

CONFERRONTING ILLICIT TOBACCO TRADE:



WORLD BANK GROUP

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

INTRODUCTION

TECHNICAL REPORT OF THE WORLD BANK GROUP
GLOBAL TOBACCO CONTROL PROGRAM.

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INTRODUCTION

Introduction

Why is Illicit Trade in Tobacco Products a Problem?

Tobacco use results in unparalleled health, economic, and social losses worldwide. It is estimated that 1.1 billion people smoke globally, or 21 percent of the world's adult population.¹ Tobacco kills at least half of long-term smokers, accounting for more deaths each year than HIV/AIDS, tuberculosis, and malaria combined. As a result, about 7.2 million people die each year,² and if the current trend continues, tobacco will kill more than 8 million people annually by 2030.³ Low- and middle-income countries, where about 80 percent of these premature deaths occur, disproportionately carry this burden.⁴ Tobacco-related deaths are not only tragic because they are preventable - they also impose substantive burdens on national economies, and in most cases on economies that can least afford it. The worldwide economic costs of smoking are estimated to reach at least US\$ 1.4 trillion per year, equivalent to 1.8 percent of the world's GDP. Almost 40 percent of these costs occur in developing countries.⁵

Increasing excise tax rates on tobacco to reduce its affordability and, as evidence shows, lower its consumption is a policy measure that can simultaneously save millions of lives, reduce poverty, and increase countries' domestic resources for financing development. A recent World Bank Group publication, *Tobacco Tax Reform: At the Crossroads of Health and Development*, details how this powerful human development and poverty reduction measure remains largely underutilized, especially in low- and middle-income countries (LMICs). As that report highlighted, higher tobacco taxes improve public health, increase tobacco tax revenue, and reduce the economic burden associated with tobacco use.⁶ Importantly, this publication also emphasizes the continuing extraordinary divergence between high-income countries, which are increasingly using price and non-price tools to

lower their death rates from tobacco, and LMICs, where the number of tobacco deaths continues to grow.

Illicit trade in tobacco products undermines global tobacco prevention and control interventions, particularly with respect to tobacco tax policy. It impacts average prices of these commodities, therefore their affordability; it can increase disparity in tobacco use since the illegal products are disproportionately consumed by low-income populations; it increases the choice of brands, which can increase overall demand; it enhances access to tobacco products, particularly for youth, as the illegal products are often distributed via unregulated channels; it undermines health warning and ingredients disclosure policies, since the illegal products often do not comply with the local laws; additionally, tax evasion associated with the illegal tobacco market reduces government tax revenue⁷ and can alter attitudes toward paying taxes more generally.⁸ Moreover, tobacco industry documents provide compelling evidence that the supply of international brands via illegal channels has been an important component of their market entry strategy in Africa, Latin America and in Asian countries.⁹

It has been estimated that the illegal cigarette market reduces average cigarette prices by about 4 percent and is responsible for about 2 percent higher cigarette consumption. This translates to about 164,000 premature deaths a year.¹⁰ There also are concerns about the relationship between illicit tobacco trade, public safety, and governance, since illegal networks both thrive in and contribute to weak governance contexts. In addition, tobacco business interests often use the presence of illegal tobacco products to advocate for reductions in tobacco control policies and/or to prevent tobacco tax increases. The tobacco industry commonly argues that higher taxes and prices (as well as other tobacco control measures), will motivate customers to buy illegal products rather than smoking less or quitting, and that this will impact tax revenue without a decline in tobacco use. Numerous empirical analyses, across a diversity of countries – including the case studies presented in this report – refute this argument.

What is Illicit Trade in Tobacco Products?

There is a substantial literature on issues relating to illicit trade in tobacco products. As a result, this introductory chapter merely drawing on them, outlines key issues/challenges, followed by providing an overview of this report's content. Illicit tobacco trade refers to any practice related to the tobacco supply chain, including distributing, selling, or buying tobacco products that is prohibited by law, including tax evasion. Illegal methods of circumventing tobacco taxes are called tax evasion, as they intend to avoid paying all or some tobacco taxes, and include, for example:^{11,12}

- » Smuggling tobacco products across borders;
- » Illegal tobacco product manufacturing by legal operators;
- » Producing counterfeit ^a, illicit white cigarettes ^b or unbranded tobacco ^c;

- » Distributing and selling any illegal products to the market;
- » Disguising the origin of products to avoid taxes;
- » Selling tobacco products via Internet, phone or mail without paying the appropriate taxes.

Illicit trade can be undertaken both by illicit players who are not registered with relevant government agencies, as well as by legitimate entities whose business operations are contrary to applicable laws and regulations. Dealing in illicit tobacco products can involve small- or large-scale operations. Small-scale operations usually involve moving more than the allowable tax-exempt volume of products across the border more than the allowable limits and/or when products purchased “for personal consumption” in one country are sold for profit in another country, without paying appropriate taxes (i.e., bootlegging).

Large-scale tax evasion generally focuses on avoiding all taxes and involves disguising/hiding products and organized criminal networks. Counterfeits, genuine products with counterfeit tax stamps, illicit “white” cigarettes, undeclared local production, and unaccounted for unbranded tobacco have all been identified as part of large-scale tax evasion schemes. Notably, not all products that have not paid taxes are illegal. Tax avoidance consists of legal activities and purchases in accordance with customs and tax regulations, but in a manner that uses loopholes or other legal means to reduce or eliminates taxes. Tax avoidance is often conducted by individual tobacco users, for example, frequent border crossings to bring in the maximum duty-free tobacco allowance. Tobacco companies can avoid taxes on a much larger scale by, for example, buying tax stamps or sharply building up inventories before scheduled tax increases tax occur.

In most cases, the prices of illicit tobacco products are lower than the retail price of legal tobacco products, in order to make them more attractive to consumers. For example, the average street price of smuggled cigarettes was 50 percent, 50 percent, 60 percent, and 67 percent cheaper compared to the average price of legal cigarettes in Brazil, Argentina, Uruguay and Paraguay, respectively.¹³ In Malaysia, the average price of illegal cigarettes was about 55 percent lower compared to tax-paid cigarettes in 2011.¹⁴

Unsurprisingly, the illegal nature of tax evasion makes the task of measuring its scale extremely difficult. Recent consensus among experts estimates the annual revenue loss in tobacco taxation worldwide at US\$40–50 billion, that is, about 600 billion sticks (individual cigarettes), or 10 percent of global consumption¹⁵.

^a Counterfeit cigarettes are cigarettes manufactured without authorization of the rightful owners of the trademarked brand, with intent to deceive consumers and to avoid paying duty

^b Illicit white cigarettes are brands manufactured legitimately in one country but smuggled and sold in another without duties being paid.

^c Unbranded tobacco is often sold as finely cut loose leaf tobacco. It may involve misrepresentation of the quality and origin, or failure to obtain a license to grow and produce tobacco, and/or failure to register as an importer/exporter.

Why Addressing Illicit Trade in Tobacco Products Matters

As noted above, illicit trade in tobacco products contributes to numerous health, economic, and governance challenges. However, four are most salient.

- » **Illicit tobacco kills.** The fundamental reason to confront illicit trade in tobacco products involves its public health impact. All tobacco products are dangerous to human health, including those produced and sold in strict legality. However, illicit tobacco harms individual and population health in additional ways. From a public health perspective, illicit trade weakens the effect of tobacco excise taxes on tobacco consumption - and consequently on preventable morbidity and mortality - by increasing the affordability, attractiveness, and/or availability of tobacco products.
- » **Youth and the poor are most impacted.** Illicit cigarettes generally sell for considerably less than their tax-paid equivalents, as evidenced by the case studies presented in this book. They inflict the greatest harm to the most price-sensitive population group, reducing prices to and so encouraging consumption by, in particular, young people and those with low incomes. The availability of inexpensive illicit cigarettes increases the likelihood of young people developing addiction (particularly where illicit imports "glamorize" smoking through aspirational brands). It also encourages the poorest quintiles of the population to continue smoking, rather than choose to quit, even when tobacco taxes and the price of legal cigarettes rise. The poor tend to have higher tobacco consumption levels and consequently are disproportionately impacted by tobacco-related diseases and premature deaths, placing them at higher risk of being pushed into extreme poverty due to costs of treatment and/or loss of income when an income-earning smoker develops a tobacco-related disease. As a result, illicit trade in tobacco products exacerbates equity gaps.
- » **Confronting illicit trade in tobacco products supports improved governance.** Tobacco illicit trade, by definition, reduces revenues that would otherwise be paid to government that could be invested in tobacco control and other priority programs that benefit the population. It also negatively impacts public welfare in other ways. For instance, illicit trade in tobacco is not only inconsistent with the rule of law, but often depends on and can contribute to weakened governance (e.g., through corruption and the presence of organized criminal networks). In contrast, confronting this issue can yield broader benefits for governance - tools and capacities developed to address illicit trade in tobacco products can strengthen overall tax administration, compliance, and enforcement (including for other products subject to excise taxes, such as alcohol and fuel). Controlling illicit trade in tobacco products and enhanced overall governance are mutually reinforcing.
- » **Uncontrolled illicit trade in tobacco provides opportunities for the tobacco industry to misinform public opinion and unduly influence public policy.** As emphasized in this report's country case studies and other recent analyses¹⁶, the tobacco industry routinely

uses inflated estimates of the impact of tobacco taxes on illicit trade to campaign against tobacco tax increases and misinform public opinion. By accurately measuring and better controlling illicit trade in tobacco, governments reduce industry's ability to distort policy priorities supporting improved public health, tax administration, and governance. For example, as emphasized in the Colombia chapter, an initial study to quantify the true volume of illicit cigarette trade in the country (notably, the first of its kind not to be sponsored by tobacco companies) was essential to galvanizing support for increased tobacco taxation.

What Causes Illicit Trade?

Contributing factors to illicit trade are complex. However, contrary to tobacco industry arguments, taxes and prices have only a limited impact on the illicit cigarette market share at country level.¹⁷ Evidence indicates that the illicit cigarette market is relatively larger in countries with low taxes and prices while relatively smaller in countries with higher cigarette taxes and prices.¹⁸ Non-price factors such as governance status, weak regulatory framework, social acceptance of illicit trade, and the availability of informal distribution networks appear to be far more important determinants of the size of the illicit tobacco market.¹⁹

Numerous studies confirm that higher taxes lead to higher prices of legal tobacco products, and there is some evidence that the prices of illegal tobacco products also increase in response to higher taxes. Research suggests that a cigarette tax increase can lead to more small-scale tax avoidance and tax evasion.^{20,21} However, since the supply of illegal products via these channels is relatively small, the overall impact on the size of the illicit cigarette market remains minimal.^{22,23} Additionally, higher cigarette taxes lead to overall lower cigarette demand even when illicit products are available.²⁴ As a result, any new tax avoidance/evasion activities do not eliminate the effectiveness of tobacco tax increases in reducing tobacco use and raising revenues.²⁵ For example, South Africa raised excise taxes from 38 percent to 50 percent of the retail price in the 1990s and reported a relatively small response of the illicit cigarette market, but a two-fold increase in excise tax revenue ((this was despite a drop in legitimate sales of 20 percent and resultant health benefits).²⁶ Similarly, the illicit market share in Turkey remained stable at 12 percent five months after a substantial tax increase in January 2013.²⁷

The decision to supply a market with illegal cigarettes seems largely determined by costs associated with overcoming legal and regulatory hurdles, as well as delivery costs. These costs are related to the probability of detection, the certainty of sanction, the size of penalties, the presence of smuggling routes and black markets, and licensing requirements for distributors.²⁸ Delivery costs seem to play a large role as a factor influencing the supply of illegal products, since illicit trade in tobacco frequently is viewed as a low risk operation.²⁹ Large-scale tax evasion, which is responsible for most products on illegal cigarette markets, yields higher profits and is heavily influenced by inadequate governance, existence of criminal networks, and weak tax administration.^{30,31} Small-scale smuggling (bootlegging) generally

involves lower profit and is more responsive to the relative price differences between adjacent jurisdictions, the distance to travel, and the opportunity costs of time (such as foregone income).

Measures to Address the Illicit Trade in Tobacco Products - What Do Countries Do and What Seems to be Effective?

Measures controlling the illicit tobacco market are a necessary component of a well-designed tobacco control policy. The degree of government effort to combat illicit trade in tobacco products is motivated both by the potential tax revenue gain and by public health gains due to lower tobacco use. The revenue gain is positively related to both the size of the problem and the tax level, while the public health gains depend on overall smoking prevalence. This implies that a tax increase should intensify the motivation for addressing tax evasion, while also generating the necessary funds to invest into enforcement of measures controlling the illicit tobacco market.

Since illicit trade in tobacco products is determined by multiple factors, an effective strategy to address this issue would need to be explicitly multi-sectoral, involving all relevant agencies of government. Ideally, ministries of finance, trade, industry, foreign affairs, justice, interior, customs, education, and health would be involved, in addition to civil society and the media.³² The design of an effective system must start with a detailed analysis of all aspects of illicit tobacco products supply and demand, as well as related governance strengths and weaknesses. This analysis (i) should determine any loopholes in existing tax administration, including the degree of legal tax avoidance; (ii) should analyze gaps in law enforcement, provide an overview of anticorruption efforts, assess the certainty, swiftness and severity of punishment if convicted, assess the advantages and disadvantages of using administrative rather than criminal sanctions; and (iii) evaluate the level of coordination and collaboration among different authorities and within the government. Vested interests of key stakeholders and public opinion regarding illicit tobacco trade can influence the degree of tax evasion and, consequently, also need to be examined.³³

Prioritizing and coordinating control of the entire supply chain (from the fields where tobacco leaves are grown, or the port of entry, to the final purchase by the individual consumer) and enforcement of tobacco regulations have proven to be effective measures in reducing tax evasion along with the consumption of tobacco products.³⁴ Importantly, the WHO Framework Convention on Tobacco Control's (FCTC) Protocol to Eliminate Illicit Trade in Tobacco Products defines shared global standards for addressing illicit trade (detailed in Chapter 2). **Table 1** (Annex) summarizes common measures aiming to control the supply of illicit tobacco products, including track-and-trace systems that have been identified by the Protocol as a central approach.

As noted above, enforcement is a vital component of any system aimed at prevention and reduction of illicit trade in tobacco products. **Table 2** (Annex) summarizes common features of effective enforcement strategies. In this regard, it is significant to note that tobacco excise taxes usually perform better in terms of compliance, compared to other taxes (e.g., revenue losses due to corporate or individual income tax evasion in many countries are much larger in both absolute and relative terms).^{35,36}

The nature of the illicit trade in tobacco products requires international and cross-border collaboration and coordination. **Table 3** (Annex) lists features of international collaboration aimed at prevention and reduction of illicit trade in tobacco products. Importantly, the approaches outlined in these three tables are not intended as stand-alone interventions for preventing or reducing illicit trade. As with other tobacco control strategies, these measures are most effective when implemented as part of a comprehensive approach to controlling illicit tobacco trade.

It should be noted that the approaches to control illicit tobacco trade need to be subject to very regular surveillance, monitoring, and evaluation due to the inherently dynamic and adaptive nature of the illicit market. As emphasized in a recent IMF report on tobacco tax administration and enforcement, even in a single country, solutions that worked once might not work twice.³⁷

Confronting Illicit Trade in Tobacco: A Tough Fight—That Countries Can Win

Confronting illicit trade in tobacco is critical to effective tobacco control in all countries. However, addressing this issue poses complex political, legal, and technological challenges. As such, illicit trade is one of the topics on which policymakers and program implementers responsible for national tobacco control most frequently request information and technical collaboration from international organizations.

Policymakers may have been told, in particular by representatives of the tobacco industry, that high levels of illicit trade inevitably accompany the implementation of aggressive tobacco control measures, in particular tobacco excise tax increases. This is false. The country experiences analyzed in this volume make clear that countries can and do contain or reduce illicit trade while advancing other effective tobacco control strategies, including tax increases. Indeed, as noted below, the opportunities for success are greater now than ever, for countries prepared to take bold action.

In September 2018, the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products entered into force. By providing comprehensive norms and a framework for global cooperation, the Protocol provides countries a game-changing opportunity to advance progress against tobacco-related morbidity and mortality by challenging illicit trade in tobacco. By seizing the opportunity and intensifying action against illicit trade, in line with the Protocol,

countries can harness increasing political momentum, forge global and regional partnerships for collaboration and knowledge sharing, and score decisive victories against illicit trade in tobacco in the years ahead.

To fully benefit from the Protocol, policymakers and implementers now seek to connect its normative guidance with empirical data and analysis on countries' illicit trade in tobacco control experiences to date—what has worked, what has not worked, and why. That is where this book comes in.

What This Book Offers

In response to numerous country requests, this report marshals evidence from national and regional experiences to inform anti-illicit trade strategies for tobacco products. The book presents country and regional case studies, covering over 30 countries, that detail countries' illicit trade context, legal and policy frameworks, enforcement strategies (and technologies used to address illicit trade), results obtained, and recommendations regarding further strengthening tobacco illicit trade control. Taken together, these studies show:

- » Why illicit trade in tobacco matters to policymakers in all countries
- » What constraints policy makers and implementers face in addressing illicit trade in tobacco products
- » What works to control illicit trade in tobacco products across a diverse selection of countries
- » What prioritized steps countries can take to initiate/sustain/strengthen action against illicit trade in tobacco products.

The book presents information, analysis, and options for national policymakers (and their technical advisers) in the multiple sectors that must work together against illicit trade in tobacco, including health, finance, trade and customs, and law enforcement. The book also provides resources to inform and empower civil society watchdog and advocacy organizations. As the included case studies confirm, civil society's role in monitoring and combating illicit trade in tobacco products is crucial.

Illicit Trade in Tobacco Products Case Studies: Knowledge for Action

As noted above, the reasons to confront illicit trade in tobacco products are compelling. The question is **how**. In response to demand from senior government officials and other partners, this book provides practical input and guidance based on diverse country experiences. The volume adopts a model of practice-oriented case studies designed to complement the guidelines set forth in the WHO FCTC Protocol, and other normative

sources. The aim is to present hands-on facts and good practice guidance that policymakers and implementers can readily utilize, as appropriate.

All included case studies are authored by experts with frontline knowledge of illicit trade in tobacco products control in the respective countries and/or global sub-regions - in some cases, government officials who have themselves been engaged in designing and implementing illicit trade in tobacco products programs, in other instances independent experts with deep understanding of the country or region and its tobacco illicit trade challenges. The case studies adopt varied formats, although each presents data on the following topics: (i) the jurisdiction's political, economic, and epidemiological context; (ii) specific forms of illicit trade in tobacco products; (iii) legal, policy, and institutional measures and reforms introduced to address illicit trade in tobacco products; (iv) enforcement strategies and technological solutions; (v) results; and (vi) lessons learned. Each case study offers concluding recommendations for further strengthening tobacco illicit trade control efforts.

Efforts to confront illicit trade in tobacco products are closely entwined with national and regional tobacco taxation policies, not least because of the tobacco industry's consistent instrumentalization of illicit trade in tobacco products to discourage tax increases. To maintain a clear focus, the case studies in this volume discuss tobacco taxation policies only to the extent required to understand countries' illicit trade in tobacco products challenges, responses, and results.

Structure of This Volume

The core contents of this volume are organized as follows. **Chapter 1** provides historical, conceptual, and policy foundations of addressing illicit trade in tobacco products. Authored by the Head of the Secretariat of the WHO Framework Convention on Tobacco Control (FCTC), the chapter analyzes the WHO FCTC Protocol on the Elimination of Illicit Trade in Tobacco Products, discusses challenges countries will face in implementing the Protocol, and highlights strategies for minimizing tobacco-industry influence over national illicit trade in tobacco products policy.

Part I (Chapters 2-7) looks at illicit trade in tobacco products control efforts in **Europe, Australia, and Canada**. **Australia** broke ground in illicit trade in tobacco products control with its Black Economy Task Force, whose 2017 report analyzed the economic and security threats posed by illicit trade in tobacco products; confirmed the role of organized crime in illicit tobacco; and outlined an agenda to reinforce Australia's detection capabilities and applicable penalties. The **Canada** case study addresses the complex political dynamics of illicit trade in tobacco products in that country, with distinct control models in different provinces; recurrent tobacco-industry instrumentalization of illicit trade in tobacco products to resist tobacco tax hikes; and the challenge of addressing illicit cultivation, manufacture, and sale of tobacco products by some Indigenous communities. The **European Union**

study details political and technical aspects of the EU's effort to curtail illicit trade in tobacco products through regional legislative and security collaboration, while supporting Member States to adopt EU-defined minimum tobacco tax rates. **Georgia** has brought its illicit tobacco market under greater control, largely due to a far-reaching reform of the country's Revenue and Customs services. The case study documents how, in a relatively short timeframe, Georgia reduced corruption, set up effective tax administration and enforcement, and instituted more robust border controls. Today, ongoing challenges for Georgia include countering tobacco-firm tax avoidance strategies such as "forestalling": i.e., ordering a larger-than-needed quantity of tax stamps just before a tax increase. **Ireland** reduced its illicit trade in tobacco products prevalence over the decade 2007-17 thanks to an aggressive enforcement program including dissuasive fines and custodial sentences for some convicted traffickers, among other features. The country's average fine for illicit trade in tobacco products-related offenses rose from around €600 in 2010 to more than €2500 in 2017. In the first ten years of its illicit tobacco strategy, the **United Kingdom** cut the illicit market share for cigarettes from 22 to 12 percent, even as authorities pursued tobacco tax hikes that have helped substantially reduce smoking rates. Recent threats of a rebound in illicit trade in tobacco products levels in the United Kingdom underscore, meanwhile, that even high-performing national programs can falter, if governments fail to maintain the needed anti-illicit trade in tobacco products investments.

Part II (Chapters 8-13) presents studies from **Latin America and the Caribbean**. **Chile's** average per capita consumption of tobacco products is among the highest in the world. The country lacks a comprehensive illicit trade in tobacco products control strategy but is moving forward with the implementation of a national track-and-trace system. The case study identifies priority actions to strengthen Chile's anti-illicit trade in tobacco products efforts, including: signing and ratifying the Protocol; reducing the political influence of the tobacco industry; producing independent information on the illicit cigarette trade; and applying harsher sanctions to those convicted of involvement in illicit trade in tobacco products. **Colombia** successfully contained illicit trade growth following a major tobacco tax hike in late 2016. However, wide variations in illicit trade in tobacco products prevalence across subnational regions call for more effective collaboration between national and local governments, while plans for a unified national tobacco-product tracking and tracing system remain on hold—a key pending opportunity to strengthen illicit trade in tobacco products control capacities. In 2017, **Mexico** adopted a fiscal mark for cigarettes incorporating unique identifier codes. The approach could signal a qualitative leap in Mexico's ability to control illicit trade in tobacco products. However, the absence of a public bidding process for the development of the technology used to generate codes has raised concerns about the system's vulnerability to manipulation, underlining that rigorous transparency is essential in all illicit trade in tobacco products lawmaking and enforcement processes. The illicit trade in tobacco products response in the countries of the **Organization of Eastern Caribbean States** (OECS) and **Trinidad and Tobago** remain in early stages. However, health officials

and experts in these countries are actively examining options for regional cooperation in tobacco tax policy and illicit trade in tobacco products control. Notably, **Ecuador's** tax track-and-trace system for domestically produced cigarettes, alcoholic beverages, and beer, was implemented by its Internal Revenue Service in 2017. As the first track-and-trace system to comply with the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, Ecuador system has become a benchmark for other countries. After ratifying the WHO Framework Convention on Tobacco Control in September 2004, **Uruguay** has put in place a strong national tobacco control policy implementing a comprehensive set of measures and is increasing focusing on addressing illicit trade in tobacco products.

Part III (Chapters 14-17) encompasses **East Asia** and **South Asia**. Tobacco epidemics and illicit trade in tobacco products challenges vary widely across this vast region, with some Asian countries reporting adult male smoking rates that are among the highest in the world. This context makes confronting illicit trade in tobacco products control all the more vital, particularly given the correlation between inexpensive illicit cigarettes and smoking prevalence among youth. In **Bangladesh**, authorities have successfully engaged civil society and youth in anti-illicit trade in tobacco products efforts and have used administrative innovations such as Mobile Courts to strengthen local enforcement and shorten lag times between illicit trade in tobacco products-related charges, judicial decisions, and the imposition of sanctions. **Indonesia**, with male smoking prevalence above 60 percent, has moved to tighten enforcement against illicit trade, including by raising the weight of anti-illicit trade in tobacco products activities in work contracts and performance evaluations for Customs and Excise personnel. The number of enforcement operations in Indonesia aimed at illegal cigarettes rose from 996 in 2014 to 3,950 in 2017. The estimated share of domestic illicit trade in tobacco products in the total cigarette market shrank from 12.1 percent in 2016 to 7.0 percent in 2018. The main smuggling modality in **Malaysia** is under-declaring or mis-declaring the quantity or value of transported cigarettes. Key illicit trade in tobacco products enforcement activities include inspecting goods entering Free Trade Zones. Special operations, road blocks, and regular land and sea patrols are carried out at strategic locations. Using pre-defined risk rules, inspectors target high-risk consignments. The **Philippines** moved to strengthen illicit trade in tobacco products control in line with the country's 2012 "sin tax" excise hikes on tobacco products and alcohol. Enforcement tools include revenue stamps, licensing, monitoring and surveillance of taxpayers and importers, x-ray machines, audits, and the imposition of stiff penalties for violators. Both the Philippines and Malaysia cases stress the importance of reinforced regional collaboration to take promising illicit trade in tobacco products control results to the next level.

Part IV (Chapters 18-21) looks at illicit trade in tobacco products in **Sub-Saharan Africa**. **Kenya** has invested substantially in illicit trade in tobacco products control and reaped impressive rewards. The country's new excisable goods management system for tobacco and alcohol products was introduced in 2013-14 and has proven both more effective and less expensive than the previous system. This case study emphasizes that the improvement

in Kenya's tobacco tax system and enforcement has not been an exclusively technical endeavor. It involved consensus building, the participation of multiple stakeholders, and comprehensive approaches to address tax evasion, recognizing that piecemeal measures have only short-term effects. A review of policies and enforcement capacities in the **Southern African Customs Union (SACU) countries and Zambia** identifies strengths of current control efforts, along with areas for improvement. High-quality tax stamps and track-and-trace systems are currently lacking across the sub-region, for example. The **Senegal** study shows that regional tobacco tax accords can be a double-edged weapon. The West African Economic and Monetary Union (WAEMU) has set a regional maximum tobacco tax rate, constraining Member States' options to attack cigarette affordability. In contrast, the Economic Community of West African States (ECOWAS), has recently changed its "maximum" tax rule to a "minimum" one, so that, like the EU, it does not restrain countries from going higher. This section also includes an original field study comparing cigarette and alcohol prices and stakeholder attitudes in border zones of **Botswana, Lesotho, and South Africa**. Among other findings, the research brings evidence that Botswana's introduction of substantial levies on tobacco and alcohol has not led to major increases in cross-border smuggling. These empirical findings support the argument that higher taxes alone are not decisive in fueling illicit trade.

Following the detailed exploration of individual country experiences in the case studies, **Chapter 22** steps back to propose broadly applicable lessons on strengthening tax administration to confront illicit trade in tobacco products, while reducing tobacco use. Providing a perspective from the **International Monetary Fund**, the chapter distills lessons from global experience, emphasizing that illicit trade is a context-specific activity (consequently, administrative and control measures need to reflect these realities), and that regional and international coordination can substantially improve the efficiency of national efforts.

Based on comparative analysis of all case studies through the lens of the WHO Framework Convention on Tobacco Control and its Protocol to Eliminate Illicit Trade in Tobacco Products, in addition to the International Monetary Fund perspective in supporting country efforts to control tobacco illicit trade (Chapter 22 of this volume) and the recent World Bank publication *Tobacco Tax Reform: At the Crossroads of Health and Development*, the book's **Conclusion** identifies key strategic directions that have characterized countries documenting significant advances in the control of illicit trade in tobacco products. Within this broad agenda, emphasis is placed on crucial strategic steps and specific actions policymakers and implementers can prioritize to initiate/strengthen/sustain progress in confronting illicit trade in tobacco products.

In sum, the case studies presented in this work demonstrate the importance, and feasibility, of addressing illicit trade in tobacco products as an integral part of tobacco tax reform and comprehensive tobacco control.

Annex

Table 1: Measures to Control the Supply of Illicit Tobacco Products

APPROACH	DEFINITION
Licensing	Official authorization for engaging in any activity within the tobacco supply chain, from tobacco growing to product manufacturing to product transportation, wholesale, retail, and the import/export of tobacco products. It motivates the licensees to follow legal business practices under the threat of losing the license. Linking licensing systems with product markings/stamps, recordkeeping, and a tracking and tracing system makes it more effective. Licensing producers and distributors of acetate tow, cigarette papers, and manufacturing equipment needed to produce tobacco products could control illegal manufacturing.
Product markings/stamps	Counterfeit-resistant, affixed images on product packaging that indicate at least date and location of manufacture, manufacturing facility, and product description. They should have both overt and covert security features. Markings/stamps serve up to three functions for any party in the supply system and the final buyer: a product authentication tool, a tracking/tracing tool, and a revenue collection tool. They are particularly helpful in identifying products on which taxes have been paid. They are usually applied to both domestic and imported products, but also to export if appropriate.
Track-and-trace	Systems combining markers with a national record-keeping structure to enable tracking of tobacco products throughout the supply chain, authentication, and tracing the movement of products by consulting the tracking data kept in a national information-sharing database. The system involves systematic, real-time accounting of all products, random serialization, aggregation, and monitoring of the products' movement through the supply chain. It aids crime-prevention and facilitates investigations by identifying where the originally legal products were diverted into illicit channels. The system is less effective controlling illegal manufacturing facilities or counterfeits, even though it increases the distribution costs of such products and aids their detection in the retail environment.
Bond deposit for export	Requiring export companies to deposit bonds of the same value as the excise tax on the exported products in order to create an incentive to ensure legal distribution of their products by reducing the motivation for illegal re-import of exported products, for example. The bond is released once the proof of goods' arrival at the intended destination is provided.
Controlling internet, mail and phone order sales	Requiring major credit card companies and PayPal to stop processing internet purchases of cigarettes. Collaborate with shipping companies so that they refuse to ship tobacco products.
Eliminating loopholes/ exemptions in the tax law	Sales occurring via virtual channels (e.g. internet, mail, phone) needs to be subject to the appropriate taxes. Eliminating exemptions from tax payments or managing exemptions in a way that prevents their misuse by those involved in illicit tobacco trade. These include, for example, policies addressing sales in territories exempt from taxes and in duty-free shops.
Control of special economic zones	Implementation of effective controls on manufacturing and transactions related to tobacco and tobacco products in special economic zones (SEZs) or free trade zones (FTZs), including tracking and tracing, and the prohibition of the intermingling of tobacco products with non-tobacco products in a single container.

Table 1: Measures to Control the Supply of Illicit Tobacco Products, Cont.

APPROACH	DEFINITION
Due diligence	Requiring parties engaged in the supply chain of tobacco, tobacco products, and manufacturing equipment to exercise due diligence in conducting business including proper identification of customers, monitoring sales to these customers, and reporting any suspicious activities that could result in law violation.
Record keeping	Requiring all parties engaged in the supply chain of tobacco, tobacco products, and manufacturing equipment to maintain complete and accurate records of all relevant transactions such as acquiring materials used in production, intended markets of retail sale and their volumes, the intended shipping routes, volumes kept in stock, under the transit regime or in duty suspension regime.
Supportive legal environment	Adopt legislation that clearly defines unlawful conduct related to the supply of tobacco products, determines what constitutes administrative, civil and criminal offences, and establishes liabilities for such conduct.
Public awareness	Dissemination of information about consequences of engaging in illicit tobacco trade. Educating the public about how to distinguish legal from illegal tobacco products. Dissemination of information about the impact of illicit tobacco trade on society, including easier access to tobacco products by youth, lost revenue, and support for other illegal activities. Avoid the "illegal cigarettes are more harmful" message since it can promote legal tobacco products.

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015; and from Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. Preventing and Reducing Illicit Tobacco Trade in the United States. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013; and Chris Holden. Graduated sovereignty and global governance gaps: Special economic zones and the illicit trade in tobacco products. *Political Geography* 59 (2017) 72-81.

Table 2: Enforcement Measures to Control the Illicit Trade in Tobacco Products

APPROACH	DEFINITION
Commitment to detect illicit trade activities	<p>This requires, for example:</p> <ul style="list-style-type: none"> › Installing detection equipment at customs posts such as x-ray scanners, endoscopes, mirrors, night vision equipment, special tobacco detector equipment, cameras, automatic license plate readers, and use of canines for spot-checks. › Applying physical control measures such as the separation of processing operations from the sealed storage of taxed and untaxed products, presence of an enforcement officer in the production facility, physical escort of products, inland mobile controls, joint patrols, application of radio or satellite tracking systems such as GPS-enabled devices to goods or conveyances/vehicles/containers. › Background checks, enhanced retail inspections, and zero tolerance › Setting a minimum price and ban of loose sale to aid detection › Allowing the use of special investigative techniques such as undercover operations to combat illicit trade in tobacco products. › Staff training focusing on detecting illicit tobacco professionals and anti-corruption programs supported by a code of conduct. › Constantly refining of strategies and using creativity to stay ahead of criminals.
Prosecute and sanction offenders	<p>Subject offenders to effective, proportionate, and dissuasive criminal or non-criminal sanctions, including monetary sanctions. Adopt high/escalating and swift penalties, the criminalization of excise tax/tobacco fraud, imprisonment, license revocation, confiscation of criminal proceeds, publicizing cases, and/or other measures that can be aimed at smugglers, retailers, consumers, and other participants in illicit trade to act as deterrents.</p>
Seizure and disposal of confiscated products	<p>Seizure of illegal products, identifying their geographical origin, demanding seizure payments covering at least the lost taxes from the guilty party, and destroying the products using environmentally friendly methods to the greatest extent possible, or disposing of them in accordance with national law. These need to be transparent and documented processes.</p>
Agencies' coordination	<p>Coordination among agencies within the country to support intelligence gathering, joint customs operations, and sharing of best practices. Formal memoranda of understanding between agencies help to define their respective roles.</p>
Public awareness	<p>Dissemination of information about the risks associated with illicit tobacco trade and about tools available to detect illegal products to motivate support for enforcement activities. Setting up 'hotlines' to report violations and motivate public to report illegal sales.</p>

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. *MMWR Weekly* Vol. 64, No. 20 May 29, 2015; Frank J. Chaloupka, Sarah M. Edwards, Hana Ross, Megan Diaz, Marin Kurti, Xin Xu, Mike Pesko, David Merriman, Hillary DeLong. Preventing and Reducing Illicit Tobacco Trade in the United States. Centers for Disease Control and Prevention. 2015. <http://www.cdc.gov/tobacco/stateandcommunity/pdfs/illicit-trade-report-121815-508tagged.pdf>; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013; Patrick Petit and Janos Nagy. How to design and enforce tobacco excises? International Monetary Fund 2016.

Table 3: International Collaboration to Control the Illicit Trade in Tobacco Products

APPROACH	DEFINITION
Tax harmonization	Adjacent jurisdictions agree to cooperate and try to equalize tax rates to prevent bootlegging as well as legal cross-border shopping. Since a tax reduction due to harmonization could have an adverse impact on public health and revenue that may outweigh any positive effects on reducing the illicit tobacco trade, setting up a high minimum tax floor is the best approach.
Agencies' collaboration and coordination	Collaboration and coordination among agencies across borders as well as international agencies such as Interpol and the World Customs Organization to support intelligence gathering, investigations, joint customs operations, prosecutions, posting of liaison officers, and sharing of best practices. This may require concluding bilateral or multilateral agreements/arrangements
Information sharing	Share information related to import, export, transit, tax-paid and duty-free sales, seizures and modi operandi used in illicit trade. Excise tax bonds on export should be released only after the tax administration in the receiving country confirms that all appropriate taxes for that jurisdiction have been paid.
Synchronization of national laws	Collaborate in combatting criminal offences related to illicit trade in tobacco by synchronizing national laws related to money laundering, mutual legal assistance, and extradition.

Note: Adapted from Hana Ross, Muhammad Jami Husain, Deliana Kostova, Xin Xu, Sarah M. Edwards, Frank J. Chaloupka, Indu B. Ahluwalia. Approaches for Controlling Illicit Tobacco Trade – Nine Countries and the European Union. MMWR Weekly Vol. 64, No. 20 May 29, 2015; and Protocol to Eliminate Illicit Trade in Tobacco Products, World Health Organization 2013.

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“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”ⁱ

– **Dr. Vera Luiza da Costa e Silva**
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”ⁱⁱ

– **Dr. Tedros Adhanom Ghebreyesus, Director-General**
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”ⁱⁱⁱ

– **Commissioner Vytenis Andriukaitis**
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”^{vi}

– **Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)**
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”^v

–**Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)**
Health, Nutrition and Population Global Practice / World Bank Group

