

ILLICIT TRADE: THE WORLDWIDE, MULTI-BILLION DOLLAR FUNDING STREAM

Somewhere in the world, there is a national health crisis. Doctors quickly receive the life-saving pharmaceuticals. However, the “pharmaceuticals” are counterfeits containing a combination of toxic chemicals and are powerless against the pandemic. In another part of the world, a country has developed a sophisticated, laser-guided missile capable of neutralizing targets with minimal collateral damage. Except, some of the missile’s components are counterfeit, causing its guidance system to malfunction. Meanwhile, a terrorist organization engages in the trafficking of illicit tobacco and antiquities to fund their operations while a crime group moves its proceeds across borders via diamonds. Moreover, a rogue nation is circumventing the international community’s sanctions and finances their prohibited activities through illicit trade. Unfortunately, these illustrations are not plots from Hollywood movies but examples where illicit trade and security intersect.

It is essential to analyze illicit trade, especially for counterintelligence and national security purposes, and then develop policies to combat it for four reasons. First, illicit trade provides a funding mechanism for nefarious actors. Those who engage in these activities represent transnational organized crime groups, terrorist organizations, cybercriminals, the private sector, and illicit actors who are sympathetic to those groups as well as hostile governments. Second, if the product is counterfeit or inferior, then the items can also cause direct and indirect harms. Third, the physical goods and the financial transactions can penetrate physical borders and security provisions established by sovereign nations. Fourth, governments and non-state actors can also engage in intellectual property theft, which can be a form of economic espionage.

Over the last few decades, sovereign nations have enacted semi-efficient measures to combat traditional illicit revenue streams - such as narcotics - through training, data sharing, enhanced punishments, increased international cooperation, and the enactment of anti-money laundering laws. As governments implemented these measures, illicit actors moved to more non-traditional revenue streams, such as illicit tobacco and counterfeit products. The significant profits also come with a lower risk of detection and punishment since governments have not fully realized the potential profits and harms associated with illicit trade and enact appropriate responses. Moreover, preferred methods for moving their profits have also shifted toward moving value across borders, such as diamonds and art, instead of cash.

Counterfeits are a unique form of illicit trade. They fund a wide-range of illicit activities that are intended to cause harm and disrupt, while simultaneously producing a myriad of direct harms to a nation’s security sectors, such as public health and safety, science and technology, the economy, and defense. For the United States economy alone, the Commission on the Theft of American Intellectual Property estimates that “the annual cost to the U.S. economy continues to exceed \$225 billion in counterfeit goods, pirated software, and theft of trade secrets, and could be as high as \$600 billion.”⁽¹⁾ These estimates may not include some indirect costs, such as those associated with health-related injuries and costly countermeasures that governments must implement. For these reasons and those outlined below, it is prudent for counterintelligence and national security personnel to more closely examine the threats and actors related counterfeit goods and illicit trade in general.

Counterfeit goods

Most, if not all, countries are impacted by counterfeit goods and the theft of intellectual property. For some countries, counterfeit products, or the economic losses associated with counterfeit products, harm their citizens and negatively impact their overall security. Others, however, indirectly profit from the manufacturing and exporting of counterfeit products. The economic losses and profits earned by illicit actors alone warrant attention by governments. Additional concerns are justified because the physical items penetrate borders via cargo containers, parcel post, and express mail couriers. The potential profits can be staggering, as can the

financial losses suffered by governments and the intellectual property rights holders. The counterfeit items tended to infringe on the intellectual property rights of individuals and entities located in United States, Italy, France, Switzerland, Japan, Germany, United Kingdom, and several other European countries.

A 2016 Organisation for Economic Co-operation and Development (OECD)(2) study placed the value of the 2013 worldwide trade in counterfeit products to be about \$461 billion and estimated that counterfeit products comprise about 5% of the European Union's total market. In 2016, the U.S. Customs and Border Protection had more than 31,000 seizures of counterfeit products, including counterfeit automotive and airplane parts, pharmaceuticals, computer parts, apparel, luxury goods, and numerous other categories of goods. Had the goods been genuine, the estimated value would have exceeded \$1.3 billion. During the same year, the European Union estimated the value of its counterfeit seizures at more than €672 million.(3)

Dangers and harms of counterfeit goods

All nations are vulnerable to counterfeit products' potential harm to national security. The illicit proceeds, the products themselves, and the networks that move illicit items across borders are all threats to national security. Counterfeit parts, especially those intended for the defense and aerospace sectors, can cause serious harm to individuals as well as a nation's overall security. The United Nations, through their "Counterfeit: Don't Buy into Organized Crime"(4) campaign, warned consumers about the multi-billion dollar black market and its connections to organized crime groups, money laundering, trafficking in persons, drugs, and weapons, as well as the various harms that counterfeits can cause to consumers. Furthermore, the individuals who carried out the 2015 terror attacks in Paris, France(5) trafficked in counterfeit apparel.

In 2011, the United States Senate's Armed Services Committee(6) investigated counterfeit parts in the U.S. Department of Defense's supply chain and found that the Department had 1,800 cases, involving approximately one million individual counterfeit parts. The detected counterfeit parts, such as semiconductors and memory chips, impacted guidance systems, missiles, aircraft, and numerous other types of military equipment. In addition to the direct harm to national security and public safety caused by counterfeit semiconductors, Senator Carlin Levin noted an industry estimate that places the loss to the United States' semiconductor business at \$7.5 billion annually and a loss of approximately 11,000 jobs.(7)

More recently, the United States has taken additional actions to detect counterfeit parts within its supply chains and then prosecute and punish those involved. Operation Chain Reaction,(8) a joint venture between 16 federal law enforcement agencies, investigated counterfeit products that made their way into U.S. government and military supply chains. Investigators were able to seize cash and items worth more than \$13.7 million. Among the 23 convictions, a few individuals pled guilty to the importation of counterfeit parts and selling them to the U.S. Navy. In 2011, the United States enhanced penalties for trafficking in counterfeit military goods, and some of the offenders in Operation Chain Reaction were sentenced under the new penalty structure.

Counterfeits found in information and communication technology (ITC) and parts for non-military related vehicles, vessels, and aircraft begin to blur the distinctions between national security and consumer safety. The U.S. Coast Guard recently issued a Marine Safety Alert(9) warning vessel owners, operators, and technicians about counterfeit parts. Moreover, illicit actors, including rogue nations and terrorist organizations, can reduce the ability of first responders and national security personnel's ability to communicate during a crisis if vital communication networks and devices contain counterfeit components and malfunction. A 2017 OECD report found that counterfeits could account for up to 6.5% of all ITC products worldwide. These counterfeits can become serious safety threats when they do not function correctly.

Illicit actors can instigate a humanitarian crisis or panic by penetrating supply chains for medicines. There have been numerous cases where counterfeit pharmaceuticals replaced authentic medications needed to treat malaria, HIV, and pandemics. In 2007,(10) well-publicized cases involving counterfeit diethylene glycol from China sounded the alarm, again, of counterfeit medications. The counterfeit glycol was fatal in at least 365 cases in Panama alone, and counterfeit diethylene glycol resulted in deaths and poisoning in Argentina, Bangladesh, China, Haiti, India, and Nigeria well before the Panamanian incident. Since then governments, companies, and researchers have tried to increase awareness of the dangers related to counterfeit

pharmaceuticals and authorities are increasingly concerned about counterfeit Oxycodone, Xanax, and other pills that contain Fentanyl.

The international community has organized efforts to combat the trade in counterfeit and harmful pharmaceuticals and medical devices. The World Customs Organization (WCO) and the International Institute for Research Against Counterfeit Medicines have worked together to reduce the amount of counterfeit and illicit pharmaceuticals in Africa. Since 2012, through their initiatives, they have seized illicit and counterfeit medications worth approximately €400 million.⁽¹¹⁾ During the 2016 iteration of Operation ACIM (Action against Counterfeit and Illicit Medicines), a 10-day operation made possible with the assistance of 16 African Customs agencies, authorities seized approximately 113 million counterfeit and illicit pharmaceuticals. And, INTERPOL, via Operation Pangea,⁽¹²⁾ targets online sales of counterfeit and illicit pharmaceuticals. Each year INTERPOL runs a week-long operation, and in 2017, during Operation Pangea X,⁽¹³⁾ representatives from INTERPOL, the WCO, and 123 countries joined efforts to seize more than 25 million illicit and counterfeit pharmaceuticals and medical devices worth an estimated \$51 million. Seized items included dietary supplements, contact lenses, condoms, medical and surgical equipment, and medications intended to treat malaria, psychotic conditions, epilepsy, erectile dysfunction, and pain, including opioids containing Fentanyl. The international operation also removed more than 3,500 websites.

Unscrupulous individuals can counterfeit almost any item. Authorities have uncovered examples of counterfeit airbags and other automotive components that relate to steering, braking, and safety operations of motor vehicles. Toothpaste, hair care products, cosmetics and perfumes, toys, foods and beverages, and apparel are known to be targeted by counterfeiters. These products may contain hazardous substances or may not meet manufacturing standards. For example, counterfeit batteries and e-cigarettes can cause fires on airplanes and burn users.

Finally, counterfeit products and the theft of intellectual property have an impact on a country's economic security, innovation, and its technology sector. Counterfeiters and criminals engaging in economic espionage, especially those who are state-sponsored or state-approved, also engage in reverse engineering of products and theft of defense and electronic technologies. Those who engage in state-sponsored theft of intellectual property may do so to increase military and technology advances or to bolster diplomatic and economic initiatives; whereas, non-state actors tend to be motivated by profits or to fund operations. Piracy can threaten electronic infrastructures, research and development, and productivity, especially if the pirated electronic technology and software includes malware. Economic espionage and the theft of intellectual property harms a country's academic, business, and government sectors through devaluation of products as well as attacks on infrastructures. In addition to national security concerns, theft of intellectual property negatively impacts taxation, research and development budgets, creates unfair market advantages, erodes brand integrity, reduces profits and royalties, and results in employment loss.

Other popular forms of illicit trade: tobacco, cultural artifacts & antiques, and diamonds

Numerous, seemingly legal products can generate "illicit trade" depending on their origin, transit, and legality during the supply chain. For decades, the illicit trade in tobacco, which includes counterfeit tobacco products and counterfeit tax stamps, has been a favorite revenue stream of organized crime, drug cartels, terrorist organizations, and even some governments. Some, including drug trafficking organizations, have used cigarettes instead of cash for payments or moving money. This form of illicit trade undermines health policy, reduces tobacco-related taxes that pay for various government programs and expenses, and moves production jobs to the underground economy or abroad.

The volume of trade in illicit tobacco is staggering and yields significant profits while exploiting weaknesses in sovereign countries' borders and law enforcement efforts. The estimates for the illicit trade in tobacco products are astounding. The World Health Organization⁽¹⁴⁾ (WHO) estimates that one in ten cigarettes consumed worldwide is illicit. The WCO's 2016 Operation Gryphon II,⁽¹⁵⁾ a two-month operation that involved customs agencies and other intergovernmental organizations from around the globe, seized an impressive "729 million cigarettes, 287,000 cigars, and 250 tonnes of other tobacco products [...] Components of machines used to manufacture cigarettes were also seized along with bulk cash and more than 12 million excise duty stamps." The European Union⁽¹⁶⁾ reported that counterfeit cigarettes accounted for 24% of all

counterfeit products seized in 2016 - the largest category of counterfeit products seized that year. A 2017 European Union report estimated that if all illicit tobacco were sold legally, more than €10 billion annually would be added to European Union countries' treasuries. The United Kingdom(17) alone estimated approximately £2 billion in annual revenue losses from illicit tobacco in 2015. These statistics illustrate the global nature and size of the illicit trade in tobacco as well as illicit networks' ability to penetrate borders and markets.

Numerous reports and academic studies have linked organized crime and terrorist organizations to the illicit trade in tobacco products. Italian mafias(18) engaged in cigarette smuggling throughout the 20th Century.(19) The Royal Canadian Mounted Police(20) estimated that 175 organized crime groups operating in Canada were involved in the illicit tobacco trade and about three-quarters of those groups also trafficked weapons and drugs. Concerning terrorist organizations, in their 2015 report,(21) the Center for the Analysis of Terrorism, located in Paris, France, estimated that approximately fifteen terrorist organizations, including Al-Qaeda in the Islamic Maghreb (AQIM), engage in cigarette smuggling as a regular and very profitable activity. In 2015, the U.S. Department of State, in consultation with numerous U.S. government partners, published *The Global Illicit Trade in Tobacco: A Threat to National Security*. This publication discusses the intersections of illicit tobacco national security concerns, such the involvement of transnational organized crime and terrorism and the attempted importation of a surface-to-air missile and highly-deceptive counterfeit currency. Additionally, the European Union,(22) in 2017, concluded that illicit tobacco is a funding stream for organized crime groups and terror financing.

Another form of illicit trade that has received increased attention is the illicit trade in cultural artifacts and antiquities. The theft or destruction of cultural property has two positive outcomes for illicit actors: a revenue stream and removal or destruction of cultural artifacts that contribute to ethnic cleansing. The international community began to realize the importance of combating this market during World War II with the plundering of art and artifacts during the Nazi occupation and the Soviet Union's Trophy Brigades.(23) The theft of cultural artifacts and their movements through illicit markets has occurred in Latin America, Asia, Africa, and the Middle East for decades. More recently, the Islamic State of Iraq and the Levant's(24) (ISIL)(25) use of this black market and the destruction of cultural artifacts have increased awareness of this revenue stream and the illicit networks utilized. Initially, ISIL only taxed(26) the antiquities market, but then they took over the market entirely and maintained control from extraction to exportation of the items.

Cultural property not only generates revenue streams but can also be a vehicle for moving value across borders. Illicit actors can move stolen artifacts and art pieces through specialized black markets that provide them with needed buyers and finances to continue their operations or to move funds undetected. While the proceeds of this form of illicit trade might not reach the levels of drugs, tobacco, or counterfeits, the markets themselves can provide governments with the needed intelligence(27) to map them, determine points where various actors converge, and shut down critical players and sources of revenue.

The theft and trafficking of these treasures not only fund illicit activities but also contributes to the pilfering a society's cultural heritage; we cannot estimate those costs. While we cannot measure the actual proceeds or social costs, a 2011 Rand report(28) cited estimates that place the size of the illicit trade to be about \$6 billion annually. Targeted operations and seizures also help illuminate the size of the illicit trade in cultural property. In 2016, Operation Pandora(29) - a week-long operation that included the WCO, Europol, INTERPOL, The United Nations Educational, Scientific and Cultural Organization (UNESCO), and numerous countries - seized more than 3,500 items and arrested 75 people. Operation Pandora was only one week, but law enforcement and experts around the world help combat this trade throughout the year.

Cultural property and works of art are not the only commodities that can be used to move value across borders. The trade in illicit diamonds allows nefarious actors to move value across borders with little risk of detection. Diamonds can also serve as payment for weapons, cigarettes, bribes, debts, and drugs. They can fund organized crime, terrorism, corruption, and most notably - wars. While all conflict diamonds are illicit diamonds, not all illicit diamonds are conflict diamonds. Illicit diamonds can be ethically and legally sourced, polished, and traded; but, once they cross a border without the appropriate duties paid, they become illicit. Conflict diamonds(30) are illicit diamonds that are also rough diamonds, usually mined in rebel-held

territories. Conflict diamonds, or blood diamonds, are used by rebel groups to fund armed conflicts against internationally recognized governments.

Diamonds have unique properties that make them very attractive as a form of illicit currency, and as a means to move value across borders. A semi-unique quality of diamonds, and some other precious stones and metals, is that they can earn, transport, and store value. They are also difficult to detect at borders and are susceptible to customs fraud as well as under- and over-valuation schemes. Not surprisingly, the Financial Action Task Force (FATF) concluded in their 2013 analysis, *Money Laundering and Terrorist Financing Through Trade in Diamonds*(31), that diamonds have a high-value to weight ratio and are susceptible to criminal exploitation in trade-based money laundering schemes. Increasing the attractiveness of diamonds to criminals is the lack of awareness or attention paid by authorities – despite the known vulnerabilities in the diamond pipeline and that diamonds are “one of the most common methods used by criminals to launder illegally gained funds.”(32)

Countering illicit trade

When experts illuminate threats and revenue streams and then develop countermeasures, illicit actors tend to move into less risky activities. Therefore, it is prudent to raise awareness of numerous revenue streams and forms of illicit trade, dedicate analysts to monitoring these threats, and encourage data collection on not only seizures but also on the illicit networks and smuggling methods/routes. These efforts should be at the local, national, and international levels and include governments, inter-governmental organizations, the private sector, and academia. Collectively, these stakeholders can bring together their different methodologies and perspectives to create a more holistic approach and to counter these threats while expanding the knowledge base relating to the illicit networks behind these crimes.

There is diversity among the schemes and the type of actors involved, and counterintelligence and national security personnel need to be aware of the various manifestations of illicit trade and intellectual property theft. Analysts should look at supply chains, legitimate networks and infrastructure related to trade, delivery methods, and retail distribution. Focusing only on a particular product or market might not be as important as identifying key variables, steps, or skills that enable illicit actors to exploit criminal opportunities and vulnerabilities in legitimate markets. For example, some characteristics of non-traditional revenue streams include low risk of detection, low risk of punishment or punishments are minor compared to trafficking in drugs or humans, economic or other useful gains (e.g., intelligence and establishing relationships and trafficking routes), and various forums and levels of corruption.

Capacity building initiatives and training can lead to an increase in the quality and quantity of data for law enforcement and intelligence analysts. Universities and the private sector can assist with research and training programs. Inter-governmental organizations, such as INTERPOL, can play a role in capacity building too. They have designed, in cooperation with Underwrites Laboratories (UL), an online training program called the “International IP Crime Investigators College”(33) that provides free training to law enforcement officers worldwide and in more than 20 languages. The program covers the dangers of illicit trade, distribution means and networks, counterfeit goods and piracy, and illicit tobacco as well as how law enforcement can detect and investigate these crimes. Furthermore, the U.S. Department of Justice published a 2013 manual(34) and a 2016 United States Attorneys’ Bulletin(35) that provides guidance on prosecuting intellectual property crimes. Finally, public and private sectors can lessen the vulnerability of supply chains by offering training and guides that include anti-counterfeiting components and best practices, such as the U.S. Federal Bureau of Investigation (FBI)’s guide(36) for Supply Chain Risk Management.

Once governments expand their analytical approaches and efforts to combat illicit trade, then they can work together to form networks of intelligence analysts, law enforcement officers, judicial personnel, and policymakers. These networks can develop national and international strategies that limit the economic and operational benefits of illicit trade involving commodities such as counterfeit goods, tobacco, cultural property and antiquities, diamonds, gemstones, and precious metals.

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The characterizations and opinions in this piece are those of the author and do not necessarily represent those of the U.S. government.

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