

# Mitigating Cross-Border Illicit Trade

## Policy recommendations in the wake of COVID-19

- *Governments should resist tax policies that trigger reductions in purchases of taxable legal products and drive consumers to seek unregulated, untaxed illicit products.*
- *Rationalizing tax structures and strengthening border controls are effective tools to mitigate cross-border illicit trade and smuggling.*

### Introduction

In the wake of COVID-19, as governments move from crisis management to recovery planning, it will be critical to carefully shape the most constructive and inclusive ways to build back economic activity, employment and growth.

This will be especially important regarding policy decisions impacting sectors which are traditionally vulnerable to illicit trade and are already subject to high excise tax rates—such as alcohol, tobacco and petroleum. Any imposed impediments on legal industry operators will keep downward pressure on employment and contributions to GDP. Sudden increases in excise taxes levied on these sectors, as a means to replenish budget shortfalls, could result in lower consumption of legal products, smaller pools of tax collections and an increase in demand for untaxed, cheaper illicit alternatives.

There are a great number of alternatives to increasing excise taxes, and consideration should be given to a portfolio of time-proven regulatory measures that can complement taxes, not undermine them.

For example:

- Ensuring accessibility of regulated taxable products will generate legitimate and significant levels of tax revenues. Governments cannot collect taxes on products that are not sold or on illicit products that exist outside of tax regimes.
- Imposing sanctions on the bad actors that supply markets with fakes or smuggle contraband across borders will help plug fiscal leakages by disincentivizing the supply of illicit, untaxed products.
- Increasing consumer awareness about the harms of illicit trade is an important measure that governments can use to steer people away from harm and into the legal, regulated and taxable marketplace.

In all cases, the result can be greater tax collections on a larger pool of legal, taxable product—with the knock-on value of economic growth and reduced consumer risk.

## **Rationalize Tax Policies to Mitigate Illicit Trade<sup>1</sup>**

In the wake of COVID-19, many countries look to introduce tax reforms that can deliver health, revenue, and good governance benefits. Introducing or increasing excise taxes are often among these reform policies and can generate significant public revenue. However, governments need to ensure that tax policies do not incentivize illicit trade. For example, across a variety of products—such as alcohol, tobacco and petroleum—excessive tax levels can reduce affordability of legitimate products and drive demand for illicit substitutes.

In cases where tax-driven price differentials exist between neighboring countries, it may be necessary to rationalize tax policies and subsidies to ensure that they do not incentivize illicit trade, smuggling, adulteration and theft.

Policymakers are encouraged to:

- Include proactive monitoring, evaluation and countervailing measures when considering tax reforms to ensure that they reach the desired revenue, societal and governance outcomes, as well as mitigate the risk of adverse outcomes.
- Further study empirically the consequences of excise taxes, subsidies and tax exemptions that lead to smuggling, adulteration and theft.
- Adopt simple, single tier specific tax structures, taking into account various demand-related factors including overall consumption, price, income levels and the ensuing affordability of products.

Addressing both the supply and demand side of illicit trade through increased regional coordination, and avoiding further tax divergence, can mitigate cross-border illicit trade among neighboring countries. These measures could be effective in mitigating the practice of “tax arbitrage” by organized crime groups to gain profits by smuggling products from relatively lower to higher taxed markets.

## **Strengthen the customs environment<sup>2</sup>**

Customs and other border control agencies have a key role in combating illicit trade at the border, with officers on the front-line conducting inspections and detecting and seizing illicit goods. Ideally, customs and other agencies from both sides of the border work seamlessly together to discourage illegal acts in the border areas.

A strong, clean, customs environment contributes strongly to combating illicit trade, especially where illicit trade flows across borders of neighboring countries due to supply and demand factors or because of tax arbitrage by organized crime groups to gain profits by

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<sup>1</sup> Excerpted from “TRACIT Global Policy Recommendations to Combat Illicit Trade, Section 4, Rationalize Tax Policies, p. 4, at [https://www.tracit.org/uploads/1/0/2/2/102238034/tracit\\_policy\\_recommendations\\_global.pdf](https://www.tracit.org/uploads/1/0/2/2/102238034/tracit_policy_recommendations_global.pdf)

<sup>2</sup> Ibid, Strengthen the Customs Environment, p. 5

smuggling products from relatively lower to higher taxed markets. In addition, a well-policed border is a powerful reminder for consumers to adhere to the legal allowances and not risk importing more goods for their personal use than allowed.

Promoting a better customs environment through enhanced public-private dialogue in cross-border processes can create significant benefits for society, as well as the public and private sectors.

Policymakers are encouraged to:

- Develop a comprehensive and effective cross-border response to illicit trade. Transnational criminals are not bound by national borders, and they exploit weaknesses along borders to advance their criminal activities. As such, governments must reach out to their neighbors and call for greater cooperation across borders, especially in the areas of customs, law enforcement and information exchange on exports and high-risk products vulnerable to tax arbitrage and smuggling.
- Strengthen interagency cooperation at the national level, particularly coordination with health, economic, security, finance and customs agencies. Governments should appoint an “Anti-Illicit Trade Coordinator” with high-level authority to raise the profile on illicit trade, allocate financial and personnel resources and more aggressively enforce anti-illicit trade regulations, especially in the areas of Intellectual Property Rights (IPR) violations, untaxed and unregulated parallel (grey) market imports, and illicit trade in pharmaceuticals, tobacco, alcohol, clothing, shoes and electronics.
- Empower customs authorities to take enforcement action—acting ex officio or at the request of legal cargo owners—to seize or suspend the release of illicit products and those suspected of infringing laws when they are imported, exported, in-transit and in all situations where the goods are under customs supervision including in free trade zones or other zones with special economic and tax regimes as well as bonded warehouses.
- Promote the adoption of sound, intelligence-based and risk-management approaches for the detection of illicit trade by customs agencies taking into account, in particular, the organizational framework and processes outlined in the World Customs Organization’s (WCO) Customs Risk Management Compendium.
- Ensure greater integrity and transparency in customs and cross border regulatory agencies, including through enhanced public-private dialogue in cross-border processes.
- Implement the recommendations and practices outlined in the “Ten Principles” of the WCO Revised Arusha Declaration on Integrity in Customs and the G20 High Level Principles on Countering Corruption in Customs.