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Hiding in Plain Sight

Trade Misinvoicing and the Impact of Revenue Loss
in Ghana, Kenya, Mozambique, Tanzania, and Uganda: 2002-2011



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May 2014



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May 2014

Funded by

MINISTRY OF FOREIGN AFFAIRS OF DENMARK

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DEVELOPMENT COOPERATION

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Executive Summary

Illicit flows of capital through developing countries due to trade misinvoicing is one of the most pressing challenges facing policymakers in these countries. The global figure for illicit financial outflows from developing countries is approximately \$542 billion per year on average (over a 10-year time series), and trade misinvoicing makes up close to 80 percent of this or \$424 billion.¹ Capital flight, facilitated by a global network of secrecy jurisdictions and complex, opaque corporate and account structures, robs governments and societies of needed revenue for domestic investment in the private sector, infrastructure development, and the provision of vital social services. This translates into lost opportunities, lost jobs, and lost potential.

This study explores the economic and the policy side of the issue of trade misinvoicing using case studies of Ghana, Kenya, Mozambique, Tanzania, and Uganda. Data on illicit flows for these five countries demonstrate the varying magnitudes, sources, and consequences of trade misinvoicing at the country level and provide hope and warning to other developing countries. We find that trade misinvoicing is a significant source of illicit outflows and inflows of capital in each country, resulting in billions of dollars of lost investment and hundreds of millions of dollars in unrealized domestic resource mobilization. The sources of trade misinvoicing varied across the cases, as did the policy environment in which this misinvoicing occurs. However, we also find significant facets of this issue that apply to all the countries, particularly with regards to customs invoice review procedures and access to on-the-spot information. These challenges represent opportunities for the five countries to improve their economic systems and accountability mechanisms through greater transparency.

I. Data

We analyzed data on bilateral trade flows for 2002–2011 from the UN’s Comtrade database to estimate trade misinvoicing for Ghana, Kenya, Mozambique, Tanzania, and Uganda. This represents data the governments themselves provided and includes the most recent year for which the necessary data was available at the time of writing this report. We found that Tanzania experienced the greatest annual average gross illicit flows with \$1.87 billion. Kenya is second with \$1.51 billion in average gross flows, and Ghana’s figure of \$1.44 billion is also significant. Uganda experienced gross average annual illicit flows of \$884 million, and Mozambique’s figure is \$585 million. Table 1 presents a summary of the trade misinvoicing figures for each of the five countries, as well as the estimated average annual tax revenue loss that resulted from these illicit inflows and outflows.

¹ Dev Kar and Brian LeBlanc, *Illicit Financial Flows from Developing Countries: 2002-2011* (Washington, DC: Global Financial Integrity, 2013), 15.

Table 1. Summary of Annual Average Trade Misinvoicing Figures from Five African Countries, 2002–2011 1/, 2/
(in millions of U.S. Dollars)

Country	Export Misinvoicing		Import Misinvoicing		Illicit Outflows	Illicit Inflows	Gross Illicit Flows
	Under-Invoicing	Over-Invoicing	Under-Invoicing	Over-Invoicing			
Ghana	568	-270	-464	221	732	707	1,439
Kenya	1,029	0	-438	42	1,071	438	1,508
Mozambique	140	-79	-247	119	259	326	585
Tanzania	0	-1,034	-11	828	828	1,044	1,873
Uganda	26	-46	0	813	839	46	884

1/ Data for 2011 for Kenya, Mozambique, and Tanzania was not available at the time of writing.

2/ A negative sign indicates an inflow; a positive sign indicates an outflow.

We also measured and analyzed the breakdown of each country's trade misinvoicing figure by under-invoicing and over-invoicing for exports and for imports. Export under-invoicing means that the seller is surreptitiously channeling the difference between the true value of the transaction and the misinvoiced value to a foreign account. Export over-invoicing means that the transaction is actually worth less than the official invoice and can signify that the parties are trying to collect excess export credits. This process could also be used to disguise foreign investment to avoid capital controls. Import under-invoicing happens when the buyer or the seller falsifies the value of the trade to be less than its actual market value; this reduces the amount of customs duties and VAT the transacting parties pay to the government. Import over-invoicing is the opposite of import under-invoicing and represents hidden outflows of capital, which can lead to lower year-end corporate taxes needing to be paid to the government in the importing country.

Each of the five countries we studied had a different breakdown of trade misinvoicing between the four categories. Ghana experienced trade misinvoicing in each of the four categories, with the highest levels being in export under-invoicing and import under-invoicing. Kenya's trade misinvoicing fell mostly into export under-invoicing with some import under-invoicing. Mozambique, like Ghana, had a more even split between the four types of trade misinvoicing, but import under-invoicing was the most significant. Most of Tanzania's trade misinvoicing was evenly divided between export over-invoicing and import over-invoicing, a mirror image of Kenya. Uganda experienced significant import over-invoicing, a small amount of export-based trade misinvoicing, and no import under-invoicing.

The differences between the figures and breakdowns for each of the countries reflect the variances between their respective tax and tariff regimes and how these can create perverse incentives for tax evasion. Export under-invoicing relocates profit to another jurisdiction to lower year-end corporate taxes paid in the country of export. Export over-invoicing allows a company to collect extra export subsidies or tax credits, and it secretly moves additional capital into the country of origin. Import under-invoicing reduces the amount of tariffs and value added taxes (VAT) a company pays to the government. Import over-invoicing artificially increases the importing company's input costs and lowers its year-end corporate taxes paid to the government.

Finally, we calculated rough estimates for the amount of domestic tax and tariff revenue each country may have lost as a consequence of the illicit flows of capital through trade misinvoicing. Our results suggest that Ghana lost \$386 million, Kenya lost \$435 million, Mozambique lost \$187 million, Tanzania lost \$248 million, and Uganda lost \$243 million on average per year in potential tax and tariff revenue during the ten-year period of the study. These figures represent domestic resources that the governments did not capture and thus could not mobilize. This additional tax revenue could have been used for investments in development, including providing greater access to education, healthcare, or infrastructure improvements. The lost opportunity to provide these public goods is a symbol of the real, tangible harm trade misinvoicing and illicit financial flows cause in developing countries.

Table 2. Summary of the Estimated Average Annual Tax Revenue Loss Due to Trade Misinvoicing, 2002–2011 1/
(in millions of U.S. dollars or in percent)

Country	Average Government Revenue	Average Tax Loss due to Trade Misinvoicing	Tax Loss as a Percent of Government Revenue
Ghana	3,494	386	11.0%
Kenya	5,242	435	8.3%
Mozambique	1,793	187	10.4%
Tanzania	3,339	248	7.4%
Uganda	1,916	243	12.7%

1/ Data for 2011 for Kenya, Mozambique, and Tanzania was not available at the time of writing.

II. Policy Environment

Insufficient data and limited processes for questioning mis-valued invoices are plaguing efforts of each government to curtail trade misinvoicing and reduce the reach of the shadow financial system. The customs authorities are not usually collecting, or do not have the ability to collect, the data they need to understand the magnitude of illicit flows of capital due to trade misinvoicing or the tax revenue and investment capital that are lost as a result. In order to do so, governments need to track the direction of trade flows, detect if the invoices are altered in different jurisdictions, and understand how the invoice values compare to world market norms. They also need to have access to information on who ultimately controls companies that are trading across the country’s borders, and they need to know whether income and accounts held abroad are being properly reported to the tax authorities in accordance with the country’s rules and regulations. The countries we studied are moving in this direction with the establishment of electronic customs systems and, in some cases, the creation of financial intelligence units (FIUs), which are responsible for monitoring issues of financial crime and opacity.

Customs authorities in the five governments in this study are hampered by not only the lack of data on trade, tax, and corporate transactions in their own country, but also by the lack of data on international trade. If customs officers were able to access the latest global market price for an imported good and find that the invoice value differs significantly, they could use the information to spur further investigation of the parties in the transaction. The ability to link customs invoices with

data on the beneficial owners and tax status of companies involved in a transaction would make the process much more effective and streamlined. Governments also need to make sure that they have financial intelligence units (FIUs) with enough staff and authority to carry out their responsibilities for spotting and investigating possible wrongdoing through monitoring of the country's financial system. Civil service capacity will become even more important as information collection increases from stronger anti-money laundering laws, better or new tax information exchange agreements, and electronic customs systems.

III. Recommendations

Greater *transparency* is the key to designing new or improving policies to address these illicit transfers of capital out the countries. Governments need to be able to see where, how, and at what value trade flows are moving across their country's borders, so that they can try to detect, deter, and prosecute any abuses of the laws governing these transactions.

The first line of defense against trade misinvoicing is customs agencies. The countries we studied are transitioning to electronic customs processing systems, which should make it relatively simple for officers to assess whether transactions may have been misinvoiced. It is unclear whether the governments have been attempting to track this information, but it does not appear that they have been taking advantage of this opportunity. Customs officials should use information on the beneficial owner(s) of trading companies and information from cross-border tax information sharing agreements in order to question suspect transactions.

Pursuing these recommendations will go far towards curtailing each country's illicit financial flows and corresponding domestic revenue and capital losses. Applying the principles of transparency and curtailment to address trade misinvoicing and the shadow financial system will allow governments and societies to strike a balance between open markets on one side and accountability and rule of law on the other side. It is up to each country, with input from public officials, the private sector, and civil society and with support from its development partners, to determine where that point of balance is on the spectrum based on that country's circumstances and priorities.

IV. Conclusion

Curtailing trade misinvoicing and tackling the corresponding shadow financial system would be a boon for existing efforts to boost economic development and domestic resource mobilization, strengthen accountability and the rule of law, and support human rights in the countries we studied. Financial transparency, particularly in the trade sector, is about improving efficiency and identifying and resolving policy incoherencies in Ghana, Kenya, Mozambique, Tanzania, and Uganda. This report cannot resolve these policy debates, but through an analysis of the magnitudes, sources, and policies surrounding trade misinvoicing, we hope to help inspire the governments of these five countries to commit to making this issue a top political priority.

Introduction

Global Financial Integrity's (GFI) 2013 annual report estimated that developing countries lose an average of \$542 billion dollars every year in illicit outflows (based on a 10-year time series).² A 2013 report GFI co-authored with the African Development Bank further estimated that countries in Africa lost between \$597 billion and \$1.4 trillion in net resource transfers out of the continent from 1980–2009.³ A global shadow financial system provides measures of opacity to disguise and move this illicit money throughout the world, including dozens of secrecy jurisdictions and multiple layers of confusing and concealed ownership structures. These outflows, and the shadow financial system in which they thrive, represent one of the most damaging conditions undermining economic growth and development, governance, and human rights in Africa and around the world. Governments cannot capture revenue from money they cannot see, they cannot fund investment in critical development projects with revenue they cannot mobilize, and they cannot hold wrong-doers accountable for abuses they cannot trace.

Trade misinvoicing is responsible for a majority of these illicit outflows and does enormous damage to a country's economy and development. GFI's previous reports have shown that trade misinvoicing makes up over 80 percent of illicit outflows. Illicit inflows vary by country and are another serious issue for developing countries. Trade misinvoicing robs governments of customs duties and corporate tax revenues and deprives the economy of domestic capital for investment. The resulting reductions in economic growth and opportunity, in potential resources for infrastructure investment, and in potential resources for expanding social services severely undermine efforts to develop a country's economy and raise billions of people out of severe poverty.

Ghana, Kenya, Mozambique, Tanzania, and Uganda aptly illustrate these risks and lost opportunities. All of these countries have unique economic and political situations, but they face similar challenges and could learn from and support each other to address these issues. This chapter will help build the foundation for the report through explanations of the technical facets—economic, legal, and financial—related to the magnitudes, sources, and policy environments of trade misinvoicing. This study explores the economic and the policy side of the issue of trade misinvoicing using case studies of Ghana, Kenya, Mozambique, Tanzania, and Uganda.

I. Understanding Trade Misinvoicing

Trade misinvoicing refers to the intentional misstating of the value, quantity, or composition of goods on customs declaration forms and invoices, usually for the purpose of evading taxes or laundering money. Other reports use the term trade “mispricing” to describe this phenomenon, but this term is less accurate since it does not include manipulations to the quantity or composition of

² Kar and LeBlanc, *Illicit Financial Flows from Developing Countries: 2002-2011*, 15.

³ Dev Kar, et al., *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009*, (Washington, DC: Joint Publication of the African Development Bank and Global Financial Integrity, 2013), 33.

the goods. There are four basic categories of trade misinvoicing: import under-invoicing, import over-invoicing, export under-invoicing, and export over-invoicing. Most trade misinvoicing is done with the knowledge and approval of the seller and the buyer in the transaction. The two parties, if they are not part of the same company, will agree to the misinvoicing and how they will settle the transaction outside legal confines, often through a deposit into another bank account.

Each sub-category of trade misinvoicing offers particular advantages to the parties involved. Export under-invoicing involves under-reporting the amount of exports leaving a country in order to evade or avoid taxes on corporate profits in the country of export by having the difference in value deposited into a foreign account. Similarly, export over-invoicing involves over-stating the amount of exports leaving a country, which often allows the seller to reap extra export credits. Companies or individuals may also be using this form of trade misinvoicing to disguise inflows of capital, so as to avoid capital controls or anti-money laundering scrutiny.

On the import side, traders often under-report the amount of imports in a transaction in order to circumvent applicable import tariffs and VAT, which could be significant depending on the tariff and tax regime and the good. When an importer over-reports their imports, they are often doing so in order to legitimize sending out additional capital under the guise of legal trade payments. Import over-invoicing disguises the movement of capital out of a country. This could be a work-around for capital controls, and a company may be able to subtract that input value from its year-end revenue report to the government, which would lower the amount of taxes it owes to the government.

An increasing volume of international trade occurs within corporate groups. The OECD estimates that roughly one-third of global trade is these types of intra-firm transactions among subsidiaries of multinational enterprises.⁴ The value on invoices for these transactions is referred to as the transfer price. The practice of intentionally misquoting these values is known as abusive transfer pricing. Companies may engage in abusive transfer pricing by reporting different invoice values in the importing and exporting countries, or they may use same-invoice faking. Same-invoice faking is when companies or individuals agree to record identical, manipulated values on the import and the export invoices; the misinvoicing is built into the transaction. The data that is available to us and which we use in our analysis does not include a breakdown of trade between unrelated and related parties, so we cannot estimate which percentages of our trade misinvoicing estimates these two categories represent. We are also unable to measure same-invoice faking, because there is no discrepancy between countries' aggregate trade data that results from this form of trade misinvoicing. This missing information is a critical issue for policymakers seeking to craft policies that best address the sources of trade misinvoicing without unduly burdening the private sector.

4. Rainer Lanz and Sébastien Miroudot, "Intra-Firm Trade: Patterns, determinants and policy implications" *OECD Trade Policy Papers*, No. 114, (Paris: OECD Publishing, 2011), <http://www.oecd-ilibrary.org/docserver/download/5kg9p39lrwnn.pdf?expires=1394786629&id=id&ccname=guest&checksum=8AB65568A6571D9C2559367099400E0D>

II. Trade Misinvoicing and Smuggling

Another important relationship is the one between trade misinvoicing, smuggling, and a country's underground economy. The “pure smuggling” one typically thinks of—surreptitiously transporting contraband and avoiding all interaction with the authorities—is only one facet of this issue. “Technical smuggling” occurs through manipulating customs documentation to misrepresent the value, quantity, or quality of goods being imported or exported. This includes the trade misinvoicing as captured in our analysis, where goods are recorded differently in the importing and exporting country.

We consider our estimates to be conservative, capturing only a subset (albeit a substantial one) of the full amount of illicit financial flows in and out of a country's economy. The figures in the report would likely be much higher if we were able to include estimates for service sector trade and same-invoice faking. As a result, our policy recommendations reflect a broader focus. While addressing trade misinvoicing and smuggling of all types is an important focus, effectively curtailing illicit flows requires not only improving customs administration to better track trade documentation, but also limiting the methods through which illicit money is transferred and absorbed.

III. Understanding the Relevant Policy Areas

Policies that address trade misinvoicing focus primarily on customs agencies and financial intelligence units (FIUs). The overarching goal is to improve transparency, so that government officials have better information on the true nature of the transactions going across their borders. Trade misinvoicing thrives on the parties being able to disguise the true nature or value of the transaction. Up-to-date information exists on average world market prices for a number of goods and commodities, and access to this information at the border can help customs officials determine whether the declared values on an invoice are within a normal range for a particular category of goods. More information means a greater chance of detecting the illicit flows, which flags and hopefully stops those transactions and deters similar behavior in the future. The information asymmetry that exists without access to this data favors those committing trade misinvoicing and disadvantages the government and the public.

FIUs are important for monitoring trends in trade misinvoicing and other sources of illicit flows and in supporting or conducting investigations of financial crimes. FIU analysts examine possible evidence of money laundering, corruption, and tax evasion, among other financial crimes, and pass this information along to law enforcement and other government authorities for further investigation and possible prosecution. These analysts need access to data on financial and trade transactions in order to do their jobs properly, even though this data may overlap with other government agencies and with private interests. Analyzing and investigating the data is also time consuming and requires a sophisticated understanding of the technical and legal issues. Investing the necessary authority, access, training and human capital in FIUs will be even more important in the near future as the international community moves towards greater information sharing on foreign account holders and beneficial ownership of corporate entities.

IV. Trade Misinvoicing and the Shadow Financial System

Trade misinvoicing is part of the larger picture of illicit financial flows and the global shadow financial system. The misinvoicing occurs through commercial invoices and customs declarations, but the transfers and motivations involved are linked to money laundering, beneficial ownership, and cross-border tax evasion or avoidance. A country with weak laws or lax enforcement of money laundering statutes could encourage trade misinvoicing by making it easier to transfer and use the money gained from the illegal transaction. Beneficial ownership refers to information about the ultimate person who controls an account. Having access to beneficial ownership information for accounts helps government officials track and prosecute the parties engaging in trade misinvoicing, instead of getting lost in a global web of anonymous shell corporations and nominee directors and shareholders. Governments exchanging tax information with each other on corporations that have a presence in both countries can also help officials detect possible trade misinvoicing and tax evasion.

The aim in any of these policy areas is *curtailing* the illicit activity rather than striving to eradicate it. Focusing on curtailment creates space for policymakers and societies to strike a balance between the desire to and benefits of reducing illicit financial flows and the economic, political, and human rights rewards of free markets and open societies.

V. Conclusion

Ghana, Kenya, Mozambique, Tanzania, and Uganda represent prime examples of this damaging phenomenon. These countries could instead become champions of transparency, accountability, and greater financial independence. The remaining chapters in this report explore the magnitudes and sources of trade misinvoicing in each of these five African countries, estimates lost government revenue, and the related policy environments. We propose policy areas and actions for each country to explore in order to begin curtailing these illicit flows, and we present broad recommendations that apply equally to all five. First, however, we will continue exploring the academic foundations of trade misinvoicing by summarizing the methodology we and others have used to estimate these flows and analyze their sources.

Methodology

I. Introduction

A recent Global Financial Integrity (GFI) study found that the deliberate misinvoicing of trade played a significant role in the transfer of capital illicitly out of Africa, representing 63 percent of the total illicit outflows over the decade ending 2011.⁵ Ajayi,⁶ Boyce and Ndikumana,⁷ and Mohammed and Finnoff⁸ have also found trade misinvoicing to be a significant, if not dominant, factor in illicit transfers of capital from Sub-Saharan African countries. Inflows have received less attention in the literature but are also important.

Our method for estimating trade misinvoicing inflows and outflows incorporates and improves on the methods of other economists who study illicit financial flows. The core of our methodology is an analysis of the discrepancies between trade figures developing countries report to the IMF and the UN and the figures developed countries report on their trade with each developing country. We adapt this basic methodology by correcting for possible data issues and by combining, rather than subtracting, inflows and outflows. This section will present the methodology we have used to estimate trade misinvoicing in Ghana, Kenya, Mozambique, Tanzania, and Uganda, including information on how our method builds on the work of other economists in this field. We will also explain our method for and challenges with estimating potential government revenue loss as a result of trade misinvoicing, which we use in this report to demonstrate the human consequences of this phenomenon.

II. GFI's Methodology for Estimating Trade Misinvoicing

Jagdish Bhagwati was one of the first economists to estimate illicit outflows from developing countries due to trade misinvoicing, by comparing a country's reported bilateral trade statistics to that of its trading partners. He theorized that discrepancies between the two figures indicate that one or both parties manipulated invoices in order to move capital into or out of their respective countries.⁹

An important caveat to Bhagwati's methodology is that it is necessary to be able to accurately determine in which country the transacting parties reported the "actual" invoice value to customs officials. If trade data on both sides of the transaction are weak, then the methodology based on discrepancies in bilateral trade becomes unreliable because there is no accurate figure with which to make comparisons. To correct for this problem, we measure trade misinvoicing between developing countries and advanced economies only. Customs administrations in advanced countries, on average, are more accountable, transparent, and technically sophisticated than

5. Kar and LeBlanc, *Illicit Financial Flows from the Developing Countries, 2002-2011*.

6. S. Ibi Ajayi, "An Analysis of External Debt and Capital Flight in the Severely Indebted Low Income Countries in Sub-Saharan Africa," IMF Working Paper No. 97/68, (International Monetary Fund, 1997) <http://www.imf.org/external/pubs/ft/wp/wp9768.pdf>

7. J.K. Boyce and L. Ndikumana, "Is Africa a Net Creditor? New Estimates of Capital Flight from Severely Indebted Sub-Saharan African Countries, 1970-1996," *Journal of Developmental Studies* 38, no. 2 (2001).

8. Seeraj Mohammed and Kade Finnoff, "Capital Flight from South Africa, 1980-2000," in *Capital Flight and Capital Controls in Developing Countries*, ed. Gerald Epstein (Northampton, MA: Edward Elgar Press, 2005).

9. *Illegal Transactions in International Trade*, ed. Jagdish N. Bhagwati (Amsterdam: North-Holland/Elsevier, 1974)

their developing country counterparts, so we assume their data is the more reliable for making the comparison. We then scale-up the amount of trade misinvoicing estimated proportionately to include the country's total trade with all countries.

The following two equations represent this methodology:

$$\text{Export Misinvoicing} = \frac{(M_{\alpha i}/\text{COIF}) - X_{i\alpha}}{\left(\frac{X_{i\alpha}}{X_{i\alpha} + X_{id}} \right)}$$

$$\text{Import Misinvoicing} = \frac{(M_{i\alpha}/\text{COIF}) - X_{\alpha i}}{\left(\frac{M_{i\alpha}}{M_{i\alpha} + M_{id}} \right)}$$

Where M are imports, X are exports, and COIF¹⁰ is the cost of freight and insurance, taken to be 10 percent of the importing country's reported imports, which is used to deflate the cost of imports for comparison purposes. The subscripts α , d , and i represent advanced countries, developing countries, and the country of interest, respectively. The first subscript indicates the reporting country and the second subscript indicates the direction of the trade. For example, $X_{i\alpha}$ refers to "exports reported by the country of interest to advanced economies," and $X_{\alpha i}$ refers to "exports reported by advanced economies to the country of interest." The denominator in both equations represents the percent of the country of interest's total trade with advanced economies, which is then used to scale up the trade misinvoicing figure calculated in the nominator.

There are two main databases that report trade statistics on a bilateral basis for all countries: the IMF's Direction of Trade Statistics (DOTS) database and the United Nation's Commodity Trade (UN Comtrade) database. Previous GFI reports have relied mainly on DOTS data for estimating trade misinvoicing, but we were not able to make use of this dataset for this study, because neither Ghana, Kenya, Mozambique, Tanzania, nor Uganda reported their information to the IMF for all the years in our time series. The IMF derives an estimate of each non-reporting country's bilateral trade based on what that country's trading partners reported. This method automatically eliminates any possible discrepancies, which nullifies our trade misinvoicing methodology. The UN Comtrade database provides a more detailed set of numbers on member countries' external trade by commodity and has bilateral trade data for each of the five countries in our study. We therefore used the UN Comtrade's reported trade data between the five countries studied and advanced economies, as laid out above, for estimating trade misinvoicing in this study.

¹⁰. Previous studies have referred to this as "CIF," but this creates confusion because "CIF" is a long-standing term in the business community that refers to cost, insurance, and freight.

There are some drawbacks to using UN Comtrade instead of DOTS. Countries that do not necessarily report their trade statistics for each and every year may have understated trade figures due to the fact that UN Comtrade data contains no estimates for missing data. Assuming that advanced economies have larger statistical capacities and are much better data reporters than developing countries, the missing data from developing countries, which are consistently poor reporters, might make it appear that these countries are under-reporting their exports and imports when in fact the database is just incomplete. This does not seem to be an issue in the case of the five countries in our study, however, due to the presence of over-reported imports and over-reported exports in many of the trade misinvoicing estimates.

Our methodology differs from those of other economists in this field, because we do not net out illicit inflows and illicit outflows in our trade misinvoicing estimates. Traditional literature has taken the position that illicit inflows through trade misinvoicing can be viewed as a benefit to society that can offset the losses incurred from illicit outflows. The reality is that subtracting illicit inflows from illicit outflows severely understates the problem illicit financial flows pose to the developing world. For example, illicit inflows through import under-invoicing can be effectively thought of as a form of “technical” smuggling where a firm uses legal trade channels to bring goods illegally into a country in an unrecorded manner. A firm may also pay lower VAT and import tariffs by understating the amount of imports actually entering a country, which could have otherwise gone to fund development efforts. A recent GFI report on the Philippines found that illicit inflows through import under-invoicing added significantly to the underground economy and robbed the Philippine government of at least \$19.3 billion in tax revenue from 1990 to 2011.¹¹ Instead of netting out illicit inflows from illicit outflows, we present figures for both in each of the country case studies. This gives a more accurate depiction of the totality of such flows and the negative implications each bring to a country. Since all of the inflows and outflows presented in this study are illicit in nature, netting the two would be equal to “net crime,” an absurd concept.

III. Estimating Tax Revenue Loss from Trade Misinvoicing

A section in each of the country chapters in this report presents estimates of lost government revenues due to trade misinvoicing and compares these figures to published spending levels on key social services. The tax regimes of each country are too varied and too complex for us to be able to make an accurate estimate using a uniform formula. Instead, we used each country’s trade misinvoicing figures to detect possible incentives for tax evasion, and we reviewed tax policies that might explain the trade misinvoicing present. We then estimated the amount of tax evasion resulting from trade misinvoicing according to applicable tax rates. Figure 1 provides a broad outline of key tax-related incentives for misinvoicing trade, as per our explanation of this issue in the previous

¹¹. Dev Kar and Brian LeBlanc, *Illicit Financial Flows from the Philippines: A Study in Dynamic Simulation, 1960-2011* (Washington, DC: Global Financial Integrity, 2013).

chapter. The incentives for misinvoicing trade are vast and will vary from firm to firm, but it is beyond the scope of this report to cover these additional areas.

Figure 1. Matrix of Tax-Related Incentives for Misinvoicing Trade

	...Under-invoicing	...Over-invoicing
Export	Reallocation of taxable profits to low-tax jurisdictions	Collection of export subsidies or export-related tax credits
Import	Circumvention of applicable tariff rates and value added taxes (VAT)	Lower taxable income due to artificially inflated input costs

IV. Macroeconomic, Structural, and Governance-Related Drivers of Trade Misinvoicing

Incentives to misinvoice exports and imports can be complex depending upon the exchange control regulations in effect, the structure of tax rates, price controls in effect for the commodity being imported, as well as additional factors. It is therefore difficult to pinpoint any one driver that can be applicable to all developing countries, and in-depth individual case studies are necessary in order to arrive at any firm conclusions. This section explains some of the key underlying drivers of the different types of trade misinvoicing: export under-invoicing, import under-invoicing, export over-invoicing, and import over-invoicing.

Many actors will often under-report exports or over-report imports in order to transfer and keep foreign exchange outside the country. The motivations for this activity are diverse and vary depending on the actors and the countries involved. For one, firms can surreptitiously shift a portion of their taxable profits outside a country through the process of under-reporting their company's exports. To do so, an exporter may instruct the foreign purchaser to make a partial payment to an offshore bank account, often in a tax haven, and the remaining amount of the payment is requested to be made to the company's bank account within the country. The portion that is diverted to the offshore account remains untaxed and unutilized for development purposes, and the exporter is only taxed on the actual amount reported to customs officials. The process of falsifying the invoice—so that it reads as a lesser amount than what actually was shipped—is when the transaction becomes illicit in nature.

The incentives to under-report exports are even more diverse than relocating taxable profits. For instance, if export proceeds surrender requirements are in effect or are expected to be tightened, which means that more foreign exchange earned through exports would need to be surrendered to the government, this would provide a strong incentive to circumvent such controls and transfer funds through trade misinvoicing.

On the import side, if corporate tax rates are higher than import duties, the higher payment of customs duties from over-invoicing imports can be offset by lower taxes from the reduced profits

that result from higher input costs. Moreover, if price controls for the commodity being imported are in effect, traders may over-invoice the commodity to justify charging a higher price for the goods sold domestically. Either way, over-invoicing the imports allows the trader to keep capital outside the country, rather than inside where it can be utilized more effectively for development purposes.

Companies and individuals can also employ trade misinvoicing to bring money into a country illicitly. For instance, an individual can bring capital (in the form of goods) into a country by under-reporting imports, the incentive for which is commonly thought to be the circumvention of import duties and VAT taxes. Due to the fact that all of the countries involved in this study rely heavily on international trade taxes to finance government budgets, the tax revenue lost through under-reporting imports is severely problematic. Likewise, a firm can also bring capital in illicitly through over-reporting exports. This form of misinvoicing can be present if there are export tax credits or subsidies available where an exporter may claim to have shipped more than they actually did in order to wrongfully collect a higher tax credit or subsidy than they are warranted.

V. Conclusion

GFI's 2013 report on illicit outflows from the developing world showed that trade misinvoicing was responsible for upwards of 80 percent of the \$946 billion in illicit outflows from developing countries in 2011. These illicit outflows undermine domestic resource mobilization and the rule of law in their countries of origin, and they reduce the capital that is available domestically for investment. Likewise, illicit inflows of capital can be detrimental to a country, because they represent a significant loss in tax revenue and often fuel the underground economy. The next five chapters in this report present estimates for the volume of trade misinvoicing in five key developing countries in Africa: Ghana, Kenya, Mozambique, Tanzania, and Uganda. We also derive rough estimates of tax revenue loss and make comparisons to government spending on social services to demonstrate the real, human consequences of these illicit financial transactions. The end of each chapter discusses the relevant policy and transparency environments in each country and how the government and the people can begin to go about curtailing trade misinvoicing. A final chapter presents overall recommendations on needed reforms and upgrades for the five countries.

Ghana

I. Introduction

Policymakers and experts often cite Ghana as an example for other countries in Africa to follow, due to its relatively stable government and economy. It ranks well in measures such as the Failed States Index¹² and the Corruption Perceptions Index¹³ compared to other countries in Africa. Its recent economic performance has been strong, with an average annual increase in GDP of eight percent over the past five years, thanks in part to economic and institutional reforms. Its economy is the ninth-largest on the continent. The beginning of oil production and the corresponding increases in foreign direct investment (FDI) have also helped Ghana achieve its high rates of GDP growth. These positive changes and increases in wealth have also created challenges for the government, particularly ensuring that extractive revenue is not misdirected and that reforms continue to improve the domestic investment climate and increase the availability of health and education facilities, especially in rural areas.¹⁴

Increasing financial transparency in Ghana would help significantly in moving the economy to middle-income status and addressing some of the pressing economic and development challenges. This is particularly the case with trade flows. We estimate that \$7.32 billion in capital drained out of the country illicitly through trade misinvoicing from 2002–2011. This money represents significant lost domestic investment opportunities and, combined with illicit inflows of another \$7.07 billion during the same period, may have led to \$3.86 billion in lost government revenue. In this chapter we will examine the magnitudes and sources of Ghana's illicit flows of capital due to trade misinvoicing, how the foregone government revenue could have boosted development, and how the government should approach policy reforms to begin curtailing these flows.

II. The Extent and Nature of Trade Misinvoicing in Ghana

Table 3 shows that cumulative gross illicit flows in Ghana from trade misinvoicing amounted to \$14.39 billion over the ten-year period 2002–2011 or about \$1.44 billion per year on average. The average scale of gross illicit flows at around 6.6 percent of GDP is bound to have had a significant adverse impact on the average fiscal balance over this period. Illicit outflows through export under-invoicing, which averaged \$568 million per year (\$5.11 billion total for the period), was the predominant method of transferring capital out of Ghana through trade misinvoicing. Most of these outflows occurred from 2007–2011, although the levels fluctuated from year to year. Import over-invoicing amounted to a total of \$2.21 billion in illicit outflows over this period, which is less than half the amount transferred out of the country through export under-invoicing. For inflows, we find that import under-invoicing (a cumulative \$4.64 billion) outstrips export over-invoicing (\$2.43 billion)

¹². The Fund for Peace, *The Failed States Index 2013*, <http://ffp.statesindex.org/rankings-2013-sortable>.

¹³. Transparency International, 2013 *Corruption Perceptions Index*, <http://cpi.transparency.org/cpi2013/>.

¹⁴. African Economic Outlook, *Ghana*, September 6, 2013, <http://www.africaneconomicoutlook.org/en/countries/west-africa/ghana/>.

over this period. This finding is broadly in line with the findings of previous researchers such as Bhagwati, who noted that the direct circumvention of import duties tends to be prevalent in many developing countries.¹⁵

Efforts to evade import duties through under-reporting imports seem to have increased between 2008 and 2010, with 95 percent of the cumulative \$4.64 billion occurring during these years. It is important for Ghanaian government authorities to continue the efforts seen in 2011 that have significantly curtailed import under-invoicing. Ghana lost \$4.64 billion over the decade ending 2011 due to import under-invoicing, which is \$464 million per year on average.

Table 3. Ghana: Trade Misinvoicing Vis-à-Vis the World, 2002–2011
(in millions of U.S. dollars) 1/

Year	Export Misinvoicing		Import Misinvoicing		Illicit Outflows (A+D)	Illicit Inflows (C+B)	Gross Illicit Flows	GDP	Total Trade	Total ODA	Gross flows as percent of GDP	Gross flows as percent of Trade	Gross flows as percent of ODA
	Under-Invoicing (A)	Over-Invoicing (B)	Under-Invoicing (C)	Over-Invoicing (D)									
2002	No data	No data	0	79	79	0	79	6,200	4,570	686	1.27%	1.73%	19.51%
2003	0	-1,113	-194	0	0	1,307	1,307	7,600	5,534	983	17.20%	23.62%	270.13%
2004	163	0	0	158	321	0	321	8,900	6,524	1,419	3.61%	4.92%	34.57%
2005	0	-109	0	334	334	109	443	10,730	8,150	1,151	4.13%	5.44%	71.99%
2006	0	-90	-59	0	0	149	149	20,410	10,480	1,243	0.73%	1.42%	25.04%
2007	681	0	0	95	776	0	776	24,760	12,256	1,165	3.13%	6.33%	109.30%
2008	1,877	0	-1,377	0	1,877	1,377	3,254	28,530	15,538	1,307	11.41%	20.94%	448.19%
2009	300	0	-1,531	0	300	1,531	1,831	25,980	13,886	1,582	7.05%	13.19%	223.07%
2010	2,090	0	-1,482	0	2,090	1,482	3,572	32,170	18,882	1,693	11.10%	18.92%	396.90%
2011	0	-1,119	0	1,542	1,542	1,119	2,661	39,200	28,754	1,800	6.79%	9.25%	293.03%
Average	568	-270	-464	221	732	707	1,439	20,448	12,457	1,303	6.64%	10.58%	189.17%
Cumulative	5,111	-2,431	-4,643	2,208	7,319	7,074	14,393	204,480	124,575	13,029	...	...	...

1/ Outflows (export under-invoicing and import over-invoicing) have a positive sign whereas inflows (export over-invoicing and import under-invoicing) have a negative sign. Estimates of misinvoicing are based on export and import of commodities reported by all member countries to the United Nations for publication in the Commodity Trade database (UN Comtrade). Capital flows due to trade in services are not included in the above estimates.

III. Tax Revenue Loss and Implications for Development

The \$7.32 billion dollars that left the country over the course of this study equates to 56 percent of Ghana's total aid receipts of \$13.03 billion from all donors across the same period. Now if we consider the fact that export under-invoicing totaling \$5.1 billion over this decade led to the fraudulent understatement of corporate profits, it implies a loss in corporate tax revenues on top of the loss in customs revenues through import under-invoicing. Similarly, an exporter who over-invoices his exports can significantly increase the value of the export tax credit, particularly if the exported goods have a high import content that is subject to a refund of value-added tax (VAT).¹⁶ In sum, the fiscal impact of trade misinvoicing can be very significant. Given that on average corporate

15. J. Bhagwati, "On the Equivalence of Tariffs and Quotas," in *Trade, Tariffs, and Growth*, ed. Jagdish N. Bhagwati, 248-265 (Cambridge, MA: MIT Press, 1969).

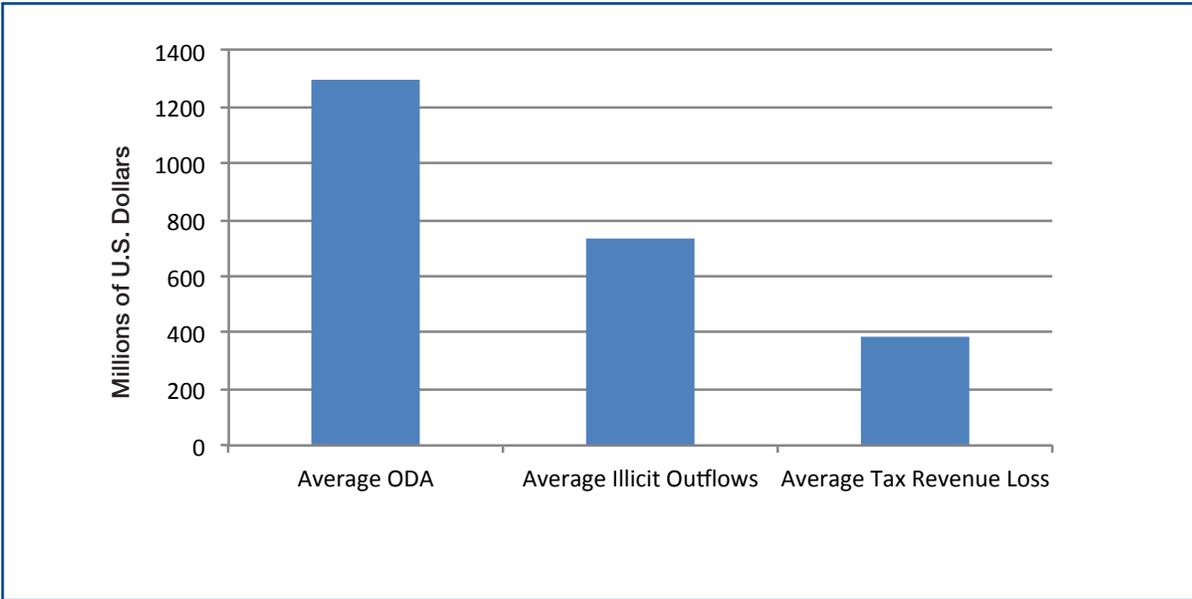
16. Traders who export at least 70 percent of their domestic supply are eligible for VAT tax rebates. Exports of VAT-exempt items are also eligible for corporate tax rebates. Ghana Revenue Authority, Government of Ghana, *Value Added Tax*, http://www.gra.gov.gh/index.php?option=com_content&view=article&id=44&Itemid=47 accessed October 1, 2013

income taxes are 25 percent, the simple average tariff rate is 12.44 percent, and the average VAT tax is 12.5 percent, the total loss in revenue over the period of this study could be \$3.86 billion or \$386 million on average per year.¹⁷

The government’s total expenditure on poverty reduction, which includes health, education, and other services, amounted to \$1.84 billion in 2011, which was 4.8 percent of its \$38.39 billion GDP for the same year.¹⁸ If the average revenue loss per year due to trade misinvoicing is \$386 million and the average expenditure on programs aimed at poverty reduction per year is around \$1.8 billion, this implies that if all of the revenues lost due to trade misinvoicing were used for social and economic development programs, the budget for poverty reduction efforts could have been increased by 21.4 percent. The Government of Ghana could have significantly reduced its dependency on foreign aid and increased its fiscal independence.

Ghana experienced significant illicit flows due to trade misinvoicing from 2002–2011, funds that could have otherwise been used to fund development within the country. The next section will discuss the policies that may have played a role in these outflows, and on which areas the government and its partners should focus on making changes to begin to curtail future trade misinvoicing.

Chart 1. Ghana: Annual Average ODA vs. Average Illicit Outflows vs. Average Tax Revenue Loss, 2002–2011
(in millions of U.S. dollars)



¹⁷. Ghana Revenue Authority, Government of Ghana, *Domestic Taxes*, http://www.gra.gov.gh/index.php?option=com_content&view=article&id=41&Itemid=46 (accessed October 1, 2013).
¹⁸. International Monetary Fund, African Dept., “Ghana Staff Report for the 2013 Article IV Consultation,” in *Ghana: 2013 Article IV Consultation*, IMF Country Report 13/187 (USA, 2013), <http://www.imf.org/external/pubs/ft/scr/2013/cr13187.pdf> (accessed October 1, 2013).

IV. Trade and Transparency Policy Environment in Ghana

Ghana's economy is growing explosively—its GDP has increased six-fold in a decade—and at the same time its international trade has grown substantially and with it opportunities for misinvoicing. Along with lost customs duties, the increasing complexity of Ghana's economy and business environment has created more opportunities to avoid income taxes through misinvoicing, depriving the Ghanaian government of crucial revenue. Recent reforms in Ghana's customs, revenue, and financial authorities are promising, but these agencies still face significant capacity issues.

i. Customs Administration and Trade Data

The total values of recorded exports and imports to Ghana increased more than five-fold between 2002 and 2011, and Ghana's customs authority has had to work hard to try to keep pace. In 2009, in order to streamline and better coordinate tax collection, the Ghanaian government established the Ghana Revenue Authority (GRA), merging several agencies of the Ministry of Finance, including the Internal Revenue Service and Customs, Excise, and Preventive Service.¹⁹ While the integration has streamlined some operations and brought important, interrelated government functions into closer communication, the GRA still appears understaffed.²⁰

The GRA operates the fully computerized Ghana Customs Management System (GCMS) to screen imports and is a signatory to the WTO Customs Valuation Agreement. As a result, GRA may be inclined to accept values as invoiced except where clear evidence suggests misinvoicing. GCMS uses a risk-based system for classifying imports based solely on the type of good being imported; as of 2008, approximately 50 percent of imports were classified as "high-risk goods" subject to physical inspection. However, the categories appear to have been chosen for the danger they may pose to Ghanaian citizens (food, pharmaceuticals, weapons, electrical equipment, etc.) rather than any particular risk of misinvoicing.²¹

Ghana's most recent IMF consultation specifically noted that GRA does not publish either their aggregate trade statistics or the underlying trade data in a timely manner, which makes assessing the country's susceptibility to trade misinvoicing an inherently incomplete and imprecise endeavor. The IMF also found that data collection issues could potentially cause some discrepancies, such as double-counting imports or allowing "leakages" of goods from warehouses or free-trade zones prior to proper payment of import duties. While the IMF notes that Ghana's tax collections are improving, continuing this trend will require expanding the capacity and technical ability of GRA to efficiently track trade across Ghana's borders and investigate potential misinvoicing.²²

19. Ghana Revenue Authority, Government of Ghana, *Profile of the Ghana Revenue Authority*, http://www.gra.gov.gh/index.php?option=com_content&view=article&id=4&Itemid=22 (accessed October 1, 2013)

20. Ghana Revenue Authority, Government of Ghana, "Operational Times of Customs Division of Ghana Revenue Authority," http://www.gra.gov.gh/index.php?option=com_content&view=article&id=151:operational-time-of-customs-division-of-ghana-revenue-authority&catid=11:latest-news&Itemid=26 (accessed October 1, 2013)

21. World Trade Organization, Trade Policy Review: Ghana, WT/TPR/S/194/Rev.1, May 7, 2008, https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=81179,65371,20713&CurrentCatalogueIdIndex=0&FullTextSearch=

22. International Monetary Fund, "Ghana: Staff Report for the 2013 Article IV Consultation," p. 103.

ii. Transparency and Governance

According to a 2012 study, Ghana is the fifth easiest jurisdiction worldwide in which to establish anonymous shell corporations—legal entities where the true, human beneficial owner is unknown even to law enforcement. Such entities can be used to hide ownership of ill-gotten assets or disguise the source of corrupt funds.²³ Ghana currently maintains a central registry of corporate information, and the registration process should be extended to require beneficial ownership information. This upgrade would benefit the government and the private sector. Greater account-holder information would help banks comply with global anti-money laundering standards to flag suspicious transactions. Ownership transparency will allow Ghanaian law enforcement and tax authorities to trace transactions identified as trade misinvoicing and to follow the global web of accounts and transactions back to the culpable individual or company, instead of getting mired in fake or secret registrations.

Ghana is a member of the Extractive Industries Transparency Initiative (EITI) and is an EITI-compliant country. As Ghana fully adheres to the EITI standard, it is required to ensure the disclosure of payments to the government by private companies operating in the extractives industries, a major source of corruption in many countries. More importantly, the information gleaned from these reports is made public, allowing civil society organizations and concerned citizens to hold the government accountable for its use of the revenue gained through natural resource extraction. Information gathered through EITI reports can also be used as a rough proxy to ensure that commodities for export are not being misinvoiced.

Ghana is also a signatory to the Convention on Mutual Administrative Assistance in Tax Matters, which allows the government to request information on Ghanaian citizens' assets and income from other signatory countries' tax authorities. But while this is a potential boon for pursuing trade misinvoicing, in reality the convention only requires information exchange "on request" rather than automatically, thus slowing and complicating the process. Further, secrecy jurisdictions, where much of the illicit funds reside, have little impetus to comply with a request. It is therefore unclear that participation in the Convention will substantially improve Ghana's ability to curtail misinvoiced goods.

The benefits of improving transparency and governance are manifold. Along with enabling identification of misinvoiced trade, transparency can lead to greater corporate and individual income tax collections, and developing a culture of better governance enables economic development well into the future. The Government of Ghana should prioritize ensuring that the GRA has the technical and human capacity to effectively utilize the data that these transparency tools will provide.

²³. Michael Findley, Daniel Nielson, and Jason Sharman. "Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies." Centre for Governance and Public Policy, Griffith University, September 2012, http://www.transparencyinternational.eu/wp-content/uploads/2012/11/Global-Shell-Games_CGPPcover_Jersey.pdf.

iii. Financial Regulation

Ghana has made great strides towards bringing its economy and financial system up to global standards by allowing its currency to float, removing most restrictions on imports, and opening its financial sector to foreign banks. This rapid development has not always been accompanied by similar growth in resources for monitoring and regulatory enforcement. In particular, Ghana's regulatory apparatus for addressing money laundering, including trade-based money laundering, lags behind global standards.

Ghana is a member of the Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA), a Financial Action Task Force (FATF)-style regional body, which issued a Mutual Evaluation Report on Ghana in 2009²⁴ along with two follow-up reports in 2010 and 2011 and an action plan in 2011.²⁵ The reports identified specific deficiencies in Ghana's anti-money laundering (AML) regime, most of which derived from the lack of an operational financial intelligence unit (FIU), which is the arm of the government that would process suspicious transaction reports from banks. Ghana established and brought online an FIU as of 2010, but it must also ensure adequate resources for the FIU and training for FIU staff, particularly on trade-based money laundering and on sanctions. Additionally, the U.S. Department of State considers Ghana a "Jurisdiction of Money Laundering Concern," a designation requiring U.S. banks to take additional precautions when handling transactions originating from Ghana.²⁶

Improving AML regulation is a key component for tracking and seizing illicit money that has been laundered and integrated into the financial system, whether through trade misinvoicing or other means. Equally important is having the capacity and ability to effectively enforce regulations and follow up on the deluge of information generated by suspicious transaction reporting requirements. Ghana's new FIU will need technical assistance to improve its operations and effectiveness. Once the FIU is efficiently processing suspicious transaction reports from Ghanaian banks, it can begin to look for patterns of activity resembling trade misinvoicing that it can then refer to the GRA for follow-up.

24. Inter-Governmental Action Group Against Money Laundering in West Africa, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Ghana* (Dakar: Nov. 2009), [http://www.giaba.org/media/f/340_GHANA%20-MER%20-English-1\[1\].pdf](http://www.giaba.org/media/f/340_GHANA%20-MER%20-English-1[1].pdf).

25. Inter-Governmental Action Group Against Money Laundering in West Africa, *First Follow-Up Report to the Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Ghana* (Dakar: Dec. 2010), http://www.giaba.org/media/f/342_FUR%20%20ME%20GHANA%20_1_%20English.pdf; *Second Follow-Up Report to the Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Ghana* (Dakar: Nov. 2011), http://www.giaba.org/media/f/267_2nd%20FUR%20ME%20-%20Ghana%20-%20dev011812%20-%20English.pdf; *Mutual Evaluation Implementation Action Plan: Anti-Money Laundering and Combating the Financing of Terrorism – Ghana* (Dakar: May 2011), http://www.giaba.org/media/f/343_MER%20Action%20Plan%20Ghana%20-%20English.pdf.

26. Bureau of International Narcotics and Law Enforcement Affairs, United States Department of State, *2013 International Narcotics Control Strategy Report (INCSR): Major Money Laundering Countries*, March 5, 2013, <http://www.state.gov/j/inl/rls/nrcrpt/2013/vol2/204062.htm>

V. Conclusion

The Ghanaian government has put many effective policies in place recently to combat illicit financial flows through trade misinvoicing and other means. It has streamlined customs operations, implemented transparency and governance initiatives, and worked towards effective anti-money laundering regulations and financial oversight. Nonetheless, the rapid growth of the Ghanaian economy and its international trade has made it difficult to keep up with demands for capacity and technical ability.

Our analysis of trade misinvoicing in Ghana is an introduction to this important issue and its causes and consequences. An in-depth study is needed to more closely examine the sources of trade misinvoicing on the export and import sides. We have laid out some basic steps the Ghanaian government can take to begin to curtail these sources of illicit flows. Additional analysis will be needed to develop more detailed recommendations on how to tackle the issue further and unlock even greater domestic resources to fund public expenditure priorities.

Kenya

I. Introduction

Kenya aspires to be the financial center of East Africa but moderate growth and political instability are holding the country back from reaching its full potential. Average annual real GDP growth since 2004 has been well under six percent, including a significant dip following post-election violence in 2007 into 2008. Investment is supporting a boom in construction, and Tullow Oil plc and its partner Africa Oil Corp discovered two wells in the northern part of the country in 2012, raising the prospects for improved economic growth in the future.²⁷ Kenya held another presidential election in the first half of 2013 that did not repeat the political violence that followed the previous presidential election.²⁸ Overall, however, Kenya fares the worst of the five countries in this study in the Failed States Index²⁹ and second-worst in the Corruption Perceptions Index.³⁰ A group of Somali fighters from the terrorist group al-Shabab attacked the Westgate Mall in Nairobi on September 22, 2013, killing more than 60 and injuring nearly 200, and there is a risk of further terrorist attacks in the near future.³¹

Pursuing greater financial transparency in Kenya will help the government work through these growing pains and achieve its goal of becoming a major economic and financial center. The economy lost \$9.64 billion in potential domestic investment from export under-invoicing and import over-invoicing during the period we covered in this study, and we estimate that the government may have lost \$3.92 billion in tax revenue resulting from these illicit outflows and from the \$3.94 billion in illicit inflows. This chapter will examine the full data on the levels and breakdowns of trade misinvoicing in Kenya and how that may have undermined the government's domestic resource mobilization. We follow this economic analysis with our assessment of the policy environment in Kenya that may be contributing to these outflows and the opportunities this presents to curtail trade misinvoicing in the future.

II. The Extent and Nature of Trade Misinvoicing in Kenya

Table 4 shows that cumulative gross illicit flows from trade misinvoicing through Kenya amounted to \$13.58 billion from 2002–2010, roughly \$1.51 billion per year on average.³² The latter figure represents 7.8 percent of GDP and is significant and likely to have had a detrimental impact on the average fiscal balance over this period. That being said, Kenya is making progress in reining in trade misinvoicing. Export under-invoicing was much lower from 2005–2010 than it was from 2002–2004.

27. African Economic Outlook. *Kenya*, September 6, 2013, <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Kenya%20-%20African%20Economic%20Outlook.pdf>.

28. "Kenyatta sworn in as Kenya's new president," *Al Jazeera*, April 9, 2013. <http://www.aljazeera.com/news/africa/2013/04/201349752557578.html>.

29. The Fund for Peace, *The Failed States Index 2013*.

30. Transparency International, *2013 Corruption Perception Index*.

31. "Kenyan forces move to end siege at Nairobi mall as death toll mounts," *Al Jazeera America*, September 23, 2013. <http://america.aljazeera.com/articles/2013/9/22/standoff-continuesatkenyamallfollowingalqaedaattack.html>.

32. Data for Kenya in 2011 was not available at the time of writing.

Illicit inflows into Kenya over the period of this study came almost entirely from the under-reporting of imports. Although illicit outflows trumped illicit inflows for every year in question besides 2008, the \$3.94 billion in cumulative under-reported imports indicates a large amount of forgone tax revenue, the extent of which will be discussed in sections that follow.

The estimates of trade misinvoicing presented in this note corroborate those found by earlier researchers, but the pattern of misinvoicing differs. Ajayi noted that countries with overvalued exchange rates and restrictions in access to foreign convertible currencies such as Kenya often provide the incentive to misinvoice trade. In Kenya, the existence of domestic parallel markets in foreign exchange also facilitates illicit flows through trade misinvoicing. He found significant evidence of over-invoicing of exports and under-invoicing of imports in Kenya.³³ More recently, a study by Ndikumana and Boyce³⁴ found that significant trade misinvoicing drove capital flight from Kenya over the period 1970–2004. The total stock of capital flight amounted to about 16.6 percent of end-period GDP; they did not provide a breakdown of how much of this stock was due to trade misinvoicing.

We find that under-invoicing of exports averaging \$1 billion per year is more than double the under-invoicing of imports (\$438 million) over the period 2002–2010. This is the exact opposite of what Ng'eno found.³⁵ It may well be that as import duties have declined as a result of trade liberalization and globalization, the incentive to understate corporate profits (through export under-invoicing) to lower corporate taxes is much greater than the incentive to lower customs duties on imports

Table 4. Kenya: Trade Misinvoicing Vis-à-Vis the World, 2002–2010
(in millions of U.S. dollars) 1/

Year	Export Misinvoicing		Import Misinvoicing		Illicit Outflows (A+D)	Illicit Inflows (C+B)	Gross Illicit Flows	GDP	Total Trade	Total ODA	Gross flows as percent of GDP	Gross flows as percent of Trade	Gross flows as percent of ODA
	Under-Invoicing (A)	Over-Invoicing (B)	Under-Invoicing (C)	Over-Invoicing (D)									
2002	1,698	0	0	45	1,743	0	1,743	13,150	5,361	393	13.25%	32.51%	604.24%
2003	1,084	0	-592	0	1,084	592	1,676	14,900	6,137	523	11.25%	27.31%	523.64%
2004	1,920	0	-861	0	1,920	861	2,781	16,100	7,237	660	17.27%	38.43%	590.76%
2005	846	0	-388	0	846	388	1,234	18,700	9,442	759	6.60%	13.07%	236.43%
2006	756	0	-143	0	756	143	899	22,500	10,748	947	4.00%	8.36%	115.77%
2007	702	0	-555	0	702	555	1,257	27,240	13,069	1,327	4.61%	9.62%	151.99%
2008	844	0	-1,095	0	844	1,095	1,939	30,500	16,047	1,366	6.36%	12.08%	203.10%
2009	715	0	-305	0	715	305	1,020	30,600	14,670	1,776	3.33%	6.95%	83.28%
2010	695	0	0	332	1,027	0	1,027	32,200	17,224	1,629	3.19%	5.96%	88.49%
Average	1,029	0	-438	42	1,071	438	1,508	22,877	11,104	1,042	7.76%	17.14%	288.63%
Cumulative	9,260	0	-3,939	377	9,637	3,939	13,576	205,890	99,934	9,379	...	...	...

1/ Outflows (export under-invoicing and import over-invoicing) have a positive sign whereas inflows (export over-invoicing and import under-invoicing) have a negative sign. Estimates of misinvoicing are based on export and import of commodities reported by all member countries to the United Nations for publication in the Commodity Trade database (UN Comtrade). Capital flows due to trade in services are not included in the above estimates.

33. S. Ibi Ajayi, *An Analysis of External Debt and Capital Flight in the Severely Indebted Low Income Countries in Sub-Saharan Africa*. IMF Working Paper No. 97/68. Washington, DC: International Monetary Fund, June 1997. p. 53, table 21.

34. Léonce Ndikumana and James K. Boyce, "New Estimates of Capital Flight from Sub-Saharan African Countries: Linkages with External Borrowing and Policy Options," Working Paper 166 (Political Economy Research Institute, University of Massachusetts at Amherst, April 2008), http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_151-200/WP166.pdf.

35. Ng'eno, N.K., "Capital Flight in Kenya," in *External Debt and Capital Flight in Sub-Saharan Africa*, eds. S. Ibi Ajayi and Mohsin S. Khan (Washington, DC: International Monetary Fund, 2000).

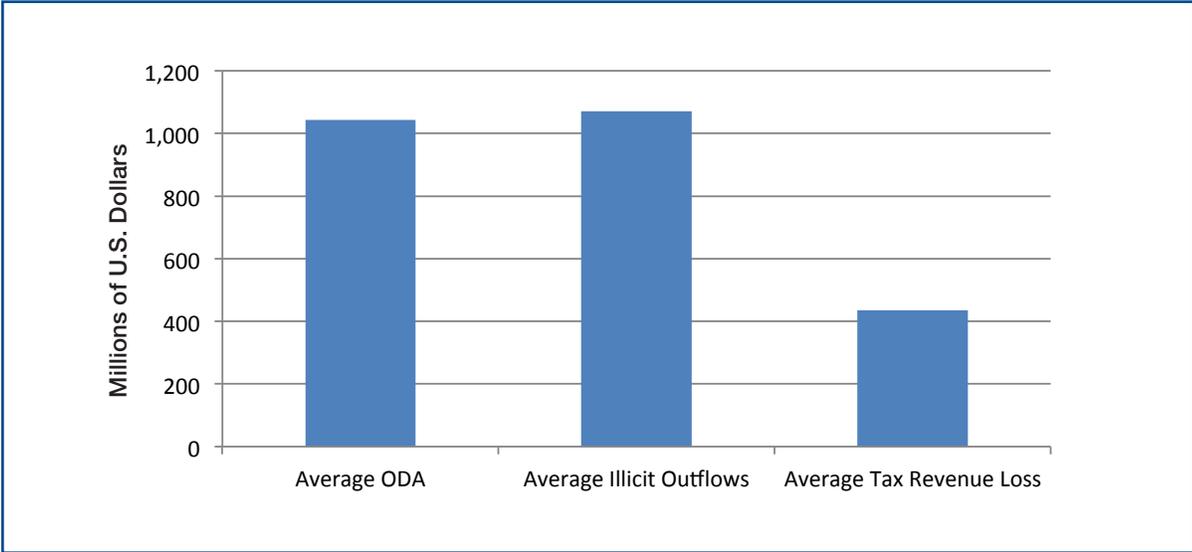
(through import under-invoicing). We observe then that the pattern of misinvoicing can shift significantly over time depending upon the tariff and tax regimes in place.

Also, in contrast to Ajayi, we do not find evidence of export over-invoicing. This may be due to the fact that Kenya, along with many other developing countries, has reduced the coverage and extent of export subsidies, in line with WTO guidelines. Absent the incentive to over-invoice exports to claim fraudulent subsidies, this type of misinvoicing is no longer significant in Kenya. More in-depth analysis of trade regulations and related incentives to misinvoice specific commodities is needed to arrive at firm conclusions.

III. Tax Revenue Loss and Implications for Development

We estimate that the Government of Kenya potentially lost tax and tariff revenues of \$3.92 billion over the course of this study or an average of \$435 million per year, based on official tax and tariff rates. The statutory corporate tax rate in Kenya is 30 percent, the average simple mean tariff rate over the period where data is available is 12.93 percent, and the VAT on imports is 16 percent.³⁶ Given that cumulative government revenues reported to the IMF were approximately \$44 billion over the course of this study, the Kenyan Revenue Authority’s total collection of government revenues would have been 8.9 percent higher had there not been any trade misinvoicing present since 2002.

Chart 2. Kenya: Annual Average ODA vs. Average Illicit Outflows vs. Average Tax Revenue Loss, 2002–2010
(in millions of U.S. dollars)



³⁶ The World Bank, “Doing Business: Paying Taxes in Kenya,” December 2012, <http://www.doingbusiness.org/data/exploreconomies/kenya/paying-taxes>; The World Bank, “World Development Indicators Database: Kenya,” <http://data.worldbank.org/country/kenya> (accessed February 1, 2014).

IV. Trade and Transparency Policy Environment in Kenya

Kenya's economy is the most diversified of the countries studied here with extensive agricultural, extractive, industrial, and financial industries. As a result, Kenya's international trade reflects a similarly complex mix of commodities and goods, providing many opportunities for misinvoicing. Our data demonstrates a clear pattern of import under-invoicing, driven by avoidance of import tariffs and VAT, and export under-invoicing, driven by avoidance of company taxes. Kenya also faces substantial deficiencies in its financial regulations, allowing unscrupulous individuals to easily move illicit money in and out of the country. Addressing these issues will require vigilance and technical savvy on the part of Kenyan customs, revenue, and financial authorities. The following paragraphs discuss three key policy areas for curtailing trade misinvoicing and our recommended initial actions for the Kenyan government.

i. Customs Administration and Trade Data

Kenya is a member of the East African Community (EAC)—along with Tanzania, Uganda, Burundi, and Rwanda—which includes a free-trade pact, a common market, and a customs union.³⁷ Consequently, the Kenyan Revenue Authority (KRA), which administers Kenya's customs, works in concert with Tanzanian and Ugandan customs authorities to ensure goods leaving and entering the EAC are properly recorded and assessed under the EAC's Common External Tariff (CET).³⁸

KRA utilizes the Simba electronic customs clearance system, which was developed proprietarily and implemented in 2005, and the Revenue Authorities Digital Data Exchange (RADDEX) system for electronic exchange of documents between EAC-member customs authorities. Simba is used for clearing both imports and exports and flags shipments for inspection under a risk-based approach. Kenya has implemented a customs valuation system in line with EAC requirements and WTO standards. The WTO specifically noted that KRA still struggles with detecting undervalued shipments, an assessment reflected by our data, which shows that under-invoicing significantly affects both imports and exports.³⁹

Nonetheless, our data indicates that the Simba system may be helping to curtail trade misinvoicing in Kenya. Average export under-invoicing prior to 2005 (\$1.57 billion), the year the system was implemented, was substantially greater than for the period from 2005–2010 (\$760 million). However, export under-invoicing still affects roughly five percent of Kenya's trade, and the under-invoicing figures have remained fairly constant since 2005. Similarly, import under-invoicing has decreased on average since Simba was implemented but it remains a problem.

³⁷. A common currency for the group has been proposed and appears likely to enter circulation in coming years. The group's membership may also soon expand to include South Sudan. East African Community, <http://www.eac.int/>.

³⁸. Kenya Revenue Authority, Government of Kenya, *Customs Services Department*, http://www.revenue.go.ke/portal/customs/about_customs.html (accessed October 1, 2013).

³⁹. World Trade Organization, "Annex 2 – Kenya," in *Trade Policy Review: East African Community (EAC)*, WT/TPR/S/271/KEN, November 23, 2012. http://www.wto.org/english/tratop_e/tp_r_e/tp371_e.htm.

Addressing the problem of undervalued trade is the most direct way to enhance local revenue collection, as nearly every form of duty or tax assessed depends on these values in some way. We encourage Kenyan customs to focus its efforts specifically on identifying undervalued transactions for trade misinvoicing, requesting technical assistance from its development partners as necessary. Taking a stand and pledging to vigorously pursue trade misinvoicing would have a deterrent effect on its own and, combined with other policy initiatives, could place Kenya's customs authorities at the forefront of the fight against illicit financial flows.

ii. Transparency and Governance

Kenya has historically faced substantial problems with corruption and maintains a large underground economy (approximately a third of GDP according to the World Bank⁴⁰), factors that drive illicit financial flows through trade misinvoicing and other means. Kenya ranks second-lowest on Transparency International's Corruption Perceptions Index (at 136th of 177) of the countries in this report.⁴¹ Political corruption scandals frequently implicate government officials and affect public opinion, making it more difficult to implement effective policies to counter illicit financial flows. Reversing this decline and developing a culture of transparency and accountability will be difficult but necessary for curtailing capital flight and supporting sustainable economic development in Kenya.

Kenya is the single easiest jurisdiction in the world in which to form an anonymous shell corporation, meaning that traders engaging in misinvoicing have ready avenues to disguise and utilize their ill-gotten gains.⁴² Recent reforms of Kenya's central corporate registry have made it even easier to incorporate but do not appear to address the lack of ownership information needed to do so.⁴³ As a result, this may not be a net benefit for the economy. We urge the government to take immediate steps to remedy this issue by collecting meaningful beneficial ownership information and making such information easily accessible in a public registry.

Despite the recent discovery of oil, Kenya has not signed on to the EITI. Particularly in light of Kenya's issues with government corruption, requiring companies and the government to provide and publicize information on extractive revenues will be crucial to ensuring that the growth of Kenya's nascent extractives industries remains aboveboard and beneficial to the Kenyan people.

Kenya also has not signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The government has only a few double-tax-avoidance agreements currently in effect, some of which do not have information exchange provisions.⁴⁴ As a result, Kenya does not appear to

40. Friedrich Schneider, "Shadow Economies all over the World: New Estimates for 162 Countries from 1999 to 2007," Policy Research Working Paper 5356, World Bank Group (August 2010), <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-5356>

41. Transparency International, *Corruption Perceptions Index 2013*, <http://www.transparency.org/cpi2013/results>.

42. Michael Findley, Daniel Nielson and Jason Sharman. "Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies." *Centre for Governance and Public Policy*. Brisbane, Australia: Griffith University, 2013, http://www.transparencyinternational.eu/wp-content/uploads/2012/11/Global-Shell-Games_CGPPcover_Jersey.pdf.

43. George Omondi, "Mobile company registry to boost Kenya investment climate," *Business Daily*, August 8, 2013, <http://www.businessdailyafrica.com/Mobile-company-registry-to-boost-Kenya-investment-climate/-/539546/1941686/-/13i1mj8/-/index.html>.

44. Organization for Economic Co-operation and Development, *Exchange of Tax Information Portal: Kenya – Agreements*, <http://eoi-tax.org/jurisdictions/KE#agreements> (accessed October 1, 2013).

receive much, if any, tax information from other countries to allow it to track down those avoiding or evading taxes through illegal capital flight. We therefore encourage the Kenyan Ministry of Finance to investigate and pursue such arrangements and consider requesting policy support from other governments and experts for implementing any information-sharing programs adopted.

iii. Financial Regulation

Kenya has significantly liberalized its economy in pursuit of becoming the financial center of East Africa, with substantial success. However, regulation has not always kept up with the growth of the country's financial sector. To date, Kenya is considered a country with strategic deficiencies in its AML/CFT laws (the FATF "gray list")⁴⁵ and an International Narcotics Control Strategy Report (INCSR) jurisdiction of primary concern.⁴⁶ Kenya's Mutual Evaluation for FATF compliance was conducted through the Eastern and Southern Africa Anti-Money-Laundering Group (ESAAMLG) and published in 2011.⁴⁷ This evaluation noted significant deficiencies in Kenya's AML regime, with the primary issue being its lack of a properly functioning financial intelligence unit—a centralized repository for suspicious activity reports and a crucial tool for investigators.⁴⁸ Technical assistance and capacity-building will be key to success as these issues are addressed.

V. Conclusion

Our data for Kenya demonstrate a clear pattern of tax evasion and avoidance through trade misinvoicing, which is enabled at least in part by Kenya's close connections to the global financial system and by Kenya's lax regulation and governance of financial activities within the country. While these issues are complex and sensitive, addressing them is necessary for Kenya to curtail illicit capital flight through trade misinvoicing and other illicit activity. We encourage Kenya's development partners to engage the Kenyan Ministry of Finance to explore potential assistance needed in this area. The cost of increasing capacity to handle the information gathered may be substantial, but the amount of additional revenue collected should ultimately more than compensate for this initial investment.

45. Financial Action Task Force, "High-Risk and non-cooperative jurisdictions," June 21, 2013, <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/public-statement-june-2013.html>

46. INCSR 2013 reports. The INCSR reports are produced by the U.S. Department of State and highlight countries likely to be the source of drug-related or other laundered money, requiring U.S. banks to subject any transactions from those countries to greater scrutiny. Bureau of International Narcotics and Law Enforcement Affairs, *2013 INCSR*.

47. Eastern and Southern Africa Anti-Money Laundering Group, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Republic of Kenya* (Dar Es Salaam: ESAAMLG, Sept. 2011), 13-14. [http://www.esaamlg.org/userfiles/Kenya_Mutual_Evaluation_Detail_Report\(2\).pdf](http://www.esaamlg.org/userfiles/Kenya_Mutual_Evaluation_Detail_Report(2).pdf).

48. *Ibid*

Mozambique

I. Introduction

Mozambique's economy has been growing at an impressive rate in the years of this study, but the economy lacks diversity. Foreign investment and natural resource extraction have helped the country achieve an average annual real GDP growth rate of over seven percent since 2004, buoyed in part by reforms to improve the country's business climate. Investors are working on developing the country's vast natural gas reserves, estimated to be some of the largest in the world, which may be ready for commercial sales around 2019. As a result, the World Bank estimates that Mozambique could achieve middle income status by 2025. Limiting this potential, however is a high dependency on aid—external funding supports nearly half of all government expenditure, one of the highest rates in the world. Concerns regarding the openness of the political system⁴⁹ and the potential for renewed violence between government forces and the Mozambican National Resistance (Resistência Nacional Moçambicana or RENAMO) rebel group also weigh heavily on the economy.⁵⁰ Of the five countries in this study, only Kenya ranks lower than Mozambique in the Corruption Perceptions Index,⁵¹ and Mozambique falls in the middle on the Failed States Index.

The Government of Mozambique should support greater financial transparency to help ensure that its economic growth leads to broader development benefits and generates the needed government revenue. The country lost \$2.33 billion in illicit outflows of capital due to trade misinvoicing in the period we studied, which, combined with cumulative illicit inflows of \$2.93 billion, may have denied the government \$1.68 billion in revenue. These rates are smaller than some of the other countries' in this study, but they still represent significant missed opportunities for the government and the people of Mozambique and should be addressed before the country begins exporting its natural gas resources. This chapter will delve into the nature of Mozambique's trade misinvoicing flows to get a better understanding of the country's specific challenges. The policy section will consider how to begin approaching reforms and upgrades to curtail future illicit flows and bolster the country's economic prospects.

II. The Extent and Nature of Trade Misinvoicing in Mozambique

Table 5 shows that cumulative gross illicit flows from trade misinvoicing through Mozambique amounted to \$5.27 billion over the nine-year period 2002–2010.⁵³ Average annual illicit flows were \$585 million, which represents a massive 8.9 percent of annual average GDP over the same period.

Both export under-invoicing and import over-invoicing seem to occur in roughly equivalent amounts, implying that traders and companies utilize both methods in transferring capital illicitly out of the

49. African Economic Outlook, *Mozambique*, September 6, 2013, <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Mozambique%20-%20African%20Economic%20Outlook.pdf>.

50. Agence France-Press, "Deadlock in talks between Mozambique government, ex-rebels," Foxnews.com, September 11, 2013, <http://www.foxnews.com/world/2013/09/11/deadlock-in-talks-between-mozambique-government-ex-rebels/>

51. Transparency International, *2012 Corruption Perceptions Index*, December 2012, <http://cpi.transparency.org/cpi2012/>.

52. The Fund for Peace, *The Failed States Index 2013*, <http://ffp.statesindex.org/rankings-2013-sortable>.

53. 2011 data for Mozambique was not available at the time of writing.

country. The pattern of outflows indicates that export under-invoicing and import over-invoicing are typically not used simultaneously but rather that they tend to alternate as the preferred method from one year to the next.

The preferred method of bringing in illicit capital is through import under-invoicing, which totaled \$2.22 billion from 2002-2010, \$247 million per year on average. This figure appears even more significant when viewed in the context of Mozambique's total imports. On average, approximately nine percent of Mozambique's total imports are under-invoiced. This implies that a little less than one out of every ten dollars worth of imports into Mozambique goes unrecorded and untaxed through import under-invoicing. In contrast, illicit inflows through export over-invoicing at less than \$80 million per year are almost negligible.

Table 5. Mozambique: Trade Misinvoicing Vis-à-Vis the World, 2002–2010
(in millions of U.S. dollars) 1/

Year	Export Misinvoicing		Import Misinvoicing		Illicit Outflows (A+D)	Illicit Inflows (C+B)	Gross Illicit Flows	GDP	Total Trade	Total ODA	Gross flows as percent of GDP	Gross flows as percent of Trade	Gross flows as percent of ODA
	Under-Invoicing (A)	Over-Invoicing (B)	Under-Invoicing (C)	Over-Invoicing (D)									
2002	274	0	-1,073	0	274	1,073	1,347	4,200	2,353	2,219	32.07%	57.25%	81.04%
2003	14	0	0	153	167	0	167	4,700	2,798	1,048	3.55%	5.97%	23.91%
2004	0	0	-274	0	0	274	274	5,700	3,539	1,243	4.81%	7.74%	37.39%
2005	239	0	-328	0	239	328	567	6,600	4,191	1,297	8.59%	13.53%	74.41%
2006	0	0	0	259	259	0	259	7,100	5,250	1,639	3.65%	4.93%	27.52%
2007	163	0	-55	0	163	55	218	8,000	5,462	1,777	2.73%	3.99%	20.24%
2008	0	-525	0	561	561	525	1,086	9,900	6,661	1,996	10.97%	16.30%	80.74%
2009	0	-186	0	102	102	186	288	9,700	5,911	2,012	2.97%	4.87%	22.34%
2010	569	0	-491	0	569	491	1,060	9,210	7,600	1,952	11.51%	13.95%	77.97%
Average	140	-79	-247	119	259	326	585	7,234	4,863	1,687	8.98%	14.28%	49.51%
Cumulative	1,259	-711	-2,221	1,075	2,334	2,932	5,266	65,110	43,765	15,183	...	...	...

1/ Outflows (export under-invoicing and import over-invoicing) have a positive sign whereas inflows (export over-invoicing and import under-invoicing) have a negative sign. Estimates of misinvoicing are based on export and import of commodities reported by all member countries to the United Nations for publication in the Commodity Trade database (UN Comtrade). Capital flows due to trade in services are not included in the above estimates. 2011 data for Mozambique was not available at the time of writing.

According to a study by Alfieri and Cirera, overall tariff rates have been reduced and all duties have been converted into ad-valorem with just five tariff bands.⁵⁴ As a result Mozambique has one of the most transparent and simple to administer tariff regimes of countries in Sub-Saharan Africa. High tariff rates are mostly confined to consumer goods. A detailed study on illicit flows from Mozambique could involve an analysis of imports of consumer goods from major advanced economies in order to determine whether circumvention of applicable duties relates to the relatively high customs duties payable on such goods.

III. Tax Revenue Loss and Implications for Development

Import under-invoicing reflects the extent to which the government has lost customs duties through undervaluation and non-reporting of imports. Average tariff rates are around 15 percent of the value

⁵⁴. Andrea Alfieri and Xavier Cirera, "Unilateral Trade Preferences in the EU: An Empirical Assessment for the Case of Mozambican Exports," Discussion Paper 60E (National Directorate for Studies and Policy Analysis (DNEAP), 2008).

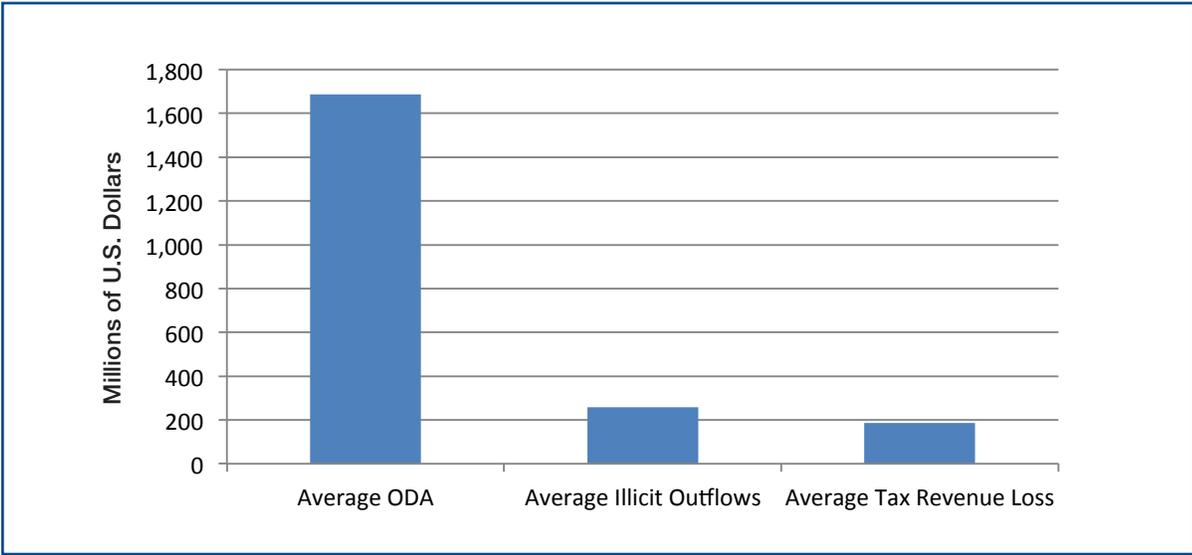
of imports, unadjusted for the cost of freight and insurance; this implies a loss of import duties of \$37 million. Average VAT is 17 percent, so the loss in VAT revenues would be around another \$42 million.

Firms can also lower the amount of corporate taxes they pay to the government of Mozambique through fraudulently under-stating exports or over-stating imports, both of which lower a firm’s taxable income. Considering that the statutory corporate tax rate in Mozambique is 32 percent, the loss in corporate tax revenue equates to approximately \$83 million on average.⁵⁵ This combined with the losses incurred from import under-invoicing brings the average annual tax loss estimate to approximately \$187 million per year.

According to government data reported for publication in the IMF’s Government Finance Statistics (GFS), Mozambique’s social expenditures totaled around 2.4 percent of GDP in 2010.⁵⁶ This translates to approximately \$222 million (2010 GDP of \$9.2 billion). Had the government been successful in curtailing trade misinvoicing by 50 percent, it would have been able to expand its social program by nearly 36 percent, which represents a significant loss in its fight to alleviate poverty.

According to OECD statistics, Mozambique received \$1.69 billion on average per year in total ODA. Although Mozambique’s average illicit outflows only equate to 15 percent of this figure over the course of this study, Mozambique’s problem with illicit financial flows is severely impacting its development efforts.

Chart 3. Mozambique: Annual Average ODA vs. Average Illicit Outflows vs. Average Tax Revenue Loss, 2002–2010
(in millions of U.S. dollars)



55. The World Bank, “Doing Business: Paying Taxes in Mozambique,” <http://www.doingbusiness.org/data/exploreeconomies/mozambique/paying-taxes> (accessed October 1, 2013).
 56. International Monetary Fund, African Dept., “Republic of Mozambique: Staff Report for the 2013 Article IV Consultation, Sixth Review Under the Policy Support Instrument, Request for a Three-Year Policy Support Instrument and Cancellation of Current Policy Support Instrument,” in *IMF Staff Country Reports: Republic Mozambique – Staff Report for the 2013 Article IV Consultation, Sixth Review Under the Policy Support Instrument, Request for a Three-Year Policy Support Instrument and Cancellation of Current Policy Support Instrument*, IMF Country Report 13/200, July 2013, p5. <http://www.imf.org/external/pubs/ft/scr/2013/cr13200.pdf>.

IV. Trade and Transparency Policy Environment in Mozambique

Our fluctuating data for Mozambique is indicative of uneven trade flows and low data quality. The variable nature of the trade flows can be attributed to the Mozambican economy's reliance largely on services and agriculture, while all of the data utilized for this study is derived from an inherently unreliable paper-based customs system. As the Mozambican economy shifts to its mineral wealth as a primary source of exports and implements its new computerized customs system, the drivers of illicit flows will shift as well, requiring further study and better quality statistics.

However, there are many steps that can be taken now to ensure that Mozambique's economy grows sustainably and transparently, minimizing illicit flows through trade misinvoicing from their source. The new customs system will require technical assistance and capacity-building to implement effectively, as will putting in place effective regulation for Mozambique's financial system. Transparency reforms should focus on the new extractive sector, company ownership information, and the exchange of tax information with other countries.

i. Customs and Trade Policy

As noted above, the quality of data used in our assessment of trade misinvoicing in Mozambique was generally poor compared to the other countries studied here, at least partially as a result of the paper-based system of customs clearance Mozambique employed until 2013. Mozambique and its trading partners should make a particular effort to compile bilateral trade data in order to reveal and effectively address trade misinvoicing activity. By comparing data on specific commodities and aggregate trade with specific countries, customs administrators can better identify the high-risk forms of trade to be flagged for further inspection.

Mozambique is in the process of establishing a computerized customs clearance system, known as Single Entry Transit Window (SETW). The system appears to be a proprietary but sophisticated setup developed by a joint venture between the Mozambican government and several private enterprises.⁵⁷ The program entered into service beginning in 2011 and has been progressively rolled out, but the implementation process has been described as "chaotic."⁵⁸ The IMF noted that tariff revenues have declined slightly as a result of implementation issues, but, due to the newness of the system, neither the IMF nor the World Trade Organization has comprehensively reviewed SETW's effectiveness.⁵⁹

A computerized customs system with access to world market valuation data and a rigorous, risk-based approach to pre-shipment inspection will be particularly crucial as Mozambique taps its incredible wealth of mineral and energy resources. The country expects to be the single-largest

57. United Nations Economic Commission for Europe, *Trade Facilitation Implementation Guide – Case Stories: Single Window Implementation in Mozambique*. <http://tfig.unece.org/cases/Mozambique.pdf> (accessed February 1, 2014).

58. "New Mozambican customs clearance chaotic," *The Herald* (Zimbabwe), May 7, 2013, <http://www.herald.co.zw/new-mozambican-customs-clearance-chaotic/>.

59. International Monetary Fund, African Dept., "Republic of Mozambique," p. 5.

exporter of coal worldwide within a decade and possesses the fourth-largest natural gas reserves yet discovered. While these commodities are easily priced on the world market, they are also typically significant sources of misinvoicing.

The equipment and operations associated with extracting such resources also generally lead to large amounts of misinvoicing and abusive transfer pricing and must be carefully monitored. Mozambique has already taken a step towards doing so through its designation as fully compliant with the EITI Standard (discussed below) but must ensure that its customs system is set up to handle commodities and heavy equipment. We recommend that the Government of Mozambique and its development partners explore the need for technical assistance focused specifically on customs issues associated with the extractives industry as well as the need for capacity building as extraction operations in the country ramp up.

ii. Transparency and Governance

Mozambique became an EITI compliant country in October 2012. This represents an important step towards more transparency in the extraction, use, and allocation of revenues from the oil, gas, and mining industries. Mozambique's economic future depends highly on its extensive mineral deposits and burgeoning extractives industry; the implementation of the EITI Standard is a monumental step towards ensuring that the proceeds of mineral extraction in the country ultimately go to support the Mozambican people. It is important that the data collected through the EITI process in Mozambique is used not only to follow the path of government revenue, but also to determine whether the government is collecting an appropriate amount of revenue from companies involved in extracting nonrenewable natural resources.

Little information is available on Mozambique's incorporation or tax information exchange regimes, but they likely require development and assistance to provide useful information to customs and revenue authorities.

iii. Financial Regulation

Mozambique's financial sector is locally focused and under-developed, having essentially collapsed following independence and languished during the long civil war. It is currently seeing a resurgence and, with increasing trade in commodities flowing through the country, will be progressively more connected to the global financial system. A well-regulated financial system will be crucial to ensuring effective tracking of income, both legitimate and illicit, and collection of tax revenue.

Mozambique is a member of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) and underwent a mutual evaluation in 2011. The report found Mozambique significantly non-compliant with FATF Recommendations due to banks having hardly any customer

due diligence requirements and the absence of an operational financial intelligence unit.⁶⁰ Mozambique's parliament passed a law in mid-2013 to address its most glaring deficiencies. The law entered into force in October 2013 but has yet to be fully implemented.⁶¹ While Mozambique has adopted a "Financial Sector Development Strategy" for the next decade focused on increasing the availability of financial services to individuals, the strategy does not appear to make adequate provision for AML implementation or enforcement.⁶²

Effective implementation of the strengthened AML law is an imperative for Mozambique to deter trade misinvoicing and other illicit activity. We recommend that development partners in Mozambique engage with the government to discuss policies and capacity needed in the Mozambique Ministry of Finance as its implementation process proceeds. Bringing Mozambique's AML regime up to international standards would help the country take its place on the global stage and continue developing into a modern economy.

V. Conclusion

Mozambique has enormous potential for growth and development through its mineral and human resources and has already taken steps to establish the culture of business transparency and accountability through accession to the EITI and AML reforms. More work remains to be done, however, to better curtail trade misinvoicing and establish the needed levels of transparency. We recommend that development partners in Mozambique support the Government of Mozambique in these efforts and in further analyzing the various factors that drive trade misinvoicing as a conduit for illegal capital flight from the country.

⁶⁰. Eastern and Southern Africa Anti-Money Laundering Group, Mutual Evaluation Report: Anti-Money Laundering and combating the Financing of Terrorism – Republic of Mozambique (Dar Es Salaam: ESAAMLG, Sept. 2011), 13-16. [http://www.esaamlg.org/userfiles/Mozambique_Mutual_Evaluation_Detail_Report\(5\).pdf](http://www.esaamlg.org/userfiles/Mozambique_Mutual_Evaluation_Detail_Report(5).pdf)

⁶¹. Mozambique AML Law. Bill No. 14/2013.

⁶². IMF, "Republic of Mozambique: Staff Report for the 2013 Article IV Consultation", 16-17.

Tanzania

I. Introduction

Tanzania's economy remains strong coming out of the global financial crisis from 2009, but the government and the economy face challenges in the short- and medium-term. Tanzania's economy has grown by an average of six percent over the past several years and its aggregate GDP increases have been impressive. Natural resource wealth, including new natural gas reserves, has played an important role in helping the country achieve these high average annual GDP growth rates. However, this growth has so far not led to major reductions in poverty levels or to shared improvements in the lives of most Tanzanians. Experts also worry about the country's power supply capacity being able to keep up with the pace of growth.⁶³ Security and tensions between different religious groups in the country are also a growing concern. Tanzania's rankings in the Failed States Index⁶⁴ and in the Corruption Perceptions Index place it in the middle of the pack for the five countries in this study.⁶⁵

The Tanzanian government should take advantage of the resources the country currently loses through illicit flows of capital due to trade misinvoicing to help address some of its development challenges. More than \$8 billion in domestic capital drained out of the economy illegally from 2002–2011, and government coffers may have missed out on an average of \$248 million per year from trade-based tax evasion. These critical resources could have helped to create more jobs, to fund greater access to social services to improve the lives of average Tanzanians, and to improve infrastructure that is vital to additional economic development. The government should continue its recent progress to increase financial transparency and accountability through an electronic customs clearance system, its implementation of the EITI Standard, and its participation in the Open Government Partnership. This chapter will present an economic assessment of Tanzania's trade misinvoicing and the estimated government revenue loss due to illicit trade flows. The second half of the chapter will examine the policy challenges related to these issues and how the government can work towards curtailing such flows in the future.

II. The Extent and Nature of Trade Misinvoicing in Tanzania

A number of observations can be drawn regarding Tanzania's illicit flows over the period of this study. Cumulative gross illicit flows due to trade misinvoicing were \$18.73 billion from 2002–2011, most of which occurred in the last five years of this period. On average, this represented 9.4 percent of annual GDP; the ratio between gross illicit flows and GDP was around four percent from 2002–2007, but by 2011 it was up to nearly 25 percent. The illicit outflows came exclusively in the form of import over-invoicing, which raises questions about Tanzania's reliance on import duties to finance

⁶³. African Economic Outlook, *Tanzania*, September 6, 2013, <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Tanzania%20-%20African%20Economic%20Outlook.pdf>.

⁶⁴. The Fund for Peace, *The Failed States Index 2013*, <http://ffp.statesindex.org/rankings-2013-sortable>

⁶⁵. Transparency International, *2013 Corruption Perceptions Index*, December 2013, <http://cpi.transparency.org/cpi2013/>.

the government budgets. The estimates of trade misinvoicing show that the vast majority of the import over-invoicing transactions are fuel imports, which have an import duty exemption for mining companies.⁶⁶ This suggests that mining companies could be over-inflating their import costs to shift capital out of Tanzania illicitly with the added kick-back of lower taxable income due to artificially inflated inputs.

The drastic rise in import over-invoicing that began in 2008 coincides with the implementation of the country's Export Processing Zones (EPZ). Investors who establish firms in EPZ's are granted import-duty exemption on raw materials used in the production of manufacturing goods as well as a 10-year corporate tax holiday. The elimination or easing of import duties provides a perverse incentive to move capital out of the country illicitly through import over-invoicing. The loss of revenue and the loss of capital available domestically for development undermine the benefits of the EPZs for Tanzania's economy and development.

Illicit inflows from Tanzania slightly exceeded illicit outflows between 2002 and 2011; cumulative export over-invoicing was \$10.34 billion, and import under-invoicing was zero for all but one year. The incentives to over-invoice exports can be explained partly through smuggling and money laundering.

It is also pertinent to note that the vast majority of trade that is misinvoiced in Tanzania occurs with Switzerland and, to a lesser extent, with Singapore, which the IMF and the OECD consider to be tax havens. Despite only consisting of six percent of Tanzania's total imports from advanced

Table 6. Tanzania: Trade Misinvoicing Vis-à-Vis the World, 2002–2010
(in millions of U.S. dollars) 1/

Year	Export Misinvoicing		Import Misinvoicing		Illicit Outflows (A+D)	Illicit Inflows (C+B)	Gross Illicit Flows	GDP	Total Trade	Total ODA	Gross flows as percent of GDP	Gross flows as percent of Trade	Gross flows as percent of ODA
	Under-Invoicing (A)	Over-Invoicing (B)	Under-Invoicing (C)	Over-Invoicing (D)									
2002	0	-199	0	233	233	199	432	10,806	2,563	1,270	4.00%	16.86%	47.50%
2003	0	-320	0	189	189	320	509	11,659	3,255	1,725	4.37%	15.64%	52.67%
2004	0	-689	0	118	118	689	807	12,826	4,200	1,772	6.29%	19.21%	78.35%
2005	0	-556	-108	0	0	664	664	14,142	4,962	1,499	4.70%	13.38%	77.13%
2006	0	-301	0	9	9	301	310	14,331	5,982	1,883	2.16%	5.18%	31.13%
2007	0	-611	0	98	98	611	709	16,826	7,359	2,822	4.21%	9.63%	38.54%
2008	0	-1,039	0	1,170	1,170	1,039	2,209	20,715	9,755	2,331	10.66%	22.64%	160.86%
2009	0	-1,967	0	1,661	1,661	1,967	3,628	21,368	8,663	2,933	16.98%	41.88%	257.41%
2010	0	-2,065	0	1,431	1,431	2,065	3,496	22,915	11,217	2,958	15.26%	31.17%	211.15%
2011	0	-2,588	0	3,373	3,373	2,588	5,961	23,874	15,094	2,436	24.97%	39.49%	357.38%
Average	0	-1,034	-11	828	828	1,044	1,873	16,946	7,305	2,163	9.36%	21.51%	131.21%
Cumulative	0	-10,335	-108	8,282	8,282	10,443	18,725	169,462	73,050	21,630	...	...	...

1/ Outflows (export under-invoicing and import over-invoicing) have a positive sign whereas inflows (export over-invoicing and import under-invoicing) have a negative sign. Estimates of misinvoicing are based on export and import of commodities reported by all member countries to the United Nations for publication in the Commodity Trade database (UN Comtrade). Capital flows due to trade in services are not included in the above estimates.

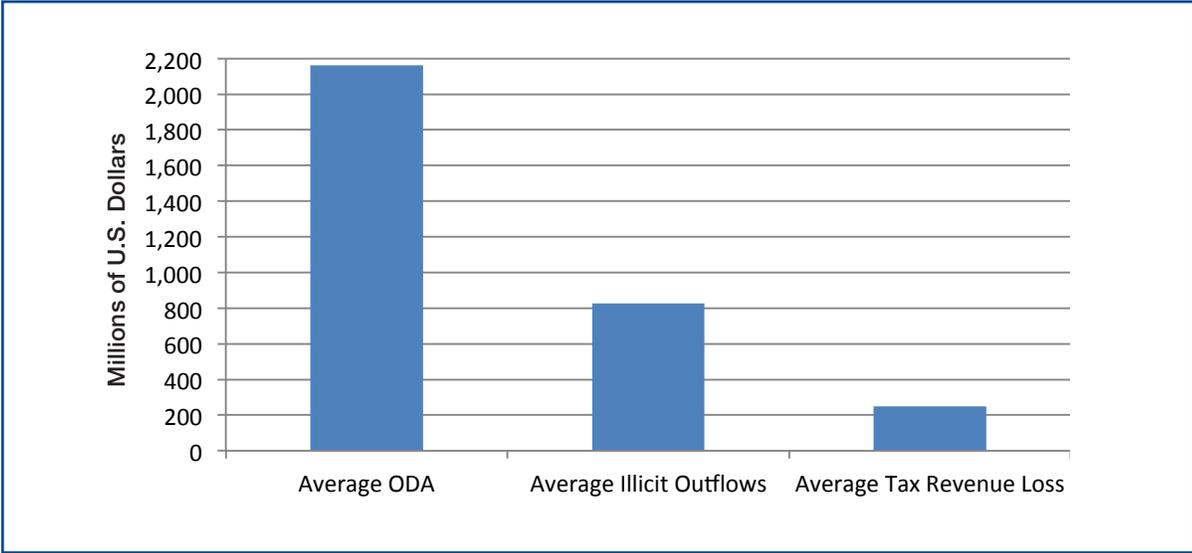
66. Tondedeus K. Muganyizi, "Research Report 1: Mining Sector Taxation in Tanzania," International Centre for Tax and Development (Brighton, UK: Institute of Development Studies, August 2012), 20, http://www.ictd.ac/sites/default/files/ICTD%20Research%20Report%201_0.pdf.

economies, Switzerland and Singapore represent over 67 percent of total import misinvoicing over the 10 year period of this study. To put this into further perspective, over 25 percent of the total import misinvoicing present in Tanzania since 2002 was specifically the misinvoicing of fuel imports from Switzerland alone.

III. Tax Revenue Loss and Implications for Development

A clear understanding of the drivers of trade misinvoicing in Tanzania is required in order to provide an accurate figure for the amount of tax revenue the government loses per year. Given that the majority of import over-invoicing present in Tanzania was shown to coincide with oil imports, which are typically tariff free for mining companies, and the implementation of EPZs in the country, Tanzanian imports are most likely over-invoiced in order to lower year-end taxable income. The official corporate tax rate for mining companies is 30 percent, so Tanzania misses out on an average of \$248 million dollars per year in lost tax revenue.⁶⁷

Chart 4. Tanzania: Annual Average ODA vs. Average Illicit Outflows vs. Average Tax Revenue Loss, 2002–2010
(in millions of U.S. dollars)



IV. Trade and Transparency Policy Environment in Tanzania

Our data indicates that Tanzania’s trade misinvoicing issues are substantial and growing. The existence of both import and export over-invoicing is unusual but likely reflects two different dynamics at work, as explained above. Over-invoiced imports are largely fuel imported by mining companies from Switzerland and Singapore, on which no import duties or VAT are assessed. By over-invoicing imports, these companies are able to reduce their taxable income (by increasing the cost of fuel as a business expense) and avoid paying corporate tax in Tanzania.

⁶⁷. KPMG, *Tanzania Fiscal Guide 2012/13*, p1, http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/MC9197_Fiscal%20Guide_Tanzania.pdf

By contrast, the large amount of export over-invoicing in Tanzania would seem to suggest that trade misinvoicing is being used to shift capital into Tanzania, and on the surface this is true. But the capital is likely being shifted into Tanzania to compensate for illicit or unrecorded activity and remains in Tanzania's vast underground economy where it is neither taxed nor contributing to economic development.

While Tanzania's customs, revenue, and financial authorities are moving forward with reforms to curtail illicit flows, they are still fighting an uphill battle against trade misinvoicing, smuggling, and the underground economy and are in need of greater capacity and technical assistance.

i. Customs and Trade Policy

The Tanzania Revenue Authority (TRA), Tanzania's customs administration, has significantly reformed its procedures in recent years, with mixed results. Tanzania has implemented the computerized ASYCUDA++ system for clearing shipments⁶⁸ and, as a member of the EAC, also participates in the RADDEX electronic document exchange network with Kenya and Uganda. TRA uses a risk-based approach to assigning import inspections, under which about a fifth of imports currently undergo physical inspection. TRA also utilizes an electronic customs valuation database, but it is unclear from what source the database's reference values are drawn. TRA has also implemented a number of additional reforms to streamline its customs process that has greatly increased the efficiency of inspections while also substantially increasing revenue collection.⁶⁹

Our data indicate that Tanzania's illicit flows are getting worse, however, and some of its customs policies may be exacerbating the problem rather than curtailing it. The drastic rise in import misinvoicing that began in 2008 coincides with the implementation of the country's Export Processing Zones (EPZs). Investors who establish firms in EPZs are granted import-duty exemption on raw materials used in the production of manufactured goods as well as a 10-year corporate tax holiday. The elimination or easing of import duties reduces the cost of moving capital out of the country through import over-invoicing, suggesting that the EPZs may be facilitating the extraction of capital through trade misinvoicing in Tanzania.

We encourage TRA to integrate world market data into its customs valuation procedures and revisit the policy benefits of EPZs. The collateral effects of illegal capital flight through trade misinvoicing could be creating a significant roadblock to sustainable economic development, and this could exceed the fiscal and development benefits of the EPZs, especially in the medium- and long-term. Establishing a system to ensure that firms operating in EPZs are importing and exporting goods

⁶⁸. The ASYCUDA (Automated System for Customs Data) system is a worldwide customs management system designed by the United Nations Conference on Trade and Development (UNCTAD) and used in over fifty countries worldwide. Of its three generations, ASYCUDA++ was the second; ASYCUDA World is the most recent.

⁶⁹. World Trade Organization, "Annex 4 – Tanzania," in Trade Policy Review: East African Community (EAC), WT/TPR/S/272/TZA, November 23, 2012, A4-406, http://www.wto.org/english/tratop_e/tp_r_e/tp371_e.htm.

at appropriate values, even if untaxed, would ensure capital remains in the Tanzanian economy to drive its development and would provide the government with more accurate data for better understanding the complete economic picture.

ii. Transparency and Governance

Tanzania has made a commitment to improving transparency through the Open Government Partnership and the Extractive Industries Transparency Initiative (EITI).⁷⁰ The government should be encouraged to extend its participation in these initiatives to their recommended private-sector reforms as well, including collecting and making information about the beneficial ownership of companies public. TRA should also be encouraged to increase its information-sharing and to explore cooperation with other revenue authorities worldwide to help curb tax evasion and fraud.

Tanzania is an EITI compliant country and has published three EITI reports since 2009. These reports have already provided a wealth of information about the extractives industries in Tanzania, and the government should continue this commitment to transparency.

Tanzania does not have effective systems in place for tax information exchange with other countries, because the government has not signed the Convention on Mutual Administrative Assistance in Tax Matters (Convention). Some governments have signed numerous bilateral information exchange agreements instead of or in addition to the Convention, but the Government of Tanzania does not seem to have pursued this avenue, either. This information asymmetry puts the government at a serious disadvantage for collecting the revenue it is owed and for understanding to where its illicit outflows may be going.

iii. Financial Regulation

Tanzania's financial and money laundering regulation is significantly behind global standards, enabling trade misinvoicing and presenting a substantial risk to the country's development. Tanzania is a member of ESAAMLG, and its latest mutual evaluation took place in December 2009.⁷¹ The evaluation exposed substantial deficiencies in Tanzania's AML regime, specifically noting Tanzania's lack of an operational financial intelligence unit or sufficient protocols for identifying or freezing terrorist finances.⁷² These deficiencies have landed Tanzania on FATF's "gray list" as a country not making substantial progress, hampering the country's ability to integrate into the global financial system.

⁷⁰. Open Government Partnership, *Tanzania and the OGP: An Update*, Sept. 11, 2012, <http://www.opengovpartnership.org/blog/blog-editor/2012/09/11/tanzania-and-ogp-update>.

⁷¹. Eastern and Southern Africa Anti-Money Laundering Group, *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – United Republic of Tanzania*, (Dar Es Salaam: ESAAMLG, Dec. 2009), 14-15. http://www.esaamlg.org/userfiles/Tanzania_Mutual_Evaluation_Detail_Report.pdf.

⁷². FATF, "High-Risk and non-cooperative jurisdictions"

V. Conclusion

Tanzania has the worst illicit flows to GDP ratio of the five countries and faces a significant challenge in curbing trade misinvoicing. The government seems to have the appropriate customs systems in place, but some policy initiatives remain to strengthen its trade policy. Additionally, the country largely lacks the culture of transparency and accountability that is needed to drive sustainable business creation and economic development and security. We encourage development partners in Tanzania to help the government of Tanzania tackle these issues to improve governance and revenue collection in the country.

Uganda

I. Introduction

Uganda's economy has grown rapidly in the past twenty years, but significant governance and transparency challenges are undermining the benefits of this growth. Many of the government's aid partners are concerned about corruption, and the government has shown worrying signs of reducing, rather than increasing, overall transparency and accountability.⁷³ Uganda discovered oil reserves in 2006, and since then oil companies have invested at least \$2 billion in exploring and developing the oil fields to get to a point of selling the resource commercially.⁷⁴ This should eventually generate considerable wealth for the country, but the government will need to improve financial transparency and accountability in order to turn this opportunity into a real benefit for the average Ugandan. So far this is not the direction in which the country appears to be headed. Foreign aid donors are pulling back support in the face of corruption scandals,⁷⁵ and the political climate needs to become freer and more open, reversing recent moves in the other direction.⁷⁶ These issues are reflected in Uganda having one of the weaker rankings of the five countries in this study on the Failed States Index⁷⁷ and the weakest ranking in the Corruption Perceptions Index of 140th.⁷⁸

Trade misinvoicing due to import over-invoicing in Uganda increased significantly from 2002 to 2011 and could undermine the benefits of future oil sales if left unchecked. The average annual value of trade misinvoicing during this period was \$884 million, from which the government may have missed out on \$243 million each year on average in tax revenue. The government may need this revenue if aid flows continue to slow before the oil comes online. In this final of the five country case chapters, we will provide an economic analysis of trade misinvoicing in Uganda and also a policy analysis to identify the areas on which officials should concentrate reform efforts to curtail these growing illicit flows.

II. The Extent and Nature of Trade Misinvoicing in Uganda

In contrast to the pattern of illicit flows to and from the four other countries included in this study, illicit outflows through trade misinvoicing significantly outpace illicit inflows in Uganda. Table 7 shows that the misinvoicing of imports is by far the primary method through which capital is illicitly transferred out of the country. The under-invoicing of exports totals just \$261 million, piling in comparison to cumulative import over-invoicing of \$8.13 billion (\$813 million per year on average). Our methodology did not reveal any import under-invoicing; the only source of illicit inflows was a total of \$457 million from export over-invoicing. The average figure for gross illicit flows to GDP was 7 percent for the ten-year period.

73. African Economic Outlook, *Uganda*, September 6, 2013, <http://www.africaneconomicoutlook.org/en/countries/east-africa/uganda/>.

74. Bariyo, Nicholas, "Uganda Says Oil Exploration Investment Hits \$2 Billion Mark," *The Wall Street Journal*, September 13, 2013, <http://online.wsj.com/article/DN-CO-20130913-002414.html>.

75. African Economic Outlook, *Uganda*.

76. CIVICUS, "Appalling Crackdown on Freedoms in Uganda Continues," August 29, 2013, <http://www.civicus.org/media-centre-129/press-releases/1844-appalling-crackdown-on-freedoms-in-uganda-continues>

77. The Fund for Peace, *The Failed States Index 2013*.

78. Transparency International, *2013 Corruption Perceptions Index*.

Import over-invoicing has two broad appeals to corporations operating in developing countries. First, it allows them to circumvent capital controls in order to keep valuable foreign exchange outside the country where it cannot be used effectively for development purposes. Second, considering that over-inflated costs of imports result in lower profit margins, corporations can significantly lower their taxable income.

Table 7. Uganda: Trade Misinvoicing Vis-à-Vis the World, 2002–2011
(in millions of U.S. dollars) 1/

Year	Export Misinvoicing		Import Misinvoicing		Illicit Outflows (A+D)	Illicit Inflows (C+B)	Gross Illicit Flows	GDP	Total Trade	Total ODA	Gross flows as percent of GDP	Gross flows as percent of Trade	Gross flows as percent of ODA
	Under-Invoicing (A)	Over-Invoicing (B)	Under-Invoicing (C)	Over-Invoicing (D)									
2002	0	-13	0	275	275	13	288	6,200	1,534	725	4.65%	18.77%	61.69%
2003	69	0	0	326	395	0	395	6,300	1,938	998	6.27%	20.38%	67.13%
2004	0	-30	0	353	353	30	383	7,900	2,492	1,216	4.85%	15.37%	55.88%
2005	0	0	0	445	445	0	445	9,200	3,065	1,192	4.84%	14.52%	64.26%
2006	0	-8	0	641	641	8	649	10,000	3,745	1,586	6.49%	17.33%	68.97%
2007	16	0	0	813	829	0	829	11,900	5,496	1,737	6.97%	15.08%	82.45%
2008	0	-142	0	1,282	1,282	142	1,424	14,440	7,237	1,641	9.86%	19.68%	141.14%
2009	47	0	0	1,112	1,159	0	1,159	15,800	7,251	1,785	7.34%	15.98%	113.99%
2010	129	0	0	1,134	1,263	0	1,263	17,200	7,805	1,723	7.34%	16.18%	121.88%
2011	0	-264	0	1,745	1,745	264	2,009	16,810	6,996	1,582	11.95%	28.72%	201.97%
Average	26	-46	0	813	839	46	884	11,575	4,756	1,419	7.05%	18.20%	97.94%
Cumulative	261	-457	0	8,126	8,387	457	8,844	115,750	47,560	14,187	...	...	...

1/ Outflows (export under-invoicing and import over-invoicing) have a positive sign whereas inflows (export over-invoicing and import under-invoicing) have a negative sign. Estimates of misinvoicing are based on export and import of commodities reported by all member countries to the United Nations for publication in the Commodity Trade database (UN Comtrade). Capital flows due to trade in services are not included in the above estimates.

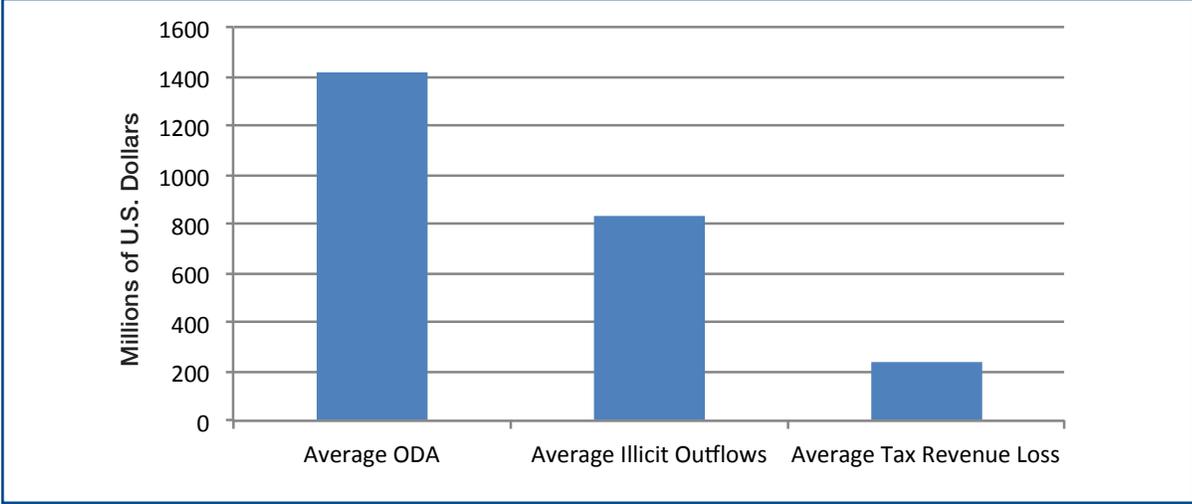
III. Tax Revenue Loss and Implications for Development

Taxes on trade as a percent of total government revenues have been declining since 2002, partly as a result of reductions in Uganda's relatively low import tariff rates. Corporate tax rates in Uganda are 30 percent, so the average amount of tax revenue lost per year may be \$243 million.⁷⁹ Illicit outflows through import over-invoicing have been steadily increasing from \$275 million in 2002 to \$1.75 billion in 2011. In regards to the last year of this study, tax revenue loss through import over-invoicing may have been \$524 million, which would constitute approximately 77 percent of the government deficit during the same year.

Over the period of 2002 to 2011, Uganda received a total of \$14.19 billion dollars in foreign aid compared to \$8.31 billion that left the country illicitly through export under-invoicing and import over-invoicing. To the extent that the money that left Uganda represents both a loss of capital that could have otherwise been used for development as well as a substantial loss in tax revenue, illicit outflows are significantly hindering development efforts in the country.

⁷⁹. KPMG, *Uganda Fiscal Guide 2012/13*, p1. http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/MC9197_Fiscal%20Guide_Uganda.pdf.

Chart 5. Uganda: Annual Average ODA vs. Average Illicit Outflows vs. Average Tax Revenue Loss, 2002–2010
(in millions of U.S. dollars)



IV. Trade and Transparency Policy Environment in Uganda

Among the countries studied in this report, Uganda has the smallest amount of trade but the largest percentage thereof flowing out through trade misinvoicing 18.2 percent on average over the full 10-year period. The method almost exclusively used to do so is import over-invoicing, meaning goods are brought into the country at highly inflated prices. As noted, import over-invoicing is generally driven by a desire to circumvent foreign exchange controls, escape corporate income taxes, and accumulate money abroad, with accordingly little concern for evading import tariffs. Illicit financial flows of this form are particularly insidious, as they deprive both the government of revenue and the economy of needed capital and suggest that Uganda faces a serious and pressing issue with trade misinvoicing.

i. Customs and Trade Policy

Uganda’s customs administration has undergone a comprehensive reform program in recent years. Uganda employs the ASYCUDA++ system, uses a risk-based approach that flags approximately one-third of imported goods for inspection, and has fully implemented the EAC’s customs valuations procedures, which largely comply with global standards.⁸⁰ Nonetheless, as with the other EAC countries studied here, the extent of trade misinvoicing shown in our data suggests that Ugandan customs still faces difficulties with valuing imports. Indeed, the WTO cites used cars, a traditional subject of rampant misinvoicing, as a particular area in which valuation documentation is often lacking, and customs officials report continued problems with imports, particularly falsification of documents and issuance of dual or blank invoices.⁸¹

⁸⁰. World Trade Organization, “Annex 5 – Uganda,” in Trade Policy Review: East African Community (EAC), WT/TPR/S/271/UGA, November 23, 2012, A5-511, http://www.wto.org/english/tratop_e/tpr_e/tp371_e.htm.
⁸¹. WTO, “Annex 5 – Uganda,” A5-512.

ii. Transparency and Governance

Uganda is widely regarded as a country that has faced persistent and serious governance issues, which have become particularly concerning following the recent discovery of substantial oil and gas deposits. The government needs to significantly improve financial transparency and accountability, so that the benefits of economic growth spread out to the people of Uganda instead of leaking out through trade misinvoicing. Uganda is not yet a member of the Extractive Industries Transparency Initiative (EITI) but has pledged to join soon. Establishing an EITI regime in the country would be a useful first step for ensuring that government revenue from its oil deposits is properly accounted for. We encourage the Ugandan government to officially join EITI and begin implementing the relevant policy instruments as soon as possible.

Very little information is available regarding the stringency of Uganda's incorporation regime or its tax authorities' level of cooperation with other countries. Further investigation of these and possibilities for reform will be necessary for sustainable development and effective oversight of Uganda's business environment.

iii. Financial Regulation

The current state of Uganda's financial regulation is in flux, particularly with respect to money laundering. Uganda's most recent FATF-style mutual evaluation was done in 2007 and found Uganda non-compliant with nearly all of the Recommendations.⁸² The mutual evaluation has not been updated since 2007, but the FATF placed Uganda on the list of countries with "significant deficiencies" in their anti-money laundering and counter financing of terrorism (AML/CFT) regimes in February 2014.⁸³ Although Uganda has had various assorted bank regulations in place, the country only passed the comprehensive anti-money laundering bill recommended in the report in July 2013, and, after a delay, the President signed it into law.⁸⁴ We encourage the Government of Uganda to implement the law as swiftly as practicable.

The links between Uganda's financial industry and the world will increase as the Ugandan economy develops, particularly with regards to extraction of natural resources. Laying effective, efficient groundwork now is necessary for a robust and efficient regulatory regime in the future.

⁸². Eastern and Southern Africa Anti-Money Laundering Group. *Mutual Evaluation/Detailed Assessment Report: Anti-Money Laundering and Combating the Financing of Terrorism – Republic of Uganda*. (Dar Es Salaam: ESAAMLG, Aug. 2007), 8. http://www.esaamlg.org/userfiles/UGANDA_MER1.pdf.

⁸³. Financial Action Task Force, "Improving Global AML/CFT Compliance: on-going process - 14 February 2014." <http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-feb-2014.html>.

⁸⁴. Abdallah, Halima, "Uganda finally passes anti-money laundering Bill in sync with partners," *The East African*, July 13, 2013, <http://www.theeastafrican.co.ke/news/Uganda-finally-passes-anti-money-laundering-Bill/-/2558/1913692/-/991vag/-/index.html>

V. Conclusion

As Uganda is the only landlocked country in this study, it seems plausible that smuggling across its borders is the largest source of capital flight, rather than the misinvoicing of trade at ports as in the other countries. While customs reform and implementation can still be effective against misinvoicing of trade through legitimate channels, curtailing widespread smuggling requires bringing the underground economy into the light. We encourage development partners in Uganda to discuss options with the government of Uganda for doing so.

Policy Assessments and Recommendations

Addressing illicit financial flows due to trade misinvoicing is a complex undertaking, and there is no “silver bullet” or single policy initiative that will solve the problem. There are numerous policy instruments available to significantly curtail trade misinvoicing, though, driven by two overarching principles: greater transparency in domestic and international financial transactions, and greater cooperation between developed and developing country governments to shut down the channels through which illicit money flows.⁸⁵

I. The Importance of Customs Valuation

The goal of policies to curtail trade misinvoicing is relatively straightforward: ensure that goods being imported or exported are recorded at a value based on the accurate market price of the goods. While this task is generally the sole responsibility of customs authorities, our data demonstrates that the recorded value of goods in cross-border transactions can affect several streams of revenue for the government beyond customs duties and excise taxes. Importers or exporters can misinvoice trade to understate their net income to avoid corporate taxes (import over-invoicing or export under-invoicing), or to claim fraudulently excessive export subsidies or VAT refunds (export over-invoicing). Customs authorities generally focus only on assessing appropriate import duties, so exports and over-invoiced imports are rarely examined or questioned.

Misinvoicing schemes can remain relatively simple yet foolproof and essentially risk-free. For instance, an importer of fuel oil in Uganda could requisition a shipment of \$10,000 worth of fuel oil from his overseas distributor and remit payment for \$20,000 to the distributor with an understanding that the distributor would then transfer \$10,000 into a foreign account controlled by the Ugandan importer. The invoice for the fuel oil submitted to customs would reflect that the fuel was imported at a value of \$20,000, which is \$10,000 more than the actual value of the oil. Customs officers are less likely to challenge this transaction since the over-invoicing means that more import duties were paid.

Export under-invoicing works conversely: an exporter of coffee from Kenya could agree to export \$20,000 worth of coffee to an overseas wholesaler but receive payment of only \$10,000, with an understanding that the wholesaler will deposit the remaining \$10,000 into a foreign account controlled by the Kenyan exporter. The invoice for the coffee submitted to customs would reflect that the coffee was exported at a value of \$10,000, which is \$10,000 less than the actual value of the coffee. Customs officers are less likely to challenge the buyer or the seller on the transaction, because there are no export tariffs to collect, as there would be for import under-invoicing.

⁸⁵. Dev Kar et al., *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009* (Washington, DC: Joint Publication of the African Development Bank and Global Financial Integrity, 2013) <http://africanetresources.gfintegrity.org/index.html>

Many development partners have invested a significant amount of resources in developing customs administrations in Ghana, Kenya, Mozambique, Tanzania, and Uganda, yet trade misinvoicing remains an issue and in many cases is increasing. This does not mean that customs reform, capacity building, and technical assistance are hopeless endeavors. Rather, such efforts must be coupled with increased access for customs officers to the international pricing data needed to efficiently identify and challenge misinvoiced transactions. While specific customs procedures are beyond the scope of this report, we present several novel customs and trade policy reform measures below that would deter misinvoicing or encourage accurate invoicing on the part of importing and exporting entities.

Trade misinvoicing schemes exploit the inability of authorities in the affected countries to discover either the trade-fraudsters' secret agreements with external parties or the secret bank accounts they control. This is the area in which the principles of transparency and cooperation are most helpful, and we present several policy ideas below that could be adopted in the countries studied here, and worldwide, to bridge these information gaps.

II. Customs and Trade Reform

All of the countries studied here have recently implemented fully computerized systems for collecting customs documentation and assigning risk-based inspections, and all of the countries have received significant amounts of technical assistance and capacity building aid specifically for their customs administrations. Yet trade misinvoicing remains a significant and growing issue. Continuing to provide technical assistance and capacity building programs for these countries is important to help them keep up to speed with international best practices and support them in utilizing the latest technology to combat trade misinvoicing. However, we recommend that the individual country governments explore whether and to what extent the countries' relatively new electronic clearance systems utilize international or national reference values when clearing goods; whether and to what extent the countries' risk-management systems consider trade misinvoicing a risk; and, whether customs officers have the necessary amount of authority and discretion to investigate and revalue transactions that appear to be misinvoiced. Along with addressing these issues and continuing to develop adequate capacity to effectively oversee the substantial and increasing volumes of trade passing through these countries, customs authorities should be encouraged to take several basic steps to deter trade misinvoicing, which we describe below.

i. Designate Potential Misinvoicing as a Risk and Aggressively Use International Trade Data to Identify Red-Flag Shipments

Customs authorities usually do not challenge reported customs values without clear evidence of manipulation, but they may still investigate shipments that they suspect have been misinvoiced and are explicitly allowed to request additional documentation from the importing party. The potential delay and hassle of such an investigation will, on its own, deter some amount of misinvoicing.

Hence, customs authorities should publicly and repeatedly declare their intention to pursue trade misinvoicing, pledging to use their investigative authority vigorously and extend existing risk-based approaches to consider trade misinvoicing, flagging any shipments falling outside a plausible range of values.⁸⁶

Much of the infrastructure for implementing an efficient but effective anti-misinvoicing campaign is in place: computerized trade systems, risk-based approaches, and access to data on imports and exports through the Internet. Judging whether goods are accurately valued requires knowing the values assigned to those or similar goods in other transactions worldwide. Systems like USA Trade Online,⁸⁷ the United Nations Comtrade database,⁸⁸ and the International Price Profiling System (IPPS)⁸⁹ offer a wealth of data that can be used to judge whether goods for import or export are being declared honestly and accurately. Customs authorities in these countries need assistance to leverage the availability of this data and integrate it into their computerized risk assessment systems. Even merely increasing the chance that a shipment will be singled out for inspection should be enough to deter some of the most egregious cases of misinvoicing.

ii. Encourage Promotion of Individual Accountability in Customs Declarations and Company Accounts

Other methods of curtailing trade misinvoicing involve deterring misinvoicing by extending accountability to individuals involved in the transaction. GFI recommends the inclusion on customs declaration forms of a simple paragraph stating the following:

Weights, counts, measures, descriptions, and quality specifications are accurately stated on this invoice, and the prices of all items covered by this invoice conform to world market norms and contain no element of misinvoicing or abusive transfer pricing for profit shifting or manipulation of VAT taxes, customs duties, excise taxes, or income taxes. The whole of the transactions covered herein conforms to the banking regulations, exchange control statutes, anti-money laundering laws, and terrorist financing prohibitions in the country of export, in all countries where material actions relating to the transaction occur, and in the country of import.

⁸⁶. See Asia/Pacific Group on Money Laundering's *APG Typology Report on Trade Based Money Laundering* (2012), p. 26 (<http://www.apgml.org/includes/handlers/get-document.ashx?d=3a653e41-8cf5-435a-ba92-55add9de276a>) and Financial Action Task Force's Best Practices Paper: *Trade Based Money Laundering* (2008) (<http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf>).

⁸⁷. See <http://www.usatradeonline.gov/>. USA Trade Online offers the most current statistics on imports and exports involving the United States, broken down by the most detailed commodity codes available.

⁸⁸. See <http://comtrade.un.org/>. Comtrade provides monthly data summaries of trade based on commodity codes, as well as information aggregated at a country level.

⁸⁹. See <http://www.internationaltradealert.com/products.asp>. IPPS provides trade data at the transaction level, and can be used to automatically flag transactions at prices outside the international norm or presenting a significant risk of trade misinvoicing.

Requiring the assent and signatures of personnel representing both the importing and exporting entities in a transaction is a simple, unobtrusive way to ensure a basic level of accountability for those engaged in international trade. Strong rule of law means that no individual, or corporation, is above the law.

We also recommend that large companies be required to include similar statements in their annual reports or accounts in which executives of the companies certify that the company does not manipulate prices or utilize abusive transfer pricing and that the executives personally reviewed their corporate accounts and found no evidence of such activity. Such a declaration would follow the trend in the United States and elsewhere for executives and directors to certify their companies' financial and other compliance programs, leading to personal responsibility at the highest level for corporate behavior.

iii. Encourage Promotion of Individual Accountability in Auditing and Accounting Practices

Ensuring that every company importing or exporting goods in a country reports and records the appropriate value for those goods cannot be done solely through customs inspections or good-faith certifications. By requiring companies to record accurate trade values on their books and report income based on accurate values to tax authorities, and by auditing companies with a specific eye towards trade misinvoicing, a country can slowly build trade misinvoicing prevention into its business culture. Both tax audits run by the government and private audits of corporate accounts should have aspects of trade misinvoicing prevention. Simply requiring a certification by corporate auditors along the lines of the executive certification—that no evidence of trade misinvoicing was found—would constitute a substantial step towards curtailing trade misinvoicing.

III. Data Transparency

All forms of trade misinvoicing directly exploit the lack of communication between governments when goods are exported from one country and then imported into another country. The only evidence of manipulation may be a wire transfer in another country that the importing country has no hope of discovering. While customs authorities are the first line of defense against trade misinvoicing, they cannot bear the full burden of curtailing it. Tax authorities, financial intelligence units, and law enforcement agencies should have access to additional data needed to recognize and investigate potential trade misinvoicing.

There are initiatives underway to collect and share data—specifically individual tax information and corporate beneficial ownership information—that would enable potentially illicit transactions to be more easily identified. Transparency in the extractives sector is also particularly important for the countries studied here, all of which have significant natural resource deposits, and can potentially

lead to identification of widespread trade misinvoicing or abusive transfer pricing by companies operating in that sector.

Making much of the data obtained through these initiatives public will contribute to developing a culture of transparent and accountable business operations, enabling sustainable economic development, governance, and accountability. The countries studied cannot achieve such an outcome in a vacuum. Obtaining all of the data discussed below requires a global effort on the part of governments, and effectively utilizing it to support sustainable development requires a similar global effort on the part of civil society, media, and academics.

i. Beneficial Ownership of Legal Entities

The use of anonymous shell companies—legal entities with no physical assets and no readily accessible information on who owns the company’s financial assets or controls the company’s activities—to enable trade misinvoicing is a scourge on both the developed and developing world. Individuals can use such companies to file fraudulent customs paperwork to “import” nonexistent goods or import actual goods at a false value and ensure that their illicit activity cannot be traced back to them. Anonymous shell companies can also wire money worldwide through accounts obtained at poorly regulated banks, making them an integral tool for remitting the ill-gotten proceeds of not just trade misinvoicing, but all other sorts of criminal and corrupt activities as well.

Collecting beneficial ownership information on legitimate companies engaged in international trade would be useful as well, enabling customs authorities to determine whether an importer and exporter are in fact controlled by the same person and hence should be subject to additional scrutiny.

Vastly reducing the use of opaque corporate arrangements is relatively simple: require legal entities to disclose information about their beneficial owners, the person or persons with ultimate ownership or control, when formed and maintain such information in an easily accessible central public registry.⁹⁰ The collection of beneficial ownership information also enables banks to more readily fulfill their obligations under FATF Recommendation 10, which requires the collection of such information for accountholders.⁹¹ The UN Convention Against Corruption (UNCAC) also addresses beneficial ownership transparency in several articles, and Ghana, Kenya, Mozambique, Tanzania, and Uganda are all signatories to the UNCAC.⁹² Collecting this information has become an international priority, and we encourage the countries studied here to follow suit.⁹³

90. Marriage, Alex, “Secret Structures, Hidden Crimes: Urgent steps to address hidden ownership, money laundering and tax evasion from developing countries,” European Network on Debt and Development (Brussels: Eurodad, 2013) <http://eurodad.org/files/pdf/520a3a680437f.pdf>.

91. Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (Paris: FATF, February 2012), 14-15. http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

92. United Nations Office on Drugs and Crime, *United Nations Convention Against Corruption* (Vienna: UNODC, 2004) http://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf.

93. G8, “Lough Erne Declaration,” Lough Erne, Northern Ireland, June 18, 2013. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207543/180613_LOUGH_ERNE_DECLARATION.pdf.

ii. Automatic Exchange of Tax Information

Ghana, Kenya, Mozambique, Tanzania, and Uganda should actively participate in the worldwide movement towards automatic exchange of tax information, the “new global standard” as declared by the G20.⁹⁴ Automatic exchange arrangements establish a system for governments to collect information on account holders at banks under their jurisdiction and exchange such information with those account holders’ home countries, where tax may be due on income deposited in those accounts.⁹⁵ Though attention on the issue generally focuses on the benefits of having such information when investigating tax cheats, automatic exchange arrangements would also allow authorities to determine whether individuals located in their jurisdictions have unexplained income abroad that could be the proceeds of trade misinvoicing. When used in combination with beneficial ownership information on companies active in international trade, this information would be a powerful tool for ensuring business owners are not stashing cash overseas.

While automatic exchange to date has occurred largely through bilateral agreements, the G20 and OECD have begun the process of establishing a multilateral system of information exchange. We encourage the countries studied here to sign the OECD Convention on Mutual Administrative Assistance in Tax Matters,⁹⁶ a precursor to fully automatic exchange,⁹⁷ and encourage the countries’ revenue authorities to involve themselves in the process of establishing the new multilateral system of automatic exchange called for in the G20’s declaration and embodied in the OECD’s recently released “Common Reporting Standard” for automatic exchange.

iii. Transparency in Domestic Resource Mobilization

Sub-Saharan Africa’s abundant natural resources are often viewed as a crucial windfall for funding development, but this will only be effective if these resources are sustainably and appropriately managed and utilized. Ensuring that the proceeds of resource extraction are returned to a country’s government and people, rather than purloined by corrupt politicians or ferreted out of the country through capital flight, is an absolute necessity. The Extractive Industries Transparency Initiative (EITI) seeks to achieve this goal by shining light on the operations of oil, gas, and mining companies and the payments made to governments for extracting natural resources.

The EITI standard requires all companies extracting natural resources in a country to report all payments made to the country’s government, comparing this information against the government’s figures and generally making the data public. From this data, government officials can ensure that revenue is actually reaching government coffers to be directed toward social welfare, while the

⁹⁴. G20, “G20 Leaders’ Declaration,” St. Petersburg, September 2013, p20. <http://en.g20russia.ru/load/782795034>.

⁹⁵. Organization for Economic Co-operation and Development, *Automatic Exchange of Information: What it is, how it works, benefits, what remains to be done* (Paris: OECD, 2012), 7. http://www.oecd.org/ctp/exchange-of-tax-information/AEOI_FINAL_with%20cover_WEB.pdf

⁹⁶. Ghana is already a signatory.

⁹⁷. Organization for Economic Co-operation and Development, “Convention on Mutual Administrative Assistance in Tax Matters.” Last updated Dec. 2013. <http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm>.

public can utilize the data to assess whether their country is effectively benefiting from its natural resources.

Kenya and Uganda should follow the paths of Ghana, Mozambique, and Tanzania in complying with the EITI standard. Uganda, which has confirmed its intention to join the initiative, has an expansive mineral and mining industry, and, while Kenya does not have significant oil or mining industries at present, exploration is proceeding apace, particularly for oil deposits off the Kenyan coast. We encourage policymakers in Kenya to consider joining EITI, and we urge the government of Uganda to follow up its previously stated commitment to join. Developed-country EITI members should continue their efforts to engage with current and potential developing-country members to promote transparency.

IV. Financial Sector Reforms

Along with illicitly moving capital out of a country, trade misinvoicing is often used as a method of laundering the proceeds of criminal activity and financing terrorism, and, as such, it can be targeted through a country's anti-money-laundering (AML) laws.⁹⁸ Stringent AML laws would require banks to better scrutinize suspicious transactions and empower countries to better track and seize the proceeds of criminal activity. Adopting and fully implementing international standards, specifically the Financial Action Task Force Recommendations, is a crucial step towards participating in the international financial system on an equal footing with developed and other developing nations.

All of the countries we studied have deficiencies in their legal frameworks for addressing money laundering. Kenya, particularly as a country aspiring to become the financial center of East Africa, faces substantial challenges in addressing terrorist financing and establishing an operational financial intelligence unit (FIU). Uganda lags well behind other East African countries in its lack of any comprehensive AML regime and should be encouraged to fully implement the country's new AML law as quickly as possible to keep pace with international developments. Mozambique does not appear to have a strategy or action plan for addressing its AML deficiencies and should be encouraged to develop one as soon as practicable. Ghana and Tanzania should be encouraged to continue implementing their action plans.

Technical assistance and capacity building for these countries' finance ministries and central banks will be needed as they develop their AML regimes. Facilitating connections with developed-country bank regulators to provide perspective and guidance, not only on legislative language but implementation procedures, which are becoming a much greater focus of the FATF evaluation process, will be crucial.

⁹⁸. Financial Action Task Force, Best Practices Paper on Trade Based Money Laundering (Paris: FATF, 2008). <http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf>; Asia/Pacific Group on Money Laundering, APG Typology Report on Trade Based Money Laundering (Sydney: APG, 2012). <http://www.apgml.org/includes/handlers/get-document.ashx?d=3a653e41-8cf5-435a-ba92-55add9de276a>.

Conclusion

Ghana, Kenya, Mozambique, Tanzania, and Uganda have all expanded their economies markedly in the past ten years, thanks largely to increases in foreign direct investment. Cities are booming, and many people are prospering. However, these countries have also continued to struggle with poverty and dependence on foreign aid to fill gaps in government budgets and social service provision. The benefits of strong GDP growth are not always reaching the average citizen. An important part of the solution to this challenge is increasing domestic resource mobilization, so that governments can invest in infrastructure and in services for their people.

Trade misinvoicing has been undermining investment and domestic resource mobilization in the countries we studied to the tune of billions of dollars. From 2002–2011, cumulative trade misinvoicing—export under-invoicing, import under-invoicing, export over-invoicing, and import over-invoicing—totaled \$14.39 billion in Ghana, \$13.58 billion in Kenya, \$5.27 billion in Mozambique, \$18.73 billion in Tanzania, and \$8.84 billion in Uganda. We estimate that the governments in each case also lost a portion of these totals from the evasion of taxes and tariffs: \$386 million for Ghana, \$435 million in Kenya, \$187 million for Mozambique, \$248 million in Tanzania, and \$243 million in Uganda, on average per year. These are not just figures on paper; curtailing these illicit outflows of capital could be a development game-changer in these countries.

A lack of data and a hampered ability to track the true nature and values of cross-border trade have contributed to these trade misinvoicing flows in each country. Customs authorities in the five countries have recently started using electronic clearance systems, but they may not have access to up-to-the-minute pricing information on goods to verify invoice values. Authorities also need access to information on the ultimate beneficial owners of the companies involved in the trades, to help spot potential abuses. They should also be able to have access to information about income recorded in accounts held abroad for companies that are registered in and pay taxes in the host country. The governments also need to be equipping the relevant officials with the right mix of training and authority, to be able to analyze and act on the data in a timely and efficient manner.

We recommend that the governments of Ghana, Kenya, Mozambique, Tanzania, and Uganda take immediate steps to increase their access to data and other information on the trade of goods moving across their respective borders. They should ensure that their electronic clearance systems can track declared customs valuations versus world market norms to detect possible trade misinvoicing, and they need to examine how they can institute accounting and auditing reforms to target trade misinvoicing. Joining the global movements to automatically exchange tax information across borders and to require public disclosure of beneficial ownership of corporate entities would support public authorities in further cracking down on companies engaging in trade misinvoicing to evade taxes. The leaders of the countries we studied should establish or strengthen their government's financial intelligence units with enough human resources and authority to analyze this

new information to support investigations of wrongdoing and deter trading parties from engaging in trade misinvoicing.

The governments in the five countries we studied in this report will need to further analyze in depth the sources and magnitudes of illicit flows due to trade misinvoicing, including their top commodity exports and imports. This will help the governments identify a fuller range of policy improvements needed to significantly curtail these outflows of capital and mobilize a larger share of these resources for investment and development. We encourage the development partners of Kenya, Uganda, Tanzania, Mozambique, and Ghana to support this process as much as possible.

Ultimately, however, curbing illicit financial flows is a *global* responsibility. Global norms and standards govern the flow of international trade and valuation principles applied by customs inspectors. Data transparency initiatives like automatic exchange of tax information and public registries of beneficial ownership information are more useful for every additional country that participates. Multilateral organizations, such as the G8, G20, OECD, European Union, and others, have made promising progress in many of these areas in recent years. Eliminating the global 'shadow financial system' that enables illicit financial flows will require continued effort in these forums and commitment to tackling the problem from developed-country governments.⁹⁹

⁹⁹. Raymond W. Baker, *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* (Hoboken, NJ: John Wiley & Sons, 2005).

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About the Authors

Global Financial Integrity (GFI) promotes national and multilateral policies, safeguards, and agreements aimed at curtailing the cross-border flow of illegal money. In putting forward solutions, facilitating strategic partnerships, and conducting groundbreaking research, GFI is leading the way in efforts to curtail illicit financial flows and enhance global development and security.

GFI's mission stems from the estimate that \$1 trillion in funds that are illegally earned, transferred, or utilized are spirited out of developing countries annually. Of this, \$500 billion a year ends up in Western accounts. This constitutes the most damaging economic condition hurting the poor. Illicit capital flows enable drug cartels, terrorist organizations, and tax evaders to move cash around the globe, undermine the goals of the World Bank and other lending institutions, strip developing countries of critical resources, and contribute to failed states.

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The authors also wish to acknowledge the contributions of Tom Cardamone, Matthew Gellerman, Stefan Koumdjiev, Taylor Le, and Channing May.



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