TRANSNATIONAL ALLIANCE TO COMBAT ILLICIT TRADE

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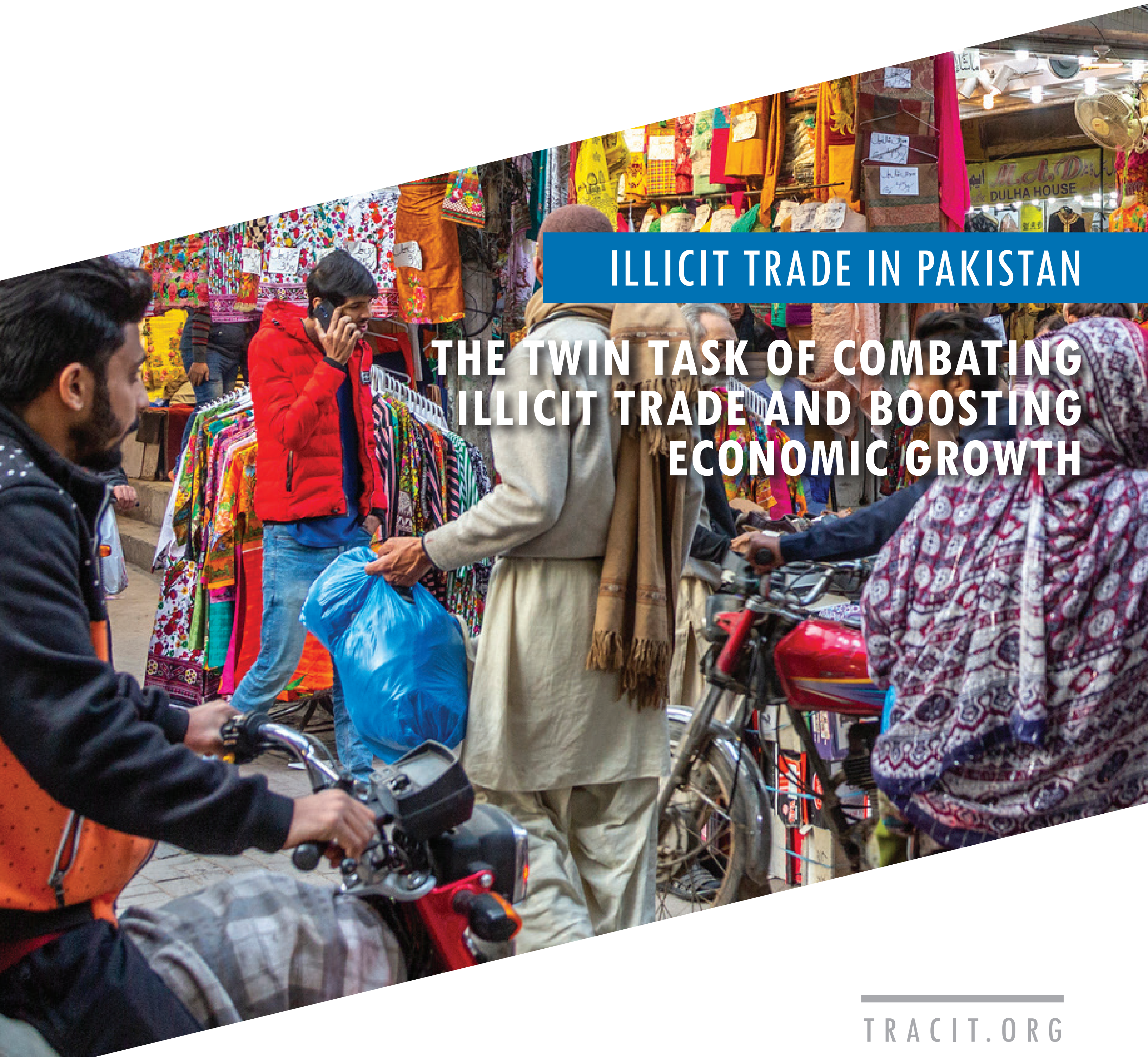

ILLICIT TRADE IN PAKISTAN

THE TWIN TASK OF COMBATING ILLICIT TRADE AND BOOSTING ECONOMIC GROWTH

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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I. INTRODUCTION

The convergence of various structural weaknesses in Pakistan's economy challenges its ability to sustain recent gains in poverty reduction and undermines objectives for long-term growth in GDP. Since these factors also create fertile ground for illicit markets to strengthen, this report investigates the associated impacts and suggests remedies for consideration by Pakistan's policy leaders.

Record high inflation is perhaps the most pressing problem. In March 2023, the inflation rate in Pakistan reached 35.4 percent, the highest level in 50 years.[1] High levels of inflation can have a disastrous impact on consumer purchasing power and "product affordability," which is widely regarded as the primary driver for illicit trade.[2] When prices rise faster than incomes, people can afford to buy fewer goods and services, and cheaper goods including illicit and black-market products become more tempting.

In Pakistan, the shadow economy is already equal to about 40 percent of GDP and significant levels of illicit trade can be found in many key economic sectors, including food fraud, illicit petroleum products, counterfeiting and piracy, and trade in falsified and substandard pharmaceuticals. These illicit markets have plagued the country for years – perpetuating a vicious circle of associated money laundering, organized crime, corruption, and tax evasion.

Tax evasion seriously undermines Pakistan's capacity for fiscal resource mobilization, especially when it amounts to as much as 6 percent of GDP. This drives persistent debt, devaluation of credit ratings and raises the cost of attracting investment. Tax evasion related to illicit trade in tea, tires and auto lubricants, and pharmaceuticals has grown to about PKR160 billion per year. The unregulated, untaxed illicit trade in cigarettes, which had increased about 10 percent over the last few years, drained another PKR 78 billion in uncollected tax revenues by 2021.[3] A more recent edition of the same survey released in June 2023 showcased that the tax loss has risen to PKR 240 billion due to tax evasion by illicit cigarettes traders.[4]

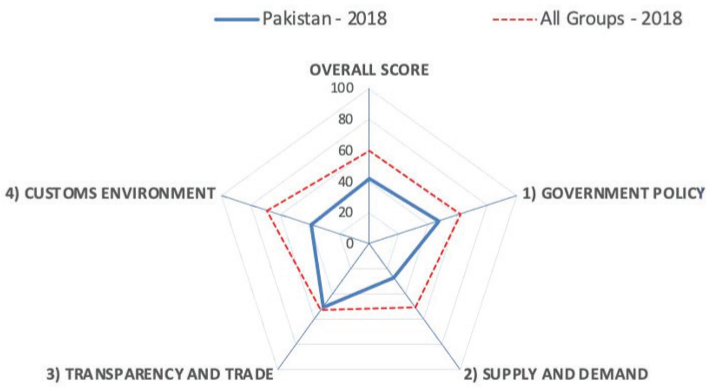
On top of macro-economic forces that facilitate illicit trade, governments themselves can exacerbate the problem. For instance, urgent measures to boost revenues can lead governments to rapidly increase excise tax rates without a proper accounting of the impact on sectors such as alcohol, tobacco and petroleum where strong markets for illicit alternatives already exist and where criminal traders are eager to exploit the price differentials accompanying the new tax regimes.

This report examines illicit trade within the context of these underlying macro-economic factors in Pakistan's economy. It highlights that high levels of inflation and tax evasion compound the problems, and urgently calls for a comprehensive and coordinated approach to address them. The report contends that effectively tackling illicit trade will be a crucial ingredient in achieving Pakistan's economic prospects.

II. PAKISTAN'S STRUCTURAL CAPABILITY TO ADDRESS ILLICIT TRADE

To better understand the regulatory environment and economic circumstances that enable illicit trade, TRACIT commissioned the Economist Intelligence Unit (EIU) to produce the *Global Illicit Trade Environment Index (Index).* Along with more than 80 other countries, Pakistan was evaluated on a number of policy, legal, regulatory, economic, trade, institutional and cultural indicators reflecting its structural capability to effectively protect against illicit trade.

Category	Rank/84	Score/100	Average of All Groups
OVERALL SCORE	**72**	**42**	**60**
1) GOVERNMENT POLICY	66	47	62
2) SUPPLY AND DEMAND	77	27	50
3) TRANSPARENCY AND TRADE	50	50	53
4) CUSTOMS ENVIRONMENT	72	39	69



Pakistan shows significant deficiencies in its structural capability to effectively address illicit trade, as evidenced by its ranking of 72 out of 84 countries evaluated, and with an overall score of 42.0 (out of 100). Pakistan's performance falls significantly below the global average across all categories and indicators, apart from the Transparency and Trade category, where its score of 50 is just slightly below the global average score of 53. The lowest score is found in the Customs Environment category, where a persistent shortage of manpower, resources, insufficient border patrols, lack of logistical support and inadequate surveillance and monitoring systems prevents Pakistan Customs from effectively protecting the long, porous borders with Afghanistan and Iran, measuring approximately 930 and 700 kilometers respectively.

The lack of personnel also means that Customs is forced to focus its limited resources on major road arteries within the country rather than stopping the flow of smuggled goods at the borders.

Other challenges include weak governance and regulatory frameworks, poor intellectual property (IP) protection, and limited capacity of law enforcement agencies, coupled with pervasive corruption, which combine to give rise to an economy where illicit trade flourishes. Furthermore, the proliferation of informal markets and a cultural acceptance among certain segments of the population that smuggling is somehow a legitimate form of trade creates an environment that is conducive to illegal activities.

It is important to understand that the *Index* is a measure of a country's structural capability to effectively protect against illicit trade, and not its actual performance – past or future. In this respect, there have been some positive developments in recent years that suggest growing political interest in combatting illicit trade.

For example, over the last five years Pakistan Customs has made seizures of smuggled or contraband goods with a CIF value of approximately PKR 170 billion, and an estimated market value of approximately PKR 300 billion according to data from Federal Board of Revenue (FBR). It is worth noting that these figures do not take into account seizures of narcotics or drugs.[5]

In addition, to face the alarming increase in illicit trade in tobacco products – between 2019 and 2021 the revenue losses from the illicit trade of cigarettes increased by 53%[6] – the FBR undertook the first steps to introduce a tax verification and monitoring of production and sales system with a view to enhancing tax revenue.[7]

Perhaps one of the most recent and positive developments in relation to Pakistan was its removal from the FATF "grey list" of jurisdictions under monitoring for money laundering. At its session of October 2022, the FATF welcomed Pakistan's significant progress in improving its Anti Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime and delisted the country from the grey list.[8]

But political interest must translate into practical change through commitment and implementation. As the *Index* shows, the challenges facing policy makers in addressing the underlying vulnerabilities in the economy remain significant. This is further confirmed by the country's credit risk profile and the numerous types of illicit trade plaguing Pakistan.

III. RELATIONSHIP BETWEEN ILLICIT TRADE, STRUCTURAL CAPABILITIES, AND CREDIT RATINGS

The relationship between illicit trade, various macro-economic forces, and related structural circumstances – like corruption and governance – are illustrated in TRACIT's 2021 report, *The link between illicit trade and sovereign credit ratings.*[9] Findings show that countries that are poorly equipped to tackle illicit trade also suffer from poor credit worthiness. This is borne out by the positive correlation that exists between the *Index* and the credit ratings assigned by the major international credit rating agencies. Countries with high scores on their capacity to fight illicit trade also have higher credit ratings. Conversely, countries with inadequate regulatory environments and weak institutions making them particularly unprepared to face illicit trade, also have lower credit rating scores.

In the case of Pakistan, the three major rating agencies – Fitch, Moody's and S&P – have assigned it credit ratings of CCC, Caa3, and CCC+ respectively, meaning a rating that falls in the category of high default.[10] Such a rating significantly affects a government's ability to borrow money on the international financial markets, dampens its attractiveness to foreign investment and ultimately chokes its economic prospects.

Beyond the relationship to illicit trade, it is worth noting that COVID-19 dynamics compounded things for Pakistan and other low- and mid-income countries, with many facing post-pandemic downgrades in their credit ratings.[11]

Low credit ratings drive up the cost of borrowing from private and public institutions, hinder the access to credit, complicate the renegotiation of the terms and conditions of existing debts, and also dampen the countries' attractiveness to local and foreign investments, jeopardizing their economic prospects. This is particularly concerning as Pakistan struggles to honor repayment of its IMF loans.

The takeaway here is that illicit trade has a direct negative impact on the very economic, social, and institutional risk factors that credit rating agencies evaluate to determine countries' ability to honor their debt. The corruption, crime, human trafficking, money laundering, and environmental degradation connected with illicit trade all combine to weaken a country's economic, financial, and institutional stability that underpin its credit ratings. This suggests that if Pakistan invests resources and develops policy initiatives to combat illicit trade more effectively, the macro-economic benefits associated with eliminating illicit trade and related criminal activities can have a significant positive impact on future credit scores.

IV. ILLICIT TRADE IN PAKISTAN

Overview

Pakistan's geographical positioning makes it a natural transit country, exposing it to illicit trade in several sectors ranging from agri-foods, pharmaceuticals, tobacco, alcohol, counterfeit and piracy, illicit petroleum products, tires and gemstones, both as an origin and destination hotspot. This problem has affected the country for years and encompasses a wide range of illegal activities like money laundering, organized crime, corruption, and human trafficking.[12]

The political unrest in the region of Khyber Pakhtunkhwa (KPK)[13] and Azad Jammu & Kashmir (AJK)[14] also contribute to enabling illicit trade:[15]

- In recent years, KPK has been affected by a number of security challenges, including terrorism and insurgency. Although Pakistan's military has conducted extensive campaigns, the region continues to suffer security threats from extremist groups.
- Like KPK, AJK has also experienced security challenges, particularly along the Line of Control (LoC) with the Indian-administered part of Jammu and Kashmir. Agitations in these areas have contributed to the expansion of serious criminal activity in the country, including illicit trade in the sectors mentioned above.

The illicit trade in Pakistan is further aggravated by the pervasive presence of illegal trafficking in arms and drugs, which represent a serious threat to security.[16] Although the government has embarked on a zero-tolerance policy against these crimes, traffickers constantly develop new strategies, for instance, by using drones to transport drugs and weapons.[17] Unfortunately, over the past years, criminal groups in Pakistan have managed to consolidate networks to traffic substantial amounts of arms, ammunition, and drugs into neighboring countries. In particular, it has been reported that smuggling networks have exploited instabilities in AJK to ensure a steady supply of narcotics to support terrorist activity in India.[18/19] This problem is also linked with illicit trade in tobacco products, as illicit tobacco is also used as a substantial source of income for terrorist groups operating in Pakistan and India.[20]

In addition to the geopolitical and security issues affecting Pakistan's ability to counter illicit trade, there are other dimensions to the problem that the country needs to address. Illicit trade in Pakistan is largely characterized by smuggling, counterfeit, and tax evasion (i.e., non-duty paid on the production and commercialization of several products). The smuggling of goods across the porous international borders of Afghanistan, India and Iran has been a significant challenge. Official reports show that Pakistan Customs face serious limitations that need to be addressed:

- Shortage of personnel, particularly in Baluchistan, severely restricts Customs' ability to effectively secure the borders with Iran and Afghanistan. With fewer than one thousand Customs personnel deployed in the region, including only 400 personnel for anti-smuggling operations, it is simply not feasible to fully monitor the 1600 km-long border. Consequently, Pakistan Customs is compelled to prioritize its efforts on major roadways within the country, rather than attempting to interdict the flow of contraband at the borders.[21]

- Pakistan Customs also faces significant logistical challenges that undermine its operational capabilities. The agency has few operational vehicles at its disposal, many of which are in poor condition, limiting its capacity to pursue smugglers or conduct swift anti-smuggling operations. New operational vehicles are needed to effectively monitor borders and interdict smuggling activities on arterial routes leading cities. Furthermore, the agency lacks aerial vehicles or helicopters for surveillance purposes. Further to these challenges, the weapons available to Pakistan Customs are largely outdated, leaving the agency ill-equipped to confront armed smugglers.[22]
- It has been reported that Customs officers are exposed to retaliation from smugglers when performing their duties. This situation has worsened due to the lack of resources to establish a formal network of informers within Customs, making difficult to collect information for anti-smuggling activities[23]

Concerning the applicable legal framework to tackle smuggling, the *Prevention of Smuggling Act of 1977* vests powers in the Federal and Provincial Governments to investigate and detain suspects of smuggling activity.[24] Nonetheless, a few legal loopholes and deficiencies include:

- Chapter I, Article 2: "*'smuggling' has the same meaning as in* [the Customs Act – 1969] *but, in Chapter II, relates only to the taking of goods out of Pakistan."* This definition could be amended to allow Chapter II (on preventive detention) to apply to all forms of smuggling, *"whether goods are being taken out of or brought into Pakistan."* This would enable Custom authorities to detain suspect smuggles trafficking products into and/or out Pakistan.[25]
- The preventive detention powers defined in Chapter II of the Customs Act are somewhat restrictive, as they are exclusive to higher ranking authorities of the Federal or Provincial Governments (Chapter II, Article 3.1). Thus, extending this power to lower law enforcement ranks (e.g., collector, director of customs intelligence) would better equip authorities and would serve as a more effective deterrent for smugglers.[26]
- Finally, whereas the Prevention of Smuggling Act 1977 is quite thorough, there is concern that Customs authorities do not invoke this Act as frequently as they should, especially considering the overlap between the seizure of merchandise and criminal proceeds.[27]

Regarding the spike in illicit tobacco products, the government has allocated additional resources to the FBR to introduce a tax verification and monitoring of production and sales system to enhance revenue collection by curbing tax evasion and illicit trade in this sector.[28] While useful, this tool must be accompanied by measures to raise awareness and improve enforcement, including the implementation of concrete actions to monitor and analyze the licit and illicit markets.

Illicit trade by sector

Agri-food Industry

In Pakistan, the agri-food production is a major employer of labor and a crucial economic sector.[29] Nonetheless, key commodities such as sugar, tea, wheat, spices, and edible oil, have had to be imported to cover shortfalls in domestic production.[30] This situation, combined with the 2022 floods[31] have aggravated the problem of food fraud.

- **Sugar:** Pakistan is one of the top 10 sugar producing countries in the world.[32] Nonetheless, pricing and distribution inefficiencies have forced it to import sugar. At the same time, domestic product is smuggled out of Pakistan into neighboring countries.[33] In response, the government has implemented measures to crackdown on illegal sugar merchants, smugglers, and hoarders.[34]
- **Tea:** While Pakistan does not produce much tea, it is one of the largest consumers and importers of product from Kenya, Sri Lanka, and India. Government restrictions on consumption (i.e., campaign to "drink fewer cups of tea")[35] have resulted in demand for illicit tea, which in turn has been associated with tax evasion and a potential tax revenue loss of PKR 8.7 billion.[36] More recent reports have evidenced that tax evasion in tea sector represents about PKR 45 billion annually.[37]
- **Dairy products:** Over the past decade, the demand for dairy products has grown considerably, giving rise to illegal practices to increase the volume of the milk, i.e., by diluting milk with tap water or even using chemicals to produce fake milk. Reports indicate that consumers continue to turn to the illicit alternatives even though they are aware of the substandard quality.[38]

Pharmaceuticals

Alongside an above average growth in the consumption of pharmaceuticals,[39] it is estimated that 40 percent of the medicines sold are counterfeit and/or substandard.[40] Experts have also estimated that more than 25 percent of total pharmaceutical exports are illicitly transported to and then sold in Afghanistan.[41]

The inflation and currency devaluations further compound this situation, as the legitimate pharmaceutical manufacturing is collapsing due to the unavailability of raw materials. For example, pricing disputes between the industry and the Health Ministry has precluded access to many of the key components needed to manufacture medicines. According to an officer from the Pakistan Chemist and Drug Association, *"most of the importers are nowadays importing a minimum quantity of dozens of essential and non-essential medicines just to keep their licenses intact. Otherwise, it's no longer a profitable business for them due to a huge devaluation of the rupee against the dollar."*[42] This context facilitates all kinds of illicit trade in pharmaceutical, including counterfeits, substandard medicines, illegal diversion, etc.

Additionally, the country's regulatory infrastructure for pharmaceuticals is fragmented and weak in different ways. For instance, the federal government controls the production and licensing of pharmaceuticals products, whereas the provincial governments oversee their distribution and commercialization. This approach has been described as a system weakness, lacking coordination between the wide array of different stakeholders and creating incongruencies in law enforcement and lack of central oversight. In particular, it has been reported that drug enforcers are very few and unable to sufficiently conduct inspections.[43] This situation has created shortages in genuine products, and the *"[l]ack of access to treatment attracts criminal entities that exploit people's health needs."*[44]

Certainly, illicit trade in pharmaceuticals in Pakistan needs to be addressed from different angles, as amending the existing regulatory framework and undertaking isolated law enforcement measures would not be enough. Effectively countering illicit pharmaceuticals in Pakistan will require authorities and industry to ensure the availability of affordable, quality-assured essential medicines.

Tobacco

Pakistan's cigarette consumption is estimated to be around 80 billion sticks. According to Oxford Economics 2022, the percentage of illicit cigarettes has grown to 38 percent of the market. Consequently, the value of tax evaded by illicit cigarettes amounts to approximately PKR 77 billion.[45] A more recent report from IPSOS released mid-June 2023 estimates that the percentage of illicit cigarettes has risen up to 48 percent of the market, causing PKR 240 billion loss.[46] This black market is dominated by locally produced cigarettes that are untaxed and sold well below legal, minimum prices compared to the relatively high prices of heavily excised legal products.[47]

The past decade has seen a surge in cigarette manufacturing units in the non-tariff area AJK, which has resulted in large volumes of cigarettes being produced and sold in Pakistan's tariff area without paying taxes or duties. In brief, the illicit cigarettes trade in Pakistan is characterized by:

- Locally manufactured, non-taxed products.
- Products manufactured in non-tariff areas (AJK, Federally Administered Tribal Areas, Provincially Administered Tribal Areas) and smuggled to tariff areas.
- Tobacco products smuggled into Pakistan across borders with Afghanistan and Iran.

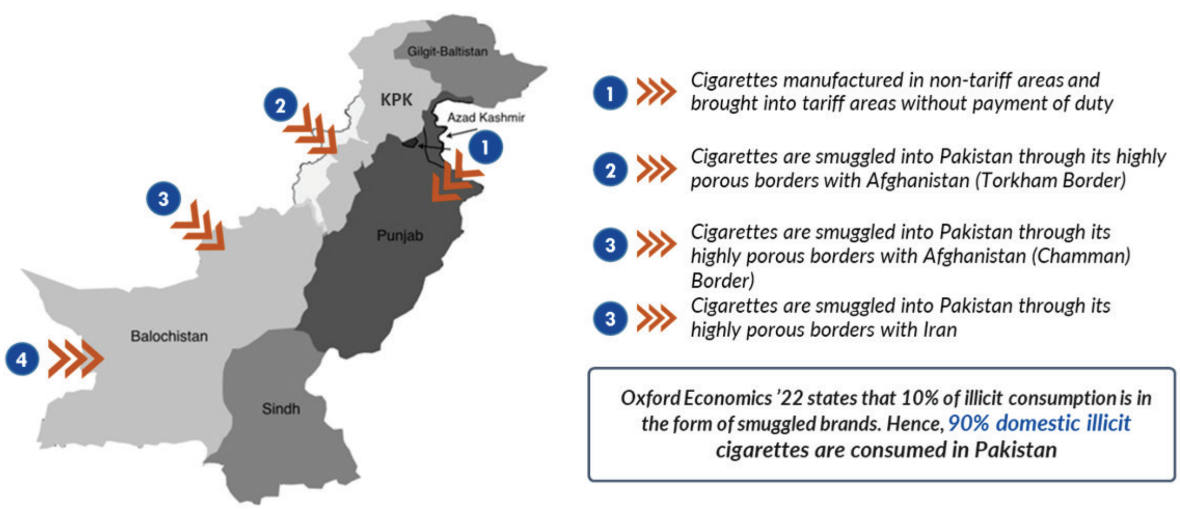
The production of illicit cigarettes not paying tax in Pakistan is a persistent challenge for the government and the legal tobacco industry. A range of factors have contributed to this problem, including the use of sophisticated manufacturing setups located in non-tariff areas, corrupt practices, contract manufacturing arrangements, unrecorded purchases of tobacco leaves, and smuggling of key raw materials across borders.

Further to the considerable loss of tax revenue, one of the most detrimental consequences of illicit trade in tobacco products in Pakistan concerns its relation to security issues, including transnational terrorism and money laundering.[48]

Alcohol

Pakistan has distinctive policies to regulate the consumption and commercialization of alcoholic beverages that have evolved over the years. For instance, from 1947 to 1977, the Government allowed the sale and consumption of alcohol, but in 1977 a criminal law was enacted prohibiting the consumption of alcohol even though in practice the non-Muslim population is allowed to apply for alcohol permits.[49]

The restrictions have served as a driver for the emergence of black markets, with several reports showing that alcohol consumption has grown steadily.[50] This situation worsened during the pandemic, as the commercialization of non-registered alcohol



spiked – due to the increase in demand and shortages in the supply of legal alcohol for the consumption by the non-Muslim population.[51]

Counterfeit Goods

Though Pakistan is equipped with legislation to protect IPR (i.e., the Intellectual Property Organization Act 2012, Trademark Ordinance 2001, Copyright Ordinance 1962, Patent Ordinance 2000, Customs Act 1969, Penal Code), counterfeit goods remain a significant problem, with a range of products being counterfeited, including clothing, electronics, and luxury goods.

Experts and rightsholders indicate that there are two main factors driving the trade in counterfeit goods in Pakistan:

- Lack of effective enforcement measures, where effective implementation of the laws is considered substantially inadequate. One of the central challenges relates to the lack of specialized training of law enforcement and justice operators.[52]
- Lack of awareness for consumers to counter their growing acceptability of counterfeit products.

On top of the enforcement gaps, Pakistan's society is not necessarily aware of the numerous and detrimental consequences that are associated with the consumption and commercialization of products violating IPRs.[53] Improved consumer awareness would be especially useful if targeted at the following six notorious markets where all types of counterfeits are regularly commercialized:[54]

- **The Golimar Market:** plumbing ball valve, non-return valve, tiles and other sanitary products.
- **The Urdu Bazaar:** primarily books and stationery.
- **The Bolton Market, Saddar:** mostly footwear, watches, motor vehicle apparel, and sportwear.
- **The Cashman Shoes Market:** primarily footwear, including sneakers of world-renowned brands.
- **Shah Alam:** primarily electronic items, cosmetics, household items, shoes, bags, accessories, and watches.
- **Bara Market, Quetta (also known as NATO Market):** primarily electronic items, mobile phones, and car parts.

Fake apparel, forced labor, and human rights violations

Counterfeit/replica clothing and accessories are widespread in Pakistan to the point that some shoppers question whether the activity is actually illegal in the country. Both international and local brands are counterfeited and sold in Pakistan.[55] Consumers of fake apparel may not be aware of the demand for forced and child labor that the expansion of this illicit market generates in Pakistan.

In December 2022, 187 brands committed to an International Accord ('Pakistan Accord on Health & Safety in the Textile & Garment Industry') aimed at protecting all workers throughout the brands' supply chain and providing them with a confidential venue to report abuses. The program is to be implemented through close collaboration and involvement of the Pakistan government and the manufacturing industry. The Accord covers the following key elements:[56]

- Independent inspections and remediation of fire, electrical, structural and boiler safety hazards.
- High level of transparency on a factory-by-factory basis.
- Provisions to ensure remediation is financially feasible.
- Safety Committee training and worker safety awareness program.

Whereas this program appears to be a positive development in terms of improving textile and garment workers' conditions, it is not clear what will be the impact on the safety and wellbeing of workers subject to illicit and otherwise clandestine productions.

Use of social media and E-commerce

The pervasive presence of counterfeits goods and fake apparel in Pakistan is compounded by the commercialization of these products online. Illicit traders have rapidly encroached on all types of online platforms, including digital marketplaces and social media, to offer counterfeit listings. The fakes include all types of products, such as toys, clothing, shoes, pharmaceuticals and software. Experts explain that the launch of 3G/4G services has driven growth in e-commerce and many fake sellers are dominating the Pakistan online marketplace.[57]

Illicit petroleum products

Following the sanctions on Iran in 2013, the smuggling of Iranian petroleum into Pakistan has steadily grown, finding its way to the country primarily through the Balochistan region.[58] The illegal transfer of crude oil, fuel, and other petroleum products is sizeable and it has been estimated that 2 million people in the Balochistan region are involved in the oil smuggling process.[59] Local media reports that the Punjab province, Khyber Pakhtunkhwa, Sindh, and the Islamabad Capital Territory are also considerably affected by illicit trade in petroleum.[60]

Pakistan is also heavily affected by illicit trade in auto-lubricants. Every year, the country's population consumes 400 million liters of lubricants. It is estimated that half of this oil is reused as reclaimed oil and according to an industry expert, 60% goes into the undocumented economy resulting in massive losses to national administration.[61] The reclaimed and reprocessed oil being used is of substandard quality and does not conform to the industry's prescribed standards. Consequently, vehicles that utilize this oil are susceptible to engine complications. Furthermore, in a 2018 investigation conducted by the Government of Punjab to identify the root causes of smog, the primary reason cited for the air pollution was "adulterated fuel" being utilized in the region.[62]

Tires

The annual tire demand in Pakistan totals 14 million units, with reports indicating that half of this demand is met through the use of smuggled products. Tires are primarily smuggled through Chaman, Taftan, and Torkham, after which they are distributed to local retail outlets. Recent reports suggest a deteriorating situation, primarily due to a decline in local tire production and legal tire imports during the first half of 2023, largely attributed to currency devaluation. Annual tax evasion related to tire smuggling could amount to as much as PKR 40 billion annually.[63]

Illegal mining and gemstones

Mountain ranges are the usual source of precious minerals in Pakistan. In particular, the northern and western regions of Pakistan where the Karakorum, Himalaya, and Hindukush mountain ranges are located. These are significant sources of precious minerals and gemstones, which play a vital role in the economy of Pakistan. Aquamarine, topaz, tourmaline, scheelite, apatite, sphene, morganite, aquamarine, brookite, aragonite, emerald, corundum, and many more are found in the country.[64]

This natural resource has attracted criminal organizations, which have increasingly infiltrated the local mining industries. In particular, the Khyber Pakhtunkhwa has been targeted by mafias and gangs, as the area is rich in gems and semiprecious stones.[65]

V. POLICY RECOMMENDATIONS TO COMBAT ILLICIT TRADE

Curbing illicit trade will be a crucial factor in achieving Pakistan's healthy economic prospects. To this end, the Pakistani Government is called to implement comprehensive policies that consider the potential impact on all sectors of the economy and work to reduce the incentives for criminals to engage in illegal activities.

Improving enforcement

Implement training programs, including interagency joint activities. This includes developing capacity building and strengthening close cooperation between police, customs, judicial, and regulators. All relevant governmental stakeholders need to deepen their understanding of the serious implications of illicit trade and the need to foster a culture of support among colleagues from different agencies and department to effectively counter organized crime's involvement in illicit trade.

Invest in staff and tools. The key agencies that tackle illicit trade, such as Customs, suffer from shortages of personnel. Considering the large and porous borders of Pakistan, it becomes pressing to incorporate new recruits in law enforcement lines. There is also a need for new equipment, including vehicles and weapons, to effectively counter crime.

Amending the Prevention of Smuggling Act of 1977 to empower law enforcement. Though this piece of legislation addresses most of the elements needed to counter contraband, it appears that the definitions and powers conferred in Chapters I and II of the Act are not sufficient. By expanding the definition of smuggling and by delegating the prevention detention and authority to other law enforcement officers, Customs will be better equipped to counter illicit trade affecting Pakistan in almost all sectors.

Improving Track and Trace solutions can help to curb illicit trade. Enhancing Track and Trace solutions is essential in the fight against illicit tobacco trade. Although Pakistan has an existing authentication system designed to combat tax evasion, its adoption among tobacco manufacturers remains limited, with few notable successes to highlight. Additionally, the widespread presence of counterfeit tax stamps in the market underscores the need for a higher level of digitization within the system. To effectively address this issue, it is recommended that the government implements a system that fully aligns with the WHO FCTC Protocol's requirements, aiming to eliminate illicit trade in tobacco products.

Improving governance and coordination

Continue developing law enforcement cooperation with neighboring countries affected by illicit trade. Pakistan should strengthen law enforcement cooperation and intelligence sharing with neighboring countries, particularly where illicit trade in oil products and tobacco generate revenues for organized criminal and terrorist groups. National authorities should also strengthen commitments to international instruments such as the UN Palermo Convention against Transnational Organized Crime and the UN Convention against Corruption.

Appoint an Interagency Anti-Illicit Trade Coordinator. To oversee the interagency cooperation, Pakistan should consider appointing an "Anti-Illicit Trade

Coordinator" with high level authority within the national government. Objectives would include raising the profile on illicit trade, allocating necessary financial and personnel resources, more aggressively enforcing anti-illicit trade regulations, and focusing on the effective implementation of already existing laws.

Strengthen interagency and interprovincial/ interregional cooperation at the national level, particularly by improving enforcement capacities between all Pakistani law enforcement agencies. Increased coordination across agencies responsible for health, economic, security, finance and customs, including between their counterparts in other regions, is critical for addressing the multifaceted problem of illicit trade. For instance, this type of cooperation will be crucial to tackle illicit trade in petroleum products, as the commodity is normally originated in Iran and finds in its destination in several regions. As such, the investigation of trade routes falls under the purview of more than one enforcement agency.

Addressing pressing institutional and governance issues in regions severely affected by smuggling and other criminal activity. The ongoing political unrest in KPK and AJK is not new. However, there appears to be explicit violations of applicable laws that need to be tackled as soon as possible. For instance, the past decade has seen a growth of cigarette manufacturing units in non-tariff areas of AJK. Local illicit manufacturers operate in KPK and AJK to escape federal tax collection and take advantage of minimal border control. It is imperative to ensure that products sold in Pakistan are subject to tax duties, even if they are manufactured in a non-tariff areas. Whereas the problem in these territories is highly complex and encompasses a wide variety of factors, policy makers should focus on enforcing Customs controls and IPRs. Achieving the effective enforcement of already existing laws and regulations is critical. Under the existing regulations, any person transporting goods from the non-tariff area must be registered with the FBR, as tax is payable upon exit from the area. As such, setting up check posts at entry points from non-tariff areas to curtail illicit stock movements is key.

Carefully evaluate excise tax increases that put upward pressure on prices, which in turn may create demand for cheaper, illicit alternatives. Tax policies should account for various demand-related factors including overall consumption, price, income levels and affordability of products – which are all active in Pakistan given the decrease in disposable income levels associated with rampant inflation. In this context it is also important to recognize that boosting tax collection can be achieved not only through tax rate increases but also through improved and effective enforcement measures.

Promote the creation of local private-public partnerships to bring key industry and government stakeholders together to define strategies, share know-how, intelligence and data, improve risk assessment, strengthen border control and improve awareness. Partnership with the private sector can play an important role in improving enforcement actions. With real-time access to commercial data and private sector intelligence, enforcement agencies can improve the effectiveness of their operations and risk assessment techniques. Consider organizing regular law enforcement agency training and workshops with right-holders to improve detection of fake goods and strengthen the cooperation between enforcement agencies and the private sector. Government should also include businesses in discussions concerning the elaboration of market regulations, tax policies and implementation of technological solutions.

Improve monitoring and analysis of high tax yield products to better understand the relationship between illicit trade and tax evasion situation. Parameters could include scale, most impacted territories and production sources. Such analysis will be instrumental in targeting and increasing overall impact and effectiveness of enforcement and therefore increase tax collection. Such monitoring could be done through deploying best international practices and through partnership and collaboration with the private sector.

Improving IP rights protections

Training and empowerment of IP law enforcement and justice operators. Whereas the regulatory framework to tackle IP rights violations is comprehensive, there is a lack of effective implementation. In particular, ex officio authority over trademark violations should be vested to law enforcement and customs officials. Also, IP officers and judicial offices need to receive adequate training and capacity building to keep pace with new trends and techniques to counter IP crime.

Awareness raising. Research indicates that Pakistani society lacks awareness of the significant and harmful implications associated with the utilization and marketing of goods infringing IP rights. Governmental authorities, industry and civil society need to make joint efforts to educate large segments of society to improve the wider understanding of the negative social and economic impact of IP crimes.

Improving criminal deterrence

Reinforce existing legislation. Sanctions should be at levels sufficient to deter criminal activity. Imposing administrative, criminal and civil penalties – such as for IP rights violations – should be a priority to prohibit illicit traders from exploiting markets with weak penal regimes. Consideration must also be given to rescinding business licenses from retailers, manufacturers and distributors involved in illegal trade.

Continue to tackle pervasive corrupt practices that continue to facilitate illicit trade, especially at the level of customs, local officials, law enforcement authorities and the judiciary. Corruption is a key enabler of illicit trade in Pakistan, so it is critical that policies and controls targeted at preventing corruption contribute to reinforcing integrity in the global supply chain. As long as corruption persists within government agencies, any attempt to improve and strengthen enforcement actions will have limited effect.

Address money laundering. Several non-compliant manufacturers have amassed a lot of wealth due to their illicit activities, so audits of “assets beyond means” should be conducted for such individuals and groups. In addition, authorities should work to foster a holistic, comprehensive anti-money laundering regime including the ability to trace, freeze, seize and confiscate assets related to illicit financial flows. It will also be important to equip regulatory and criminal asset management bodies with the resources they need to effectively pursue and combat illicit financial gains.

Strengthening border controls

Pakistan must strengthen its border controls with India, Afghanistan, and Iran, with a particular focus on the Balochistan region and AJK area bordering Iran and India. These areas require strict controls due to the alarming levels of illicit trafficking in products such as petroleum and cigarettes. The Pakistani government should allocate greater resources and technology to Customs, prioritize border controls there and set up check posts at entry points from non-tariff areas to curtail illicit stock movements.

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