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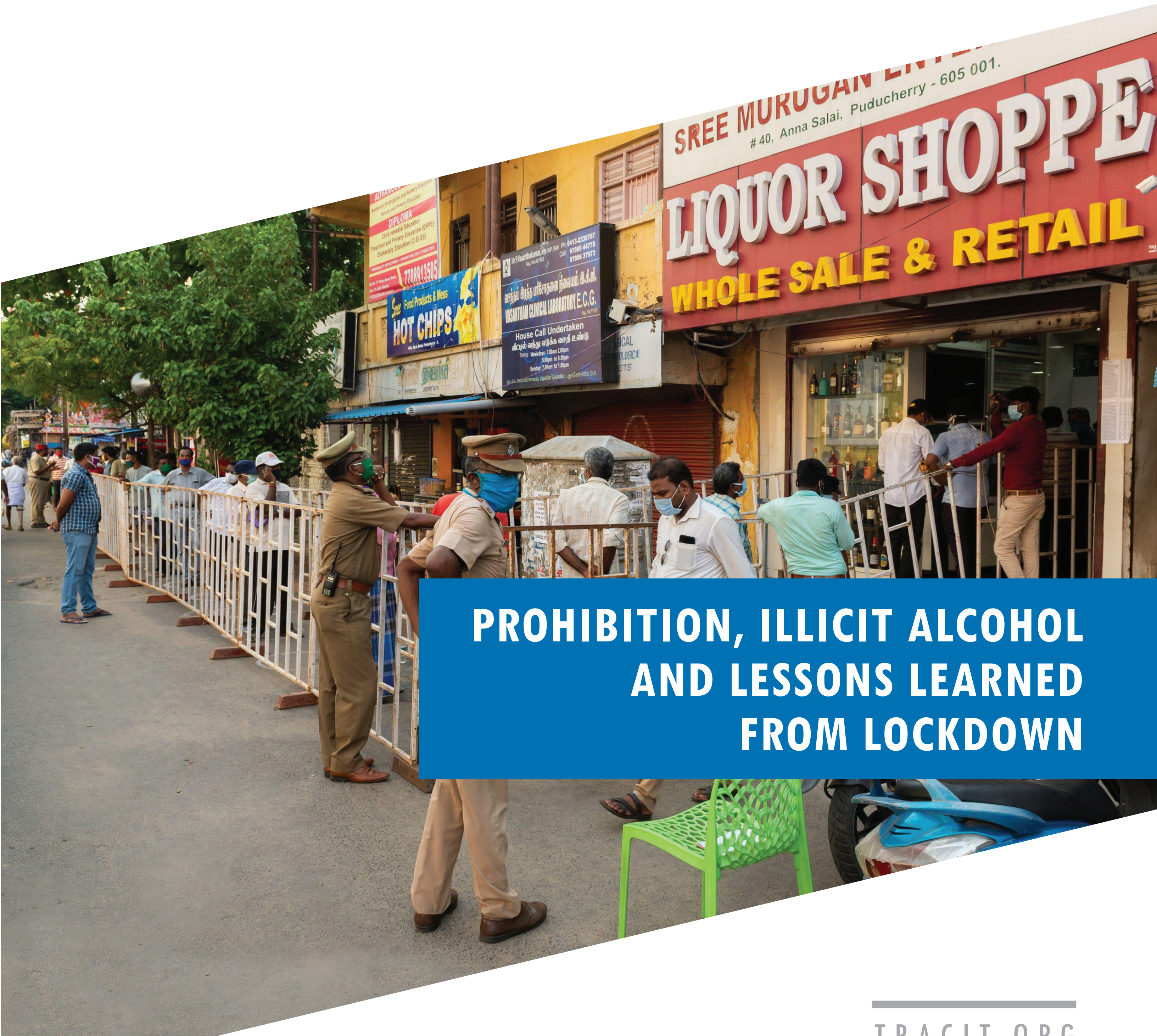

PROHIBITION, ILLICIT ALCOHOL AND LESSONS LEARNED FROM LOCKDOWN

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ACKNOWLEDGMENTS

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FOR MORE INFORMATION

This report is available online in PDF format, along with an Executive Summary and ancillary documentation. Visit www.tracit.org/publications.html

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ABOUT TRACIT

The Transnational Alliance to Combat Illicit Trade (TRACIT) is an independent, private sector initiative to drive change to mitigate the economic and social damages of illicit trade by strengthening government enforcement mechanisms and mobilizing businesses across industry sectors most impacted by illicit trade.

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Lessons learned from lockdown

In pursuit of various social, religious, health, or economic objectives governments have imposed a long history of regulatory controls on the producers and consumers of alcoholic beverages. Minimum age purchase restrictions are probably the most renowned and common. Dry laws and other forms of supply restrictions are probably the most notorious. For the most part, the failure of America's experiment with *Prohibition* has discouraged governments from imposing them. That is until the onset of the global COVID19 pandemic, when several countries opted for some form of dry law on alcoholic beverages as a tool to mitigate the impact of the virus.

> *"The sentiment in 1933, immediately following the repeal of Prohibition in the US, was that bone dry "prohibition will prove unsuccessful in controlling alcohol consumption unless such a system has behind it overwhelming public support. Even then it will tend to carry in its trail the [...] lawlessness which marked prohibition." And further, "The criminal elements arising from Prohibition must be stamped out at all costs."*[1]

Whether or not dry laws were effective in addressing the pandemic itself is not the purpose of this report. The ambition here is to analyze the economic and social impacts of dry laws beyond public health objectives, specifically those consequences associated with illicit trade.

The findings are intended to yield valuable lessons from the experience with COVID19 prohibitions, which can be applied to shaping future policymaking at the intersection of alcohol regulation, illicit trade and public welfare.

The paradox of prohibition policy

The highly contagious and lethal nature of COVID19 forced governments worldwide to rapidly implement measures to stem the spread of the virus. In pursuit of social-distancing objectives, closing large parts of economies, implementing work- and school-from-home restrictions, and even imposing personal stay-at-home quarantines quickly became the new normal. At the same time, governments were challenged to keep alive industries that they had locked down, buoy the economy and maintain employment for millions of people who might otherwise be forced into the already swollen ranks of the unemployed.

Achieving public health goals while avoiding the economic and social consequences clearly presented a paradox to policymakers rarely if ever witnessed before.

Within this mixed bag of emergency measures is the case of forced restrictions on the production, sale and consumption of alcoholic beverages, otherwise known as dry laws and collectively a modern version of prohibition.

As this report shows, well-intentioned but misconceived prohibition policies generated a number of negative health-related externalities and promoted the development of illicit markets, plunging entire industries into a financial abyss and reducing much-needed government revenue.

A step too far

Looking across these experiences, although the origin, purpose, jurisdiction and duration of the bans differed widely, a commonality was that the bans were accompanied by a number of unintended consequences, most of which conveyed negative impacts to economy and society beyond public health objectives. So, while lockdown and social distancing may have had some success in limiting the control of the virus, this report reveals that dry laws, for the most part, were a step too far. In those countries with complete bans (prohibition), the consequences have been more harmful (to consumers) and damaging (to the economy) than policymakers anticipated.

Lessons learned from lockdown

This report delineates four lessons that compel a renewed urgency to combat illicit trade in alcohol.

Lesson 1: Supply restrictions incentivize illicit markets and criminal activity

Sudden restrictions in access to legal alcohol create a downward shift in supply that causes increases in the demand for illicit substitutes and incentivizes illicit suppliers to enter the market to meet that new demand. In the case of outright bans/dry laws, consumers are prevented from purchasing legal products and pent-up demand has no other option than to shift entirely to illegal markets.

This report provides evidence on both consequences. For example, customs and police officers in India reported a significant increase in consumers' demand for illegal liquor and an uptick in seizures of illicit product. This trend repeated in Mexico, India, South Africa, Panama, Colombia, Namibia and Sri Lanka, all of which imposed prohibition measures on alcohol. Furthermore, in South Africa the Institute for Security Studies reported an increase in criminal activity and that criminal networks active during the pandemic had added illicit alcohol to other illegal products they offer clandestine customers, such as narcotics. This trend was repeatedly observed in most places where dry laws were imposed, consequently, boosting criminal activity and shifting markets further into the control of illicit actors.

Lesson 2: Beware of associated consumer health risks

Perhaps the most alarming consequence of alcohol prohibition measures was the exposure of consumers to health risks associated with toxic illicit alternatives. Beyond the fact that these illicit substitutes do not comply with sanitary, quality and safety regulations, the most hazardous are contaminated with toxic chemical additives.

In the worst cases, people died from consuming illicit beverages as a substitute or as a perceived remedy to COVID19. In other cases, they were driven to engage in harmful behaviors, such as alcohol looting and panic buying, all of which undermine social distancing objectives and their exposure to the COVID19 virus.

Therefore, the sombre lesson about prohibition and illicit alcohol is found in the collective harm, serious injury and reported death counts.

Lesson 3: Prohibition reduces tax collections and constrains budgets

Taxes collected on alcohol at various points along the legitimate supply chain are traditionally an important source of revenue for many governments. Consequently, a fiscal priority is to stop the revenue leakages associated with the sale and consumption of untaxed illicit alcohol.

During the pandemic, tax and revenue authorities from India, South Africa, Colombia, Sri Lanka, Mexico, United States, and Kenya, for example, all reported significant drops in taxes collected on alcoholic beverages.

Consequently, the lesson learned from lockdown is that governments that implement draconian supply restrictions on the alcoholic beverage sector end up depriving their own treasuries of much-needed fiscal revenue. While it is difficult to imagine that Finance Ministers would be surprised by this result, perhaps this situation highlights the need for Finance Ministers and Health Ministers to improve coordination, consultation, and joint impact assessment of proposed laws.

- This report also finds that in addition to the immediate drain on treasury revenues, negative impacts on future fiscal collections can be significant. The longer legal businesses are sidelined, the greater is the opportunity for illicit traders to capture market share and fortify demand for their untaxed, unregulated products. Under these circumstances, regaining revenue losses can take years, especially if there follows a period of economic depression and high unemployment.
- In all cases, reduced tax revenue resulting from a government's own alcohol prohibition laws puts extra burdens on its ability to pay for policing criminal activity, including cross-border smuggling activities, that underpins illicit trade. Mounting expenses in the face of declining revenues put considerable strain on government budgets at a time when fiscal stimulus is needed most.

Lesson 4: Prohibition sidelines legitimate businesses and depresses formal job opportunities

Emergency restrictions on alcohol production and sales have had an outsized impact on legitimate industry, jeopardizing long-term employment and growth, while fueling a parallel underground market that further harms the legal sector's ability to rebound once restrictions are lifted.

While it is challenging to evaluate the full effect of prohibition laws on an industry that employs millions of people in primary and secondary sectors, any job losses—especially those lost via a government's own alcohol bans—are particularly debilitating in countries where the overall unemployment rate is already high. Taking South Africa as an example where prohibition measures have had severe impacts, it is estimated that over 165,000 South African jobs were lost during the first alcohol ban.

A few words about the post-pandemic recovery

As governments move from crisis management to recovery planning, the findings from this report suggest that valuable lessons from alcohol prohibition can usefully shape the most constructive and inclusive ways to build back economic activity, employment and growth.

The alcoholic beverage sector and its multiple and varied secondary industries are significant contributors to GDP and employment—and tax revenues—in virtually every economy worldwide. Because of this, the sector will be an important part of the recovery.

But governments should think twice about sudden increases in excise taxes levied on alcoholic beverages as a means to replenish budget shortfalls. A quick fix approach could end up being as reckless as the imposition of prohibition laws, resulting in lower consumption of legal beverages, smaller pools of tax collections and an increase in demand for untaxed, cheaper illicit alternatives.

Moreover, policymakers would be wise to note that this sector and the people who work there have already been particularly hard hit by prohibition measures. To ensure a balanced and sustainable recovery, careful consideration should be given to lesson #4, from above: *Governments must anticipate that prohibition sidelines legitimate businesses and depresses formal job opportunities.*

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.

- 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 alcohol 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.

Recommendations

Government actions need to be carefully considered and finely balanced in dealing with the challenges associated with COVID19. The conclusions of this report, for example, delineate four lessons for avoiding the negative consequences associated with the imposition of alcohol prohibition laws. They also suggest the value to Finance, Trade and Health Ministers of improving coordination, consultation, and joint impact assessment of proposed laws.

There is also a role for private and public partnership dialogue on ways to prevent illicit trade. If new restrictive measures are being considered, governments should consult and cooperate with industry to ensure that any restrictions are temporary in nature, proportionate and sustainable. Any such measures should be accompanied by appropriate public health messaging and reinforced by responsible retail standards.

Governments must also ramp up implementation of enforcement measures to ensure that illicit trade activities caused by the pandemic do not become permanent features of the post-pandemic economy. All stakeholders have an interest in stamping out illicit trade in alcohol and all benefit from collective action.

In the face of a health pandemic, such as COVID19, it is recommended that governments:

- **Avoid prohibition laws** as emergency response measures to protect people from the spread of virus. The benefits are conjectural, while the negative consequences are many and counterproductive to interdependent health, employment, and economic objectives.
- **Ensure availability and access to legitimate products** that conform with social-distancing objectives without inducing demand for illicit substitutes.
- **Avoid the imposition of "emergency tax" increases on alcohol.** A quick fix approach could end up being as reckless as the imposition of prohibition laws, resulting in lower consumption of legal beverages, smaller pools of tax collections and an increase in demand for untaxed, cheaper illicit alternatives.
- **Ramp up implementation of enforcement measures** to ensure that illicit trade activities caused by the pandemic do not become permanent features of the post-pandemic economy.

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