Trade and Regional Cooperation Perspectives from Africa

Allan Mukungu's speaking notes on Trade mis-invoicing and other elements of IFFs impacting on the AfCFTA: How do we address this in context of ACFTA?

2 March 2021, 11.00-12.30hrs South African Time

(12.00-13.30 East African Time)

The creation of an African Continental Free Trade Area (AfCFTA), which aims to boost intra-African trade by providing a comprehensive and mutually beneficial trade agreement among the member states, covering trade in goods and services, investment, intellectual property rights and competition policy, is a significant development in Africa's desire for effective unity since the formal start of journey in 1963.

This AfCFTA will **connect 1,2 billion people across 55 AU countries with a combined gross domestic product (GDP) valued at USD 3.4 trillion, creating the largest free trade area in the world.**

It is to be reasonably expected that the full implementation of AfCFTA should:

- **reshape markets and economies across the region,**
- **boost output in the services, manufacturing and the natural resource sectors** on the African continent,
- **facilitate countries in diversifying their export markets, accelerating growth while attracting Foreign Direct Investment**, and
- potentially **lift 30 million Africans out of extreme poverty.**

Achieving the full potential of the AfCFTA will depend on putting significant policy reforms and trade facilitation measures in place.[1]

The beneficial and material socio-economic and developmental benefits of AfCFTA are blindingly obvious for participating countries on the continent, but implementation of this ambitious intervention will determine its success. For instance:

While it is clear that policy reforms and trade facilitation measures are needed to enable trade diversification and the expansion of trade markets, additional measures and reforms are needed to ensure that the AfCFTA is not tainted:

- **with abuse and exploitation of the international trade system,**
- **with collusion between importer, exporters and financial intermediaries, facilitating commercial tax evasion and illicit financial flows to lower tax jurisdictions or tax havens through trade-based money laundering, trade mis-invoicing, carousel fraud, abusive transfer pricing, and so forth**.

Illicit financial flows refer to activities considered as criminal offences, but also some behaviours related to tax and commercial practices.

A conceptual framework proposed by UNCTAD, UNODC, UNECA and the international task force they constituted in 2019 identifies four main types of activities that can generate IFFs, reiterating those identified by the High Level Panel on Illicit Financial Flows from Africa led by former South African President Thabo Mbeki, and whose report was endorsed by the African Union Assembly in January 2015:

[1]The World Bank (2020). "The African Continental Free Trade Area". A World Bank Publication, https://www.worldbank.org/en/topic/trade/publication/the-african-continental-free-trade-area 1

1) tax and commercial activities;
2) illegal markets;
3) corruption; and
4) exploitation-type activities and financing of crime and terrorism.

For each of these types, IFFs can generally emerge at two different stages:

- Illicit income generation, which includes the set of cross-border transactions that are either performed in the context of the production of illicit goods and services or generate illicit income for an actor during a non-productive illicit activity.

- Illicit income management, which refers to cross-border transactions that use illicit income to invest in financial and non-financial assets or to consume goods and services.

Illicit financial flows are multi-dimensional, comprising several different kinds of activities, including flows originating from illicit activities, illicit transactions to transfer funds that have a licit origin, and flows stemming from licit activity being used in an illicit way.

Simplified examples with trade mis-invoicing include:

- over-invoicing of imports to disguise capital flight as a form of trade payment;
- under-invoicing of exports to conceal trade profit abroad, in third party countries that are tax havens or secrecy jurisdictions;
- over-invoicing of exports; or
- under-invoicing of imports to incorporate illicit proceeds into the domestic legal financial system.

The March 2020 report of the Global Financial Integrity's (GFI), analysed trade related illicit financial flows from 2008 to 2017, and found that **developing and emerging economies lost US$8.7 trillion in illicit financial flows**, measured as the sum of the value gaps in trade between 135 developing countries and 36 advanced economies for that period.[2]

For Africa, excluding north Africa, this amounted to US$272.1 billion from 2008 to 2017, or an average US$27.2 billion per annum for the same period.

While this only represents **3.7 percent of total illicit financial flows associated with trade; it represents an alarming 17.8 percent of total trade for Africa, excluding north Africa**.[3]

Moreover, this report also highlights that the cumulative average trade gap from 2008 to 2017 for the top ten HS-code commodities, where US$113.2 billion of trade mis-invoicing is associated with mineral fuels and US$31.8 billion is associated with precious stones and metals.[4]

Nearly 30 percent of the cumulative trade mis-invoicing gaps stem from natural resources including: minerals, precious metals and stones, ores, copper, rubber, and agricultural produce (including grains, cereals, fruit, nuts, etc).[5]

Unfortunately, these **illicit financial flows** are illicitly acquired and channelled out of the continent; they continue to pose a development

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[2] Global Financial Integrity (2020). Trade-Related IFFs in 135 Developing Countries: 2008-2017. https://gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/accessed 1 September 2020.
[3] *Ibid.*
[4] *Ibid.*
[5] *Ibid.*

challenge to the region, as they remove the scarce domestic resources that are crucial for the continent’s development.

In fact, IFFs could **unravel the positive benefits of the AfCFTA and could result in the continent bleeding all its valuable natural resources with no legacy being established around its intrinsic natural wealth, and no benefit to its people**.

So, what can be done to ensure that Africa benefits from AfCFTA and is not plagued by illicit financial flows spurred by commercial tax evasion through trade mis-invoicing and abusive transfer pricing and/or trade-based money laundering?

There are a large number of tools, guidelines, systems and processes in place to ensure the continent reaps the rewards of expansive growth due to AfCFTA. The African Union Commission, UNECA, UNCTAD and UNODC, and other UN Regional Commissions are working on some of these measures.

In Africa, former South African President Thabo Mbeki, chairs a consortium of organizations working to curb IFFs from Africa.

In the interest of time, and to signpost some of the tools, guidelines and processes in place, I will highlight the following action areas:

- There is a need to **design new and improved policies** to better tackle these challenges, by **increasing the capacity and resources of customs, tax and border authorities to manage the increased cross-border flows, improve the facilitation of trade and the**

movement of travellers, while enhancing coordination between agencies.[6]

- The need to ensure **Coordinated Border Management (CBN) with One-Stop Border Posts**, coupled with joint control arrangements between the various institutions and participating agencies.
    - This could include, for example, joint mobile teams, hot pursuit, joint risk management or targeting centres, information exchange systems, in particular the **Single Window** that forms an intrinsic part of CBM.

- The need to introduce the **Trade Identification Number (TIN)** (and potentially a Unique Consignment Reference), and the **Legal Entity Identifier (LEI)**.

- The need to provide **capacity building** including financial and human resources for Customs to combat IFFs/TM.
    - In managing human resources, Customs should enhance integrity as a pre-requisite for the effective and efficient functioning of a Customs administration, and also in combating illicit financial flows.
- The need to **Enhance partnerships** of Customs with i) trade business, ii) other government agencies such as tax authorities, Financial Intelligence Units (FIU) and police, and iii) customs administrations of trade partners is also essential so that Customs can secure timely information and data to detect illicit financial flows concealed in trade transactions.[7]"

[6] Polner, M. (2011) Coordinated Border Management: From Theory to Practice. World Customs Journal, volume 5, number , September 2011. w.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/19_cbm_polner_en.pdf?la=en

[7] *Op.cit.,* WCO.

- The need to harness **New technology such as blockchain** could potentially provide a solution to prevent and detect any fraudulent manipulation of trade transactions and related financial transactions by **sharing and analysing relevant information in a trusted and cryptographically secure and transparent manner**.
  - Moreover, this technology could also be **used to ensure sustainable and responsible resourcing and manufacturing** (as per the latest ISO standards).

- The need to increase the **exchange of information and mutual legal assistance between customs authorities, border management agencies, tax authorities, FIUs, etc**.
  - The information exchange should be guided by the World Customs Organisation (WCO) data model with exchange of information relating to: business process models, data sets and code lists, information models and include the technical solutions for information exchange.

- Most importantly in this evolving digital world, the need to harness **Big data analytics, the use of machine learning and artificial intelligence** are some of the newer forms of **disruptive technologies**[8] that the African Union member States through the AfCFTA should capitalise on.
  - Other disruptive technologies and strategies include: the **Internet of Things**[9]; the use of **biometrics to identify the**

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[8] WCO (2019). Study Report on Disruptive Technologies, June 2019. http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/disruptive-technologies/wco_disruptive_technologies_en.pdf?la=en

[9] Asset tracking has become very important for supply chain management. It gives companies a way to make better decisions and save time and money. In that respect, the Internet of Things, or IoT, is used for monitoring the movement of goods in real time. This includes monitoring the position of the container, which can help in voyage optimization. Special apps can also help the customer receiving the goods verify whether the arriving parcel is correct, by using a bar code reader. IoT has contributed to the growth of e-commerce. It has transformed how people buy – through Omnichannel sales and superfast shipments. Suppliers and consumers are digitally connecting in real time. Big companies are using IoT to track their goods and improve customer service. The question is how can Customs and other border agencies plug into this network and benefit from this information, based on integrated supply chain management principles, to ensure that trade facilitation and security requirements are met in the movements across border. With information available via IoT technology, Customs administrations would be able to focus on using analytical tools to identify priority cargo, high-risk and low-risk shipments, and supply chains.

beneficial owners and trade intermediaries, linked to the TIN and the Legal Entity Identifier for payments through the Bank of International Settlements; **drones**[10]; **virtual, augmented and mixed reality**[11] and **3D printing**[12].

There is therefore, already a substantial arsenal of initiatives that could be exploited to tackle Trade Mis-invoicing, and at UNECA, we are working with partners to produce guidelines that could support member States to build the capacity to tackle these resource leakages and ensure the financial security of Africa to finance sustainable development and achieve Africa's aspiration enshrined in Agenda 2030 and Agenda 2063.

[10] The use of drones in the Customs environment no longer belongs to the "generation next". They are already being used by some Customs administrations for surveillance and monitoring purposes. However, while there are budding opportunities for the use of drones as a mode of delivery, there are also challenges. Customs need to monitor, analyse and comprehend emerging developments in the use of drones, and related regulatory developments, and come up with an appropriate policy response, together with potential adjustments of Customs procedures and requirements where needed. Another area to explore is the Customs regulatory perspective to meet the current and emerging challenges, especially in the context of the use of drones for cross-border delivery of illegal and legal goods. Drones have successfully used to prevent wildlife crime and poaching of rhino horn and elephant tusks in South Africa.

[11] Can be used to project visual assistance in the physical world, e.g. when carrying out a physical inspection. This assistance can be in two formats. The first is general assistance that is provided in advance to all employees. The second is the possibility that the assistance is being provided by someone who can see what the Customs officer sees, in real time. Another potential use is the visualization of big data sets. When using mixed reality, data can be projected in the physical world as digital artefacts that can be manipulated as real objects. It can also be used in training Customs officers. Different kinds of training environments can be created that are difficult to recreate in the physical world, e.g. the machine room of a large container vessel.

[12] 3D printing could potentially have a major impact on the work of Customs in the future. Some feel that the enhanced use of 3D printing would probably have more impact on movements on the domestic market rather than across borders and that, based on current legislation, that might mean 3D printing could have more implications for other governmental agencies rather than for Customs (e.g. tax administrations, national police, etc.). However, others feel that Customs should be involved in monitoring the virtual supply chain, and the question has been raised as to how this could this be achieved, including whether existing legal instruments are sufficient to cover such responsibilities. In general, cooperation of Customs with tax and other relevant agencies (possibly as a new dimension of coordinated border management) is regarded as important in the area. The implications of 3D printing on origin, valuation, IPR and security have been stressed in the WCO, and especially the VAT implications. It has even been posited that there might be a need to redefine the term "goods" in the future. There is an overarching feeling in the Customs community that administrations should play an important role in monitoring the cross-border movement of intangible goods.