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.