

Título

**The Wine Market in Brazil and Duty Evasion: a blend of glamour, crime, and opportunistic behavior**

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# The Wine Market in Brazil and Duty Evasion: a blend of glamour, crime, and opportunistic behavior<sup>1</sup>

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## Abstract

This article aims to clarify how incentives in the fine wine market in Brazil cause opportunistic behaviors, both on the part of consumers and on the part of suppliers and the government. The established incentive structure induces a rent-seeking behavior, to a greater or lesser degree, in the main participants of this market. The analysis will be based on the Economic Theory of Criminal Behavior to elucidate how attractive gains regarding costs, combined with the remote probability of being detected and punished, create a favorable environment for duty evasion (illegal trade of Argentine wines).

**Keywords:** Wine – Economics of Crime – Duty Evasion – Incentives – Consumer Behavior

## Resumo

O artigo busca esclarecer como os incentivos no mercado de vinhos finos no Brasil geram comportamentos oportunistas, tanto por parte dos consumidores como dos ofertantes e do governo. A estrutura de incentivos estabelecida induz conduta de *rent-seeking*, em maior ou menor grau, nos principais participantes deste mercado. A análise será baseada na teoria econômica do crime para elucidar que ganhos atrativos em relação aos custos, aliados a probabilidade remota de ser detectado e punido criam ambiente favorável ao descaminho.

**Palavras-chave:** Vinho – Economia do Crime – Descaminho – Incentivos – Comportamento do Consumidor

**JEL Classification – D12 - K14 - K42**

## Área 7: Microeconomia e Organização Industrial

### I - Introduction

The motivation to write this article arose from the increasing number of reported seizures of duty evaded wines from Argentina, and the debate derived from this fact. The matter is that the debate has focused on a partial view of the problem and that is why the mitigation proposals have been incomplete and, if they were to be applied, they would probably be ineffective. This partiality is related to the focus being on the consumer's conduct alone, to the ineffectiveness of the proposed mitigation measures aimed at adjusting their conduct and to the increasing surveillance. Briefly, the question is "who is the victim?" if there is one.

Based on what has been briefly exposed above, this article proposes, based on microeconomic theory concepts, first to understand the existing incentives throughout the chain of duty evasion of wine in Brazil, to explain the behavior of agents, considering the opportunities created by market failures, and to propose what would be necessary to mitigate the problem. Therefore, this article's research question is: **should the consumer of duty evaded wines bear the entire burden of fighting this crime, individually assuming to behave opportunistically?**

This article brings some numbers on the subject to help understand and scale the problem, emphasizing that, if the numbers of the legal wine market are already scarce, information on illegal activities, of course, are even more. On the one hand, this article faces the limitation of statistical data on the subject, as well as the lack of other studies that could serve as theoretical support. On the other hand, this article has the characteristic of being a pioneer in its approach and may serve as a starting point for future research to criticize it, and advance in understanding the problem and suggesting mitigating measures.

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<sup>1</sup> I thank Professor Pery Shikida for his valuable comments and suggestions, exempting him from any errors or omissions that may be found in this work.

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In the following section, we will address the economic theory concepts that based both the understanding of the problem and will guide the proposal of solution measures, even if partially. The remaining sections will deal specifically with duty evasion and the incentives of each market agent to act opportunistically.

## II – Theoretical Basis

Economic theory describes perfect competition as an ideal market situation. Although it is very difficult to achieve in practice, markets that are closest to its characteristics tend to have better results. The sought characteristics would be many providers and demanders, so that none of them can influence prices; the existence of complete information, that is, all agents have the necessary information for their decision making; a free market access for new providers; and the optimal allocation of resources. Such attributes would lead to the existence of a normal profit level accepted by all providers and, consequently, to the stability of the market with the achievement of a maximum possible well-being.

In the words of Jean Tirole (2020, p. 43):

*“If it is sufficiently competitive, the market increases the purchasing power of families, reducing prices, creating incentives for falling production costs and encouraging innovation, by expanding international exchange.”*

However, it is almost impossible to verify this situation in the real world. The most common are faulty markets, namely: imperfect competition, informational failure (information asymmetry), main agent problems and externalities. In a perfect competition, the consumer is the one who decides, through prices, the best allocation of resources, while in an imperfect competition, the producers are who decide, based on their personal interest, selfishness, and greed, which generally does not lead to the best social welfare, nor the optimal allocation of resources.

It is worth citing Daron Acemoglu (2009):

*“One of the profound and important contributions of economic science is to reveal that, in itself, greed is neither good nor bad. When channeled in the service of an innovative, competitive, and profit-centered behavior, within the framework of well-conceived laws and regulations, greed can operate as an engine of innovation and economic growth. But when it is not subject to the control of appropriate institutions and regulations, it degenerates into the pursuit of unjustified gains, corruption, and criminality”* (TIROLE, J., 2020, p. 58).

The market should be based not only on the selfishness of its participants, but seek to establish trust between agents, and there is nothing more corrosive to trust than pure selfishness. The market should be a place of balance between competition and collaboration, although a fair calibration is quite delicate (TIROLE, J., 2020, p. 59).

The perfect competition model generates natural rents, while competitive failures tend to generate artificial rents. Natural rents benefit those who take advantage of market opportunities, the interests of consumers and increase the efficiency of the economy. On the other hand, artificial rents benefit only those who are able to extract benefits from the existence of restrictions on the free operation of the market (ALVES and MOREIRA, 2004).

It is important to emphasize that the behavior of people when trying to obtain the most out of their abilities and opportunities occurs both in the case of natural and artificial rents. (ALVES and MOREIRA, 2004). In other words, you are saying the same thing as when you say that greed can be both good and bad. It is good when it generates rent and it is bad when it only appropriates the rents already created by others, taking advantage of flaws in the competitive model.

The expression “rent-seeking” indicates the activity of seeking to obtain special privileges that guarantee the extraction of artificially created rents. The gains obtained from these artificial rents are greater than the corresponding private costs. In other words, rent-seeking occurs when an agent, due to some market failure, appropriates rents generated by other market agents. The term is generally used in situations involving privileges given by governmental action, however, they are not limited to cases of this kind. It should be noted that, since the rents result from restrictions on free competition, their social value is negative. (MENDES, 2014).

The rational choice theory assumes that individuals have preferences amongst the available alternatives, allowing them to indicate which option they want. It is presumed that the rational agent (whether supplier, demander, governments, criminals or not) takes into account the available information, probabilities, costs and benefits when determining preferences.

When considering the individual, the **rational choice theory** stipulates that the agent decides to choose the action (or outcome) that he/she prefers. In the case where actions (or outcomes) can be assessed in terms of costs and benefits, a rational individual decides on the action (or outcome) that provides the maximum net benefit, that is, the maximum benefit minus the cost.

The Economic Theory of Criminal Behavior helps to understand the behavior of the agent who commits a criminal act, such as duty evasion, and is based on the Rational Choice Theory. For Becker (1968), postulating that individuals are rational, the mathematical treatment of an illicit economic activity can be summarized by the expected utility ( $U_i$ ), on one side of the equation, which is equal to the performance of an illicit activity ( $R_i$ ) times the probability of not being arrested [ $1 - p(r)$ ], minus the cost of planning and executing the crime ( $C_i$ ), the opportunity cost ( $O_i$ ), the expected value of the punishment if that individual is arrested [ $p(r) \cdot J_i$ ], also subtracting the moral loss arising from the execution of the crime ( $W_i$ ), all of this on the other side of that equation. In this way, we have:

$$U_i = [1 - p(r)] \cdot R_i - C_i - O_i - [p(r) \cdot J_i] - W_i$$

According to Shikida (2018):

*In this sense, if the net benefit of this expected utility  $U_i$  is positive, the crime tends to be committed, as the benefits are greater vis-à-vis the costs. It should be noted that in this theorization, Becker (1968) went back to the idea of the utilitarian and dissuasive calculation of Beccaria (1764) and Bentham (1843). Mutatis mutandis, in the illegal market, as in any other economic market, the individual acts rationally, being motivated by dissuasive measures or incentives, acting in accordance with the logic of obtaining the greatest possible benefit from his/her utility function.*

It is worth mentioning that the chance of success for a criminal of financial nature is estimated at 95% (SHIKIDA, 2018). From this, it can be inferred that the police power, however effective and competent it may be, will not be able, in isolation, to reduce crime. This power is essential, but it needs a strong assistance from other means that will be discussed later.

Williamson (1975) proposed the Transaction Cost Theory, which is based on two behavioral assumptions: the bounded rationality and the opportunistic behavior of economic agents. In the same line of reasoning, Simon (1980) states that a rational choice cannot be made, because individuals lack complete information and perfect computational skills, and because there is a cost in the search for information. Rationality occurs only in a limited manner because the human mind, which uses heuristic methods to perform the recognition, search and selection of information, has a limited capacity to process information, that is, “human behavior is intendedly rational, but only limitedly so” (SIMON, 1957, p. xxiv).

Opportunistic behavior was defined by Williamson (1985, p. 47) as an intentional action “in which economic agents seek their interests in transactions, act for their benefit by taking advantage of contractual gaps or omissions to the detriment of partners”. It manifests itself by the “strategic manipulation of information or falsification of intentions” (WILLIAMSON, 1975, p. 26)

Williamson (1987) argues that one of the manifestation forms of opportunistic behavior occurs when, in order to achieve a goal, the individual uses unconventional mechanisms, such as lying, stealing or cheating, as well as distorting or providing incomplete information with the intention of concealing or confusing the counterparty, resulting in information asymmetries.

Repeated transactions make it possible to acquire mutual knowledge between the parties, allowing the development of mutual trust around a common goal. If there is no solution to the problem of lack of information or, even worse, the reiteration leads to the knowledge that one of the parties has been cheated, traditional ties will be broken.

In its blog, the consulting company Deloitte defines market abuse and misconduct. (<https://www2.deloitte.com/us/en/pages/regulatory/articles/market-abuse-and-misconduct.html>):

*“Market misconduct can take many forms, from using inside information with false trading to disclosing information about prohibited transactions and other similar actions where market interference results in profits.”*

Market misconduct in its simplest terms is the deliberate attempt to interfere with the operation of the market in order to make money or minimize losses. The consultancy exemplifies market misconduct citing, amongst others: abuse of privileged information, price manipulation, disclosure of false or misleading information that induces transactions and other similar actions in which market interference results in profits.

The concepts presented are not contradictory; in fact, they complement each other. The fact that agents decide with incomplete information does not invalidate the Rational Choice Theory, nor the Economic Theory of Criminal Behavior. Rationality presupposes agents make decisions using the available information. As already mentioned, a world of perfect competition with complete information is practically impossible to be observed in real life.

### **III – Incentives for Duty Evasion**

Since it is an illegal activity, data on its operation are partial and inaccurate. In this section, we collected some information in order to have an idea of the incentives for duty evasion. For this, we grouped the different prices practiced in the wine market in Brazil and Argentina according to the manner the product is marketed. We collected prices of 37 different wine labels, which are frequently negotiated through duty evasion, offered through messaging apps. From these labels, we researched their prices in the Argentine retail and in the Brazilian retail market to compare them with the prices of the duty evasion. It is important to keep in mind that the prices of duty evaded wines are informed to customers on the sly, often by messaging apps such as *WhatsApp* or *Telegram* (there is no official public source or not, obviously).

The wide disparity between the prices practiced in Argentina and those practiced in Brazil arouses the risk appetite for the creation of a structure to operationalize the duty evasion.

In the analyzed sample, we estimated that the price differential, converted into Reals, presented an average of 273.6%, with a minimum differential of 98.5% and a maximum of 589.3%. Note that, the greater the difference, the greater the incentive for criminal activity. In view of the price disparities, it is also reasonable to abandon the idea that only the high Brazilian taxation, although relevant, can alone explain them.

In addition, Argentine retail prices were compared with the prices of the Brazilian market. The average of this comparison was 57.8%, with a minimum difference of 0.5% and a maximum of 225.7%. In this case, the differential indicates to the agent of the duty evasion how he/she can obtain significant extra gains by selling in the Brazilian market.

One cannot fail to mention the extra incentive that the blue dollar (or blue real) constitutes for these agents. Blue Dollar or Real is nothing more than the quotation of these and other foreign currencies on the parallel market in Argentina. An illegal practice, however, that is almost totally tolerated in that country. The difference between the official and parallel quotations has generated extra earning possibilities of more than 90%, considering the conversion only.

The third simulation compared the prices of duty evasion in the Brazilian market with the prices of the Brazilian legal market. The average was 143.3%, with a minimum observed difference of 34.5% and a maximum of 362.2%. For the Brazilian consumer, the price differential between the legal market and the duty evasion indicates a risk appetite to acquire the illegal product. That is, the greater the price difference, the greater the consumer's risk appetite.

#### **What differentiates Duty Evasion from Contraband**

In this subsection, the concepts of Duty Evasion and Contraband will be discussed, for they are often mistakenly used as if they were the same thing, but there are important differences that greatly change the behavior of agents operating in the wine market in Brazil. Bearing in mind the Economic Theory of Criminal Behavior presented in the previous section, suppliers and demanders have shaped their behavior in order to optimize their resources, sometimes without observing ethical precepts, or rather, pricing such precepts.

It is important to differentiate duty evasion from contraband because, although both are considered crimes and are harmful to society, they are not exactly the same thing, both regarding the victim and the damage caused.

The Brazilian Criminal Code was amended by Law 13.008/14, which typified the crimes of duty evasion and contraband in different articles (they were previously together), giving greater clarity to their peculiar characteristics, even with different penalties and procedural treatment, leaving the duty evasion in article 334 and contraband in article 334-A.

In the crime of duty evasion, the legal asset protected by the State, in general, is the Public Administration, while the specific legal asset is the Public Treasury's interest in seeing its tribute paid, and the protection of the national economy. According to Article 334 of the Criminal Code, duty evasion would be the act of circumventing, in whole or in part, the payment of duty or tax due on the entry, exit or consumption of goods. (GOMES, 2017)

Thus, taxes and/or charges related to the entry, exit or consumption of goods must be included in the criminal offense. The expression on "entry" could refer to taxes whose triggering event is the entry into the customs territory (Import Tax, PIS-Import, COFINS-Import, CIDE-Fuel-Import). While, on the word "consumption", it refers to other taxes, such as IPI and ICMS.

Complementing the provisions of the article:

*“§ 1 The following penalty also applies to those who:*

*I - practice cabotage navigation, outside the cases permitted by law.*

*II - practice a fact assimilated, in a special law, to duty evasion.*

*III - sell, display for sale, keep in storage or, in any way, use for one's own or other people's benefit, in the exercise of commercial or industrial activity, merchandise of foreign origin that has been clandestinely introduced into the country or fraudulently imported or that is known to be a product of clandestine introduction into the national territory or fraudulent importation by others.*

*IV - acquire, receive, or hide, for their own benefit or that of others, in the exercise of commercial or industrial activity, merchandise of foreign origin, unaccompanied by legal documentation or accompanied by documents that are known to be false.*

*§ 2 For the purposes of this article, any form of irregular or clandestine trade in foreign goods, including that carried out in residences, is equivalent to commercial activities.*

*§ 3 The penalty is doubled if the crime of duty evasion is committed in air, sea, or river transport.”*

In the crime of contraband, the protected legal asset goes beyond the simple pecuniary value of the elided tax, reaching the state interest of preventing the entry and commercialization of prohibited products in the national territory. Thus, combating the crime of contraband takes place for reasons of preserving moral, sanitary and environmental integrity, amongst other values threatened by the entry of clandestine goods. That is why this type was separated from the crime of duty evasion, receiving a more severe penalty. While the penalty for duty evasion is from 1 (one) to 4 (four) years of imprisonment, the penalty for contraband varies between 2 (two) and 5 (five) years. (GOMES, 2017)

Due to the more severe nature of the contraband penalty, there are impacts on important procedural issues that change the equation of the Economic Theory of Criminal Behavior, increasing its costs, amongst them:

- Conditional suspension of the process is no longer allowed, as the minimum penalty is greater than 1 year; and
- Pre-trial detention is allowed, given that the maximum penalty is more than 4 years.

According to Article 334-A of the Criminal Code, Contraband is the act of importing or exporting prohibited goods. Complementing the Criminal Code provisions for the crime of contraband:

*“§ 1 The following penalty also applies to those who:*

*I - practice a fact assimilated, in a special law, to contraband.*

*II - clandestinely import or export merchandise that depends on registration, analysis or authorization by a competent public agency.*

*III - reinsert Brazilian merchandise destined for export into the national territory.*

*IV - sell, display for sale, keep in storage or, in any way, use goods prohibited by Brazilian law for their own benefit or that of others, in the exercise of commercial or industrial activity. V - acquire, receive, or hide, for their own benefit or that of others, in the exercise of commercial or industrial activity, merchandise prohibited by Brazilian law. (Included by Law No. 13,008, dated June 26, 2014) § 2 - For the purposes of this article, any form of irregular or clandestine trade in foreign goods, including that carried out in residences, is equivalent to commercial activities.*

*§ 3 The penalty is doubled if the crime of contraband is committed in air, sea, or river transport.”*

Essentially, in duty evasion, products can be imported or exported, but the taxpayer does so without paying the taxes and duties that would be due. In contraband, on the other hand, the product cannot be imported or exported, or the taxpayer does so without having obtained the Import License (LI) or Export Registration (RE) from the consenting bodies. Another aspect that differentiates such crimes is that the principle of insignificance up to a certain value can be applied to duty evasion, while this principle cannot be applied for contraband. (GOMES, 2017)

In this way, the practice of contraband consists of the importation or exportation of prohibited goods, endangering public health and public administration. In turn, the practice of duty evasion is the illusion of paying the tax for permitted goods, offending the tax order. (GOMES, 2017)

This differentiation directly affects the equation of the Economic Theory of Criminal Behavior and the rationality on the decision to commit or not the crime, as well as the costs and benefits involved if one decides to commit the criminal action. Thus, theoretically, in order to commit the crime of contraband, the offender will probably need to see the possibility of a more attractive return, given the greater risk to which he/she would be exposed.

### **How Duty Evasion Works**

It is important to know how the logistics of the Argentine wine route works in order to understand the model of this business and why it is considered illegal. As it is a duty evasion, it should be noted that the product is legal, therefore, they are wines that legally left the Argentine wineries and also arrived legally at stores or resellers located in Argentina, close to the border with Brazil. So far there are no irregularities.

The problem begins when the Brazilian demand for Argentine wines with more attractive prices meets potential supply. However, for prices to be more attractive than those practiced in Brazil, suppliers must introduce their product into Brazilian territory without facing the legal and tax procedures that make it more expensive, in addition to the surcharges applied by many importers, distributors and legalized commerce operating in the market.

There are two possibilities for irregular entry in that border region between Argentina and Brazil: one by land (dry border) and the other by river, through rivers or through the Itaipú lake. In the first case, the transport of goods is done by small cars and, in the second, by small boats. Inspection is very difficult in both cases, especially at night. Once in Brazilian territory, the merchandise is taken to cities that are about 100 km from the border and stored for future distribution, to agents who resell to retail through e-commerce (social media group), but also to restaurants, specialized stores and distributors (i.e. companies legalized in Brazil).

### **How would Wine Contraband and Counterfeiting work**

There are known episodes in which counterfeit wines being sold in the Brazilian market were detected. However, such trade does not seem to be as profitable as duty evasion, being even less sustainable in the long term, for it has higher costs and more severe punishment (when detected).

On the side of duty evasion, the criminal sells a legal product that is already finished and ready for consumption, needing only to establish a distribution logistics. While on the other side, the counterfeiter/smuggler will need to produce the good, in this case wine. When choosing to produce wine, the offender would have to assume a fixed cost (machinery, equipment, adequate physical space, minimally specialized labor, and supplies). He/she would also need to build a network of suppliers, which could increase his/her exposure and, consequently, the probability of being detected.

Obviously, he/she will have the option of buying a lower quality, lower priced wine on the market. He/she will then need bottles identical to those of the wines he/she intends to smuggle, which will require

him/her to obtain several types of bottles (estimated average unit value, BRL 3.30). Then, he/she will have to falsify labels and back labels (BRL 1.70), capsules (BRL 0.80), corks (BRL 1.80) and boxes (BRL 0.70). The costs of these items are not negligible, according to price estimates in parentheses. Up to this moment, the logistics have already had a high cost, which the duty evasion does not incur. Then, a similar commercialization logistics will begin in both crimes. However, if caught, the smuggler will have a greater penalty and may be charged with other crimes that will increase his/her sentence much more.

Another crucial point that jeopardizes the viability of the fine wine contraband business is that the consumer of this category of wines is possibly able to perceive the low quality of the product and may not place new orders. Therefore, the smuggler will see his/her reputation decrease along with the number of new orders. It is worth remembering that this business is highly dependent on customer referrals and trust. In short, the above explains why the contraband (counterfeiting) of wine is little observed.

Below are some schematics of what the cost equations would look like for each agent in this market:

**a) Product of Duty Evasion**

Total Cost = product + transport + bribes + [Punishment Probability x (Punishment Costs + seizure losses)]

**b) Product of Contraband**

Total Cost = costs for counterfeiting the product + transport + bribes + (Punishment Probability x (Punishment Costs greater than those of duty evasion + product loss by seizure))

**c) Legalized Product**

Total Cost = product + transport + taxes + customs costs

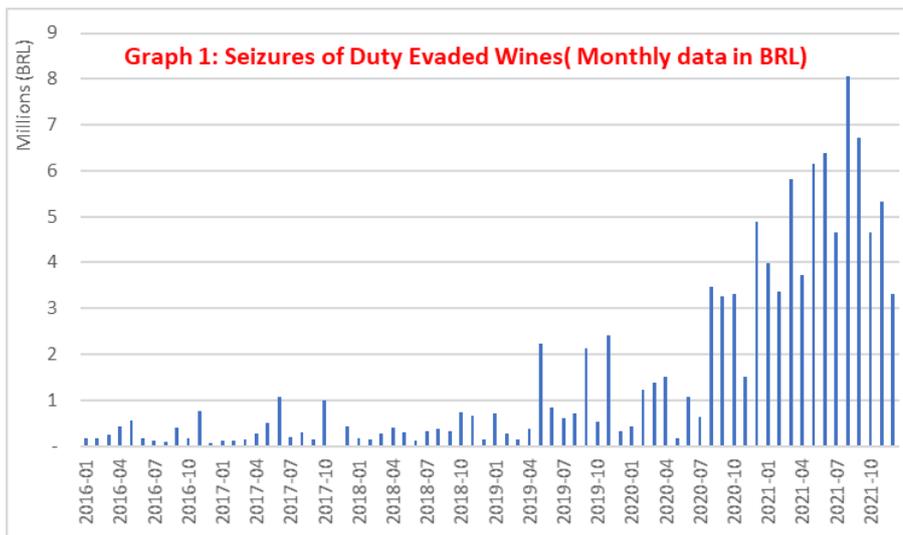
The product of duty evasion has the lowest operational and logistical costs, associated with a low probability of being detected and rare or mild punishment. The agent of duty evasion deals with a very short-term perspective. Contraband has the logistical and operational costs to produce a wine and give it the appearance of a higher quality product, but with more severe punishment in case of detection. The counterfeiter-smuggler operates with a short-term perspective. The legalized product (depending on whether the agent is a producer or only a trader) has the production or acquisition, logistics, tax and customs costs, in addition to the inherent risks of the market related to crop losses (when a producer) and decreased demand, as it operates in a long-term perspective. Based on the above, duty evasion tends to be the best alternative from the point of view of a risk-return analysis.

**Data from seizures compared with the official import of Argentine wines**

The seizures of duty evaded wines originating in Argentina have grown 1,760% since 2016, according to data on seizures from the Federal Revenue Service of Brazil (obtained via the Access to Information Law). In the same period, the importing of wines from that country grew 178%. In 2016, the number of seizures was equivalent to 2.11% when compared to the number of legal imports. In 2021, they are equivalent to 14.15%. In Reals, seizures in 2021 were a total of BRL 62 million, while formal imports were a total of BRL 1.55 billion.

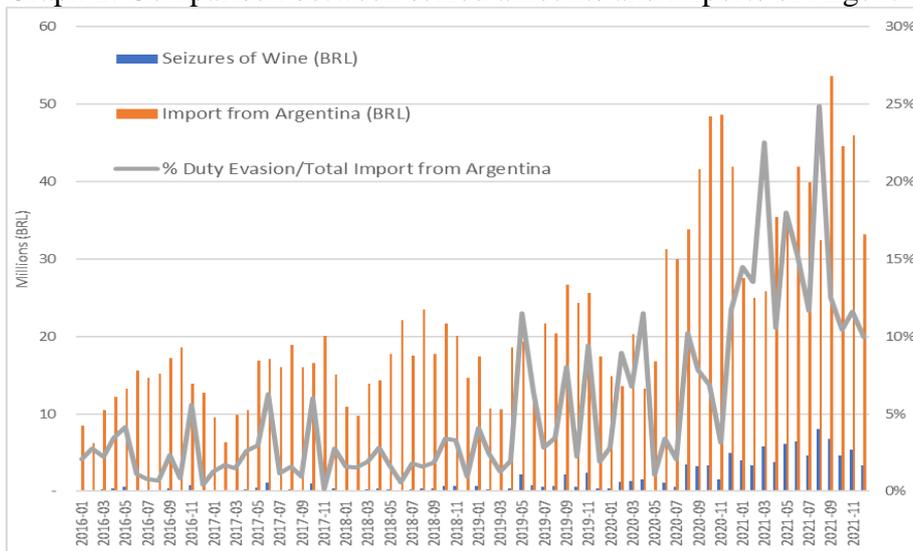
The graph below shows the evolution of seizures of duty evaded wines. It is worth noting that the growth in the number of seizures or their amount does not allow us to infer that there was an increase in the amount of duty evasion. Even if it points to this direction, it would be necessary to evaluate other variables for such an inference. It is possible that seizures have increased due to the increased effectiveness of inspections.

Graph 1: Seizures of Duty Evaded Wines (monthly data in BRL)



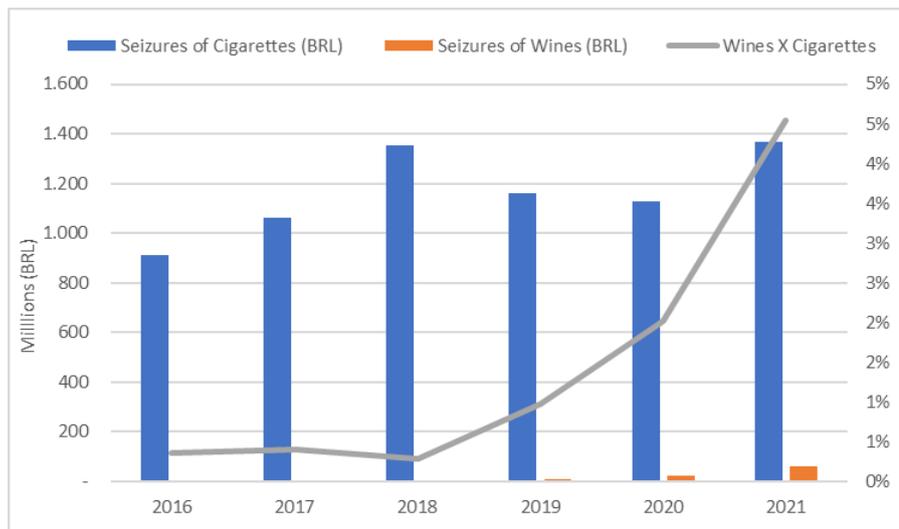
With the information in the chart below, which compares the evolution of seized amounts referring to wines from duty evasion with official imports of wines from Argentina (main origin of seized wines), there is a considerable increase in the demand for wines from the neighboring country, which strengthens the hypothesis that illegal entry has also increased.

Graph 2: Comparison between seized amounts and imports of Argentine wines



The work of the authorities in fighting cross-border crimes involves several crimes. The seizures of wine and cigarettes will be compared below. The intention is only to consider differences in magnitudes, although several other conclusions would be possible. Despite the undeniable fact of the exponential growth of seizures of illegal wines, it is also undeniable that their relative magnitude, when compared to the seizures of cigarettes, is not very representative. Wine seizures are equivalent to only 4.54% of cigarette seizures, which reached BRL 1.37 billion in 2021 (wine seizures were a total of BRL 62 million, in the same period). The graph below compares the annual evolution of both seizures over the last 6 years.

Graph 3: Comparison between seizures of wine and cigarettes



Research carried out by the Instituto de Desenvolvimento Economico e Social de Fronteiras (Institute for Economic and Social Development of Borders) - IDESF, entitled “O Custo do Contrabando” (The Cost of Contraband) (March 2015), listed the 10 most smuggled goods (the term smuggled was used since some of the goods in the ranking are thus typified) to Brazil. The ranking looked like this: 67.44% cigarettes, 15.42% electronics, 5.04% computers, 3.03% clothing, 2.45% perfumes, 2.03% watches, 1.89% toys, 1.50% glasses, 0, 85% medicines and 0.35% beverages. It is important to note that the publication did not distinguish which beverages, that is, all alcoholic beverages were considered. (IDESF, 2015)

IDESF also calculated the average costs of the smuggled goods. The percentage varied between 19.24% and 24.24%, and the estimated cost for beverages was 20.24%. The same study also estimated that the profit for the smuggling of beverages in general varies between 56.67 and 82.46%. It is worth mentioning that the costs included expenses with logistics, personnel, bribes, risk, storage, and distribution. It is also important to mention that, for goods in general, a risk of loss due to seizure at the border was estimated at 10%, and due to seizures already in the national territory, at 9%. (IDESF, 2015)

#### IV - The Opportunistic Behavior of Agents

The wine market in Brazil is far from being a perfect competition market. Market failures generate incentives for opportunistic actions. It is said that, to correct market failures, there is the need to state intervention, that is, regulation. The problem is that the state is also subject to failures, known as government failures.

The set design for a duty evasion market would be close to the following: a market with 4 agents amongst demanders, suppliers and the government. There is the **consumer**, who lacks information to make decisions regarding the price and quality of the wine product; the **government**, excessively taxing the product, either due to capture by regulatory agencies or due to inefficiency, and also due to information failure; the **legal trader**, who overprices, relying on the consumer’s ignorance and blaming high government taxation; the **informal trader**, who offers the same product at a much lower price, since he/she does not pay the due taxes. This category includes informal traders in Brazil (nicknamed “*contatinho do Whatsapp*”) and traders across the border. The hypothesis assumed in this article is that all those mentioned above adopt an “**opportunistic behavior**”, in the sense of trying to appropriate extra income.

The Government as a market regulator seeking to correct its flaws also faces information asymmetry that results in non-optimal decisions and inefficient allocation of factors; this derives from the regulatory costs that are passed on to taxpayers-consumers. An inefficient State leads to higher taxes. In the case of wines, the product is highly taxed for the Government to show the population that it is punishing the richest (since wine is wrongly considered a luxury good), thus practicing tariff populism. This could be classified as an **opportunistic behavior of the government**. When wine is imported, the problem worsens, because imported wine is seen as an even more elite good (very mistaken reasoning) and, therefore, it is more taxed. It cannot be left out that alcoholic beverages are considered harmful to consumers and, therefore, subject to the “*imposto do pecado*” (sin tax). The sin tax implies an increase in rates to discourage consumption and to increase collection for the purpose of fighting the damages caused.

By taking advantage of the asymmetry of information, the recognized high tax burden and the government's revenue collection, many importers, distributors, resellers, bars, restaurants, and national producers apply a high mark up to the product, attributing the result to the high tax burden. In other words, attributing all the blame to the government, exempting itself from its share. This situation could be classified as an **opportunistic behavior of providers**.

Another hypothetical situation that would configure as an opportunistic behavior of providers is the possibility of acquiring the product of duty evasion and merging them with legally acquired products. In this way, these establishments reduce their costs, make inspection more difficult (since it is more difficult to separate which would be the illegal portion in a formally legitimate firm) and, consequently, obtain extra profit.

On the other side of the border, we have the “exporter”, who illegally enters (mainly) Argentine wine into the Brazilian territory. As already seen before (subsection: How Duty Evasion Works), the first incentive to crime is the price differential between the markets of Argentina and Brazil, a behavior based on the Economic Theory of Criminal Behavior. The second incentive for the agent of duty evasion is the exchange rate differential in Argentina, between the official quotation and the parallel market quotation. This incentives context justifies the **opportunistic behavior of the “exporter”** across the border.

Finally, there is, in the most fragile link in the sense of being understood as injured and without bargaining power, the consumer. First, it is important to describe the Brazilian consumer of duty evaded wines. It is noteworthy that the seized wines are in a price range above BRL 70.00. The consumer profile in this price range is someone of upper-middle to high income, who has some knowledge of wines and consumes wines in the premium category even when they were not obtained through duty evasion. According to research published in the e-book *Visitando o que pensa o consumidor de vinhos no Brasil* (Visiting what the wine consumer in Brazil thinks), it is observed that only 16.2% of the respondents consume wine inside this price range. And when wines priced above BRL 100 are evaluated, the percentage drops to 4.1%. Amongst the consumers who consume wines above BRL 70, 83% earn more than 10 minimum wages and 11.7% earn more than 4 minimum wages. In addition, 82% have completed higher education, of which 53% have postgraduate degrees. (SALVO, 2021)

It is essential to point out that this consumer knows that he/she is buying a duty evaded product. He/she has already researched the price at origin and detected the abysmal discrepancy. He/she is probably not sure, due to the lack of market transparency, about who appropriates the paid differential; therefore, for various reasons, he/she distrusts the government and the entire chain of intermediaries. He/she feels cheated and helpless, therefore he/she thinks it is fair to buy his/her wines this way. In addition, he/she knows that he/she will hardly be caught by the inspection and, if caught, he/she will have a mild punishment, if any. In other words, the **opportunistic behavior of the consumer** is supported by the Economic Theory of Criminal Behavior.

A possible allegation is that both the duty evasion agents and the consumers who purchase wines from them would be committing a crime, which is true. However, the opportunistic behaviors of providers, although difficult to typify, could also be framed in legal provisions being considered a crime. One could, for example, capitulate discount campaigns such as “all for half of the double” as duty evasion, as provided for in Article 171 of the Brazilian Criminal Code, transcribed below:

***Article 171** - Obtain, for oneself or for others, an unlawful advantage, to the detriment of others, inducing or keeping someone in error, through artifice, deception, or any other fraudulent means:*

*Penalty - imprisonment, from one to five years, and fine.*

In addition, or alternatively, there is the provisions of Article 66 of the Consumer Defense Code - CDC, which could include all agents who, in possession of information relevant to the consumers' decision-making, resolve to omit them and obtain more income from this situation. Below, you will find is a transcript of the CDC text typifying deceptive advertising.

***Article 66** — Making a false or misleading statement, or omitting relevant information about the nature, characteristic, quality, quantity, safety, performance, durability, price or warranty of products or services:*

*Penalty - imprisonment, from three months to one year, and fine.*

In this way, one could classify the performance of agents considered legitimate of greed as the type that only appropriates the income of others without adding any value. This is called rent-seeking. In many of their acts, we can observe ways of increasing transaction costs for consumers, especially the cost of obtaining information. All this happens because they omit information to the customer or generate information that induces the consumer to make decisions that go against their welfare maximization. Obviously, this situation, created artificially through the abuse of the market, results in greater gains for those who manipulate it. Therefore, part of the misconduct of illegal consumers and traders can be justified as an attempt to defend themselves against the misconduct of legitimate market agents, who act in an opportunistic way, with similar conducts that are subject to punishment provided for in legal provisions.

## **V - Mitigation or Solution Proposal**

Wine traders in Brazil and their associations usually blame the consumer for the existence of this illegal market (duty evasion of wines). This stance will not lead to the mitigation of the problem. Both the problem and the solution are much more complex than simply convincing the consumer to buy the legally nationalized product.

Now that we have seen, in the previous section, how the incentives that shape the behavior of agents originate, next we will see some of the recommended measures and how they are not very effective. The first problem is that the wine market needs to increase its transparency and level of information. The consumer is suspicious (with complete reason) that intermediaries and the government appropriate part of the income generated in the sector out of pure greed. As seen earlier, the breach of trust is bad for business.

Another frequently used action that does little to reduce duty evasion is to treat it as contraband, alleging that the wines are counterfeit and can harm the health of the consumer and, therefore, it would not be smart to purchase them. It is known that the finding of counterfeit wines is insignificant, and disseminating untrue information goes against the idea of increasing the sector's transparency and the consumer's trust.

The third ineffective recommendation is to ask the consumer to request an invoice. Consumers who demand this type of wine, classified in the premium category, are fully aware of what they are buying, and their intention is precisely to pay a price that, in their view, is the "fairest". Therefore, not having an invoice will not matter to consumers who believe they are being harmed by the tax system, and their act would be a defensive and reactive attitude.

Another ineffective advice is the recommendation that consumers observe the label on the back label, mandatory by law, which contains information in Portuguese about the product and its importer. Now, first, we have the same situation as in the previous recommendation, that is, the consumer is aware of the business he/she is doing. Secondly, it would be very easy to forge such a label if the criminal wanted to improve his/her business.

It was also indicated for the consumer to be wary of very low prices or large discounts, as it would not be possible to achieve very low prices since there are many compromises throughout the whole logistics chain that increase the final price. In this case, there is again the issue that the consumer is seeking to pay less and is aware of the irregularity. The most serious problem with this recommendation is that many physical or virtual stores use the technique of increasing prices to then apply supposedly very advantageous discounts of 30, 40, 50, 60% - as it is commonly known, a sale of the type "all for half of the double". This practice, more common than one might imagine in the wine market, confuses the consumer, increasing distrust instead of making the relationship more transparent. Many suppliers advertise imported wines with great discounts, but the comparison is unfeasible if the consumer tries to search for the prices of the competition, since, in most cases, the wines are imported with exclusivity. Such a practice generates a breach of trust and uncertainty on the part of the consumer due to informational failure.

### **The most effective mitigation proposals**

The solutions proposed above are not negligible, but they are fragile. Combating duty evasion cannot be imagined without more inspection and repression, more punishment and greater severity of penalties, whether pecuniary fines, imprisonment, or other deterrent alternative penalties.

In view of what has been exposed so far, we can perceive that reducing information asymmetry will be essential to improve the business environment. Simultaneously, commercial practices to increase sales based on inducing consumption with false information must be banned from this market. In the same manner, disseminating other information that are far from reality in order to lead the consumer to make decisions based on assumptions without evidence also lead to a relationship of distrust that disfavors new business.

Reducing the tax burden would be of great value to reduce the price differential between the same product sold across borders. The alert serves both the government and national producers who, hypothetically, may be taking advantage of the high prices of imported substitutes (competing goods) to overprice the national product. The aim of protecting national wine production may be hindering the development of the sector.

## **VI - Final Remarks**

Those who advocate that the fight against the duty evasion of wines should exclusively involve the repression and punishment of those who act directly in the illegal trade, whether by offering or acquiring, did not understand the entire structure of the existing incentives. Both repression and punishment of the crime are a necessary condition; however, they are far from being sufficient, since the costs have already been priced by the agents, who have concluded that the benefits of the crime outweigh its costs. On the other hand, the costs of this fight are high. In other words, the cost-benefit analysis is favorable from the criminal's point of view but, from the point of view of the authorities involved in the fight, it is not.

It seems that reversing the outcome of the economic equation of crime cannot be restricted to the variables that increase the costs of the offender. Additionally, it is essential to adopt measures that reduce price differentials, which would include reducing the tax burden, reducing profit margins for legal trade intermediaries, commercial practices that increase the transparency of business in the sector, increasing the consumer's trust, making him/her no longer feel cheated. It is worth remembering that a non-negligible part of the incentives to duty evasion derive from the macroeconomic condition of Argentina and its blue dollar. In view of the above, it seems clear that the solution goes beyond the consumer's behavior.

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