIMAR marked 735 million bottles of alcohol, 95.2% of which were beer. Ecuador's fiscal marking as currently applied is not tackling the most significant alcohol-related sources of unpaid taxes. Only 1.0% of illicit alcohol volume (LAE) in Ecuador is beer, whereas 97.9% is distilled spirits. The government is allocating significant resources to fiscal marking for a compliant category: only 0.7% of beer volume is illicit.

Fiscal marking is not addressing the source of illicit trade which is tax leakage from local spirits and illicit artisanal. Besides reducing fiscal loss, one of the system's intended objectives was product authentication by consumers. This is not happening because consumers have not been scanning QR codes with their smartphones to verify the products.

Source: Euromonitor International



Lack of enforcement & collaboration

Even the most well-designed regulatory and legal framework will be ineffective without adequate enforcement, yet enforcement is sorely lacking in many countries. Illicit players often continue to operate with relative impunity because regulation is inexistent or it if exists, is not effectively operationalised, and penalties are not severe enough to act as deterrents.

Effective enforcement requires coordination between countries (to prevent smuggling), between different national government agencies (revenue, border, police, health, etc.) and between different levels of government (federal, state, and municipal). Initiatives can be further strengthened when governments collaborate with non-governmental organizations and legitimate businesses by sharing market information and coordinating activities.

This level of coordination and collaboration is often lacking. Corruption, complicity, and collusion can hinder collaboration and starve governments of the internal will to enforce policies. Bribery is particularly common, and it can occur in all parts of the supply chain.

The Case of Corruption's Complex Role in Mozambique

Among the countries under review, Mozambique has the highest share of illicit alcohol consumption (73.0% of total alcohol LAE) as well as the lowest score on the Corruption Perceptions Index. Corruption at the border contributes to widespread smuggling, while inspections for counterfeit and tax leakage are poorly enforced for the same reason.

Corruption intersects with other economic, political, and social factors to strengthen the conditions for illicit activity. Illicit alcohol is growing in Mozambique because high unemployment, poverty, and tax increases on licit alcoholic beverages have made licit alcohol unaffordable for many people in the country. Amidst these financial drivers, poorly resourced government offices and corruption make it even more likely that illicit players will increase the supply of illicit alcohol. The heavy drinking culture and lack of awareness about the dangers of illicit alcohol further aggravate the problem.

Source: Euromonitor International



Poorly regulated distribution channels

Illicit players worldwide take advantage of distribution channels that are unregulated or poorly regulated. Historically, illicit alcoholic beverages were more likely to be found in informal channels, such as street stalls, traditional markets, or small independent stores that did not pay all the required taxes.

However, the distribution landscape has become increasingly complex because of globalization and technological developments.

Ethanol diverted to human consumption

One effective way to control counterfeit alcohol is to control the production and importation of ethanol. Countries with very low levels of counterfeit alcohol have effective systems in place to control the trade of ethanol (meant for human consumption).

This is made possible by controlling the ethanol market: the ethanol has to be controlled and is subject to excise tax. The ethanol meant for other purposes (such as pharmacy alcohol, beauty and personal care products, and industrial use) should be denatured and is not levied excise tax.

Denatured alcohol is ethanol with additives to make it poisonous, extremely bad tasting, foul smelling or nauseating, to discourage recreational consumption. In some cases, it is also dyed. Denaturing alcohol does not chemically alter the ethanol molecule. Rather, the ethanol is mixed with other chemicals to form an undrinkable solution. The denaturant is added to prevent the alcohol from being consumed as a spirit.

Denatured alcohol provides a solution to permit legitimate use and manufacture of ethanol, whereby cheap ethanol can be made available for non-consumption use without the risk of its being converted to consumption. Therefore, there is no duty on denatured alcohol in most countries, making it considerably cheaper than ethanol meant for human consumption that is subject to excise taxes.

Countries such as Colombia and Peru have new legislation in place to control the ethanol market. These efforts have achieved positive results in controlling the flow of local and smuggled ethanol diverted to the illicit market to produce illicit distilled beverages.

Informal channels

Informal channels are still a significant source of illicit alcohol sales. Many of the countries in which illicit alcohol represents a large share of total alcohol consumption have strong and pervasive informal channels. These informal channels are often able to reach consumers in lower-income or rural areas where formal retailers have a limited presence.

The sheer number and extensive network of informal outlets in many countries makes it difficult for government authorities to control. The challenge is even greater because the vendors involved often sell a mix of illicit and licit products, making it difficult to distinguish which ones are illicit.

Duty-free areas

Illicit alcohol distributors also take advantage of differences in import taxes and controls between and within countries. Distributors bring alcoholic beverages into a country that has low import taxes and weak import requirements, then smuggle the products into neighbouring countries. They also take advantage of free trade zones, which have a temporary suspension of import duties and less scrutiny of trade flows. For example, alcoholic beverages often enter duty-free areas in Panama or Tacna (Peru), legally and are then smuggled elsewhere in the country or into other countries nearby.

The growth of e-commerce

Online channels are increasingly important in the illicit alcohol trade around the world, as distributors are taking advantage of the lack of regulation and controls online. The growth of e-commerce is especially strong in the illicit alcohol markets in Latin America, where online sales of many types of consumer goods have grown rapidly. Online sales of consumer goods in general have increased because more and more consumers have access to the internet, and because there is a wide variety of payment methods being accepted by online vendors (e.g., credit cards, debit cards, digital payment systems such as PayPal, mobile payment apps).

Illicit players take advantage of legitimate online channels that are poorly controlled and under-regulated:

- E-commerce platforms that are popular among consumers, such as the online marketplaces increasingly used by consumers in Latin America
- Social media platforms such as Facebook that have added e-commerce features to make it easier to sell online using their networks, with growth in consumer-to-consumer sales being especially strong

The growing importance of e-commerce in the global illicit alcohol trade highlights the fact that consumers of all backgrounds and income levels purchase illicit alcoholic beverages. Online channels are making illicit purchases even easier for today's increasingly tech-savvy population, especially middle-class consumers who have become accustomed to shopping online for many types of products. E-commerce is also making it harder for government authorities to control the illicit alcohol market, and for consumers to distinguish between licit and illicit products.

Conclusions and Recommendations

Five Themes in the Global Illicit Alcohol Trade, Key Takeaways and Recommendations



STRONG CONSUMER PERCEPTIONS & LOW AWARENESS

Key takeaway: Many consumers are unaware of the health risks of illicit alcohol, but other factors also influence purchasing and must be addressed in order to effectively reduce demand.

Recommendations:

- Raise awareness of illicit alcohol threats to health and tax income
- Alliances between stakeholders to target audiences at risk



HIGHER AFFORDABILITY OF ILLICIT ALCOHOL

Key takeaway: Prices are the main driver of illicit alcohol demand, so initiatives that increase licit alcohol prices may unintentionally stimulate demand for illicit products.

Recommendations:

- Avoid excessive and discriminatory taxation and regulation to the licit players because they can have unintended consequences
- Reduce price gap between licit and illicit alcohol markets (governments and licit industry players have a shared responsibility)



INADEQUATE OR EXTREME REGULATORY & LEGAL FRAMEWORK

Key takeaway: Creating an enabling environment for licit business activity can reduce the incentive for businesses to sell illicit alcohol and for consumers to purchase illicit products.

Recommendations:

- Avoid overregulating licit alcohol
- Simplified frameworks to facilitate compliance and transparency
- If using fiscal marking, target key sources of illegality



LACK OF ENFORCEMENT & COLLABORATION

Key takeaway: Efforts to combat the illicit alcohol trade in many countries are thwarted by weak enforcement systems and corruption.

Recommendations:

- Introduce/enforce strict penalties to illicit players
- Reduce informality and corruption in all agencies and levels of government
- Introduce/enforce regulation on ethanol control such as ethanol denaturing which has proven to be a very effective way to control illicit distilled beverages all over the world



POORLY REGULATED DISTRIBUTION CHANNELS

Key takeaway: Illicit players take advantage of weakly regulated or unregulated distribution channels, including informal outlets, low-duty or free trade areas and e-commerce online platforms.

Recommendations:

- Ethanol control through denaturing
- Stronger controls at customs
- Awareness campaign about smart online purchasing decisions
- Strategy for regulating and monitoring online channels

Source: Euromonitor International

About this paper

In the past seven years, SAB Miller and AB InBev have commissioned Euromonitor International to conduct research on illicit alcohol markets worldwide. This white paper analyses these research studies and summarises findings that may help stakeholders better understand the illicit alcohol trade.



How Can Euromonitor International Help?

Euromonitor International is a global market research company providing strategic intelligence on industries, companies, economies and consumers around the world. Comprehensive international coverage and insights across consumer goods, business-to-business and service industries make our research an essential resource for businesses of all sizes.



Endnotes

- 1 Volume and value sales include both on-trade (restaurants, bars, etc.) and off-trade (retail).
- 2 This paper reviews research findings from studies conducted in 24 countries in Latin America, Africa, and Eastern Europe. Latest-year data for 24 countries are included in this paper. Latin American countries are: Argentina (2013), Bolivia (2016), Chile (2015), Colombia (2017), the Dominican Republic (2016), Ecuador (2017), El Salvador (2015), Guatemala (2015), Honduras (2015), Mexico (2017), Nicaragua (2011), Panama (2015), Paraguay (2017) and Peru (2017). Countries in Africa include: Ghana (2017), Malawi (2015), Mozambique (2017), Nigeria (2017), South Africa (2017), Tanzania (2017), Uganda (2017) and Zambia (2017). Eastern European countries include: the Czech Republic (2014) and Russia (2014). For three of the countries in Latin America (Argentina, Chile and Nicaragua), quantitative data was only available for consumption volume. Therefore, these three countries are included in regional and global aggregates for volume, but excluded from aggregates for value sales and fiscal loss.
- 3 Laws differ across countries, and therefore, what is considered illicit in one country may not be in another
- 4 The regional aggregate for alcohol volume is calculated as the sum of latest-year sizes for Argentina (2013), Bolivia (2016), Chile (2015), Colombia (2017), the Dominican Republic (2016), Ecuador (2017), El Salvador (2015), Guatemala (2015), Honduras (2015), Mexico (2017), Nicaragua (2011), Panama (2015), Paraguay (2017) and Peru (2017). Data for illicit alcohol value sales and fiscal loss were unavailable for Argentina, Chile, and Nicaragua, so these countries are not included in the regional aggregate for value sales and fiscal loss.
- 5 When analysing distilled vs. fermented alcoholic beverages, only finished products destined for human consumption are compared. Surrogate products and pure ethanol are excluded.
- 6 The regional aggregate for alcohol sales, volume, and fiscal loss are calculated as the sum of latest-year sizes for Ghana (2017), Malawi (2015), Mozambique (2017), Nigeria (2017), South Africa (2017), Tanzania (2017), Uganda (2017) and Zambia (2017).
- 7 When analysing distilled vs. fermented alcoholic beverages, only finished products destined for human consumption are compared. Surrogate products and pure ethanol are excluded.

- 8 The regional aggregate for alcohol sales, volume, and fiscal loss are calculated as the sum of latest-year sizes for Russia (2014) and Czech Republic (2014). Data for Russia (2014) was not available for fiscal loss.
- 9 Time series data were available for six countries and only from 2012 to 2015. These countries are aggregated for illustrative purposes in this chart: Colombia, Ecuador, El Salvador, Honduras, Panama, and Peru.

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