

Illicit Trade in South Africa

Challenges and Solutions



A Briefing by the Transnational Alliance to Combat Illicit Trade

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Introduction

South Africa's peaceful political transition is one of the most remarkable political feats of the past century. The country has made considerable strides in economic and social development since the mid-1990s, raising income levels and reducing poverty. But the country still faces a number of challenges, including a significant threat from illicit trade.

From smuggling, counterfeiting and tax evasion, to illegal mining and the trafficking of humans and wildlife, illicit trade holds back South Africa's economic and social progress. Every year, rampant illicit trade robs Africa and South Africa in particular of massive amounts of capital critical to ensuring economic development and improving living conditions for citizens. Some of the problems can be attributed to the many, long and porous borders with multiple country entry points, which are difficult to police comprehensively, as well as regional integration through the Southern African Development Community (SADC), which allows illicit goods to enter into South Africa from foreign seaports that have less oversight and enforcement. Poor legislation on goods-in-transit across Africa aggravates the problem, where illicit goods transiting from foreign Free Trade Zones (FTZs) enter through weak spots before being distributed across the continent.

Indeed, illicit trade is not a problem confined to South Africa. Every country in the region suffers. The nexus of illicit trade with other criminal activities creates a triple threat to the financing of development by crowding out legitimate economic activity, depriving governments across Africa of revenues for investment in vital public services and increasing the costs of achieving development goals by eroding the progress already made.

The situation in South Africa

South Africa is one of the largest and most diversified economies in Africa. The country has a well-established manufacturing base, is a major supplier of goods and services to the continent, has a large consumer base, serves as a regional transport hub, has a strong tourism and financial sector, as well as robust traditional sectors such as agriculture and mining. This diversification, however, means that South Africa also faces challenges from illicit trade on multiple fronts.

- Mining has historically been a major source of illicit activity in South Africa. A 2017 report by the Minerals Council South Africa (Minerals Council) estimates that the annual commercial value of illegal mining and illicit dealings in precious metals and diamonds is about R7 billion.¹ Reportedly, there are between 8,000 and 30,000 illegal

miners in South Africa, with examples of child labor and other human rights abuses not uncommon.²

- Counterfeiting has become a major criminal activity that presents unfair trade to almost every consumer sector in South Africa.³ This contributes to trapping employment in the informal sector, robs government of sales tax revenues and exposes consumers to poor quality products and health and safety risks.
- The growing phenomenon of substandard and fake medicines puts people's lives at risk and causes profound public health challenges. A WHO report shows Africa alone accounts for 42% of globally detected cases of substandard and fake medical products.⁴
- Illicit trade in fuel is a growing challenge in Southern Africa. Over the past decade, countries along the Maputo Corridor (South Africa, Swaziland and Mozambique) have become a regional hotspot in the illicit fuel trade, which is driven by organized criminal networks.⁵
- South Africa is a primary destination for trafficked persons in the Southern African region. It is also an origin and transit country for trafficking persons to Europe and North America. The Global Slavery Index estimates that there are 155,000 people living in modern slavery in South Africa, with most people trafficked for sexual exploitation and forced labor.⁶
- South Africa's position as the third most biodiverse country in the world has also made it a prime target for wildlife traffickers. Weak penalties and poor legal enforcement have made wildlife crime a lucrative and low-risk activity for criminal syndicates. For example, South Africa is heavily impacted by the rhino poaching crisis driven by the ongoing demand for rhino horn in Asia: 769 rhinos were illegally killed in the country during 2018, a decrease on 2017's 1028 but still more than two animals per day.⁷ The booming illegal trade in abalone—the world's most valuable shellfish—is fueling an ecological crisis in South Africa, costing the economy around R628 million annually.⁸
- The prevalence of illicit tobacco is extremely widespread, geographically and among different population groups. It is estimated that between 30 and 35% of the market was illicit in 2017.⁹
- South Africa loses some \$480 million annually to illicit alcohol – the largest fiscal loss out of the 7 African countries measured in Euromonitor's global study on illicit alcohol trade. Smuggling is the largest category of illicit alcohol, representing 28% of the illicit alcohol. The illicit alcohol activity is driven by the challenging economic environment, a large price variance (51%) between the price that consumers can purchase legal alcohol compared to what they pay for illicit alcohol, weak enforcement of regulations and taxation strategies that drive up the prices of legal alcohol.¹⁰

Sustainable development and illicit trade

The South African Government is strongly committed to the 2030 Agenda for Sustainable Development and has taken exemplary initiatives to propel the UN Sustainable Development Goals (SDG) agenda forward.¹¹ The National Development Plan (NDP): Vision 2030 – “Our future, make it work,” was adopted in 2012, and outlines the efforts South Africa is undertaking on issues like poverty, reduction of inequality and growing an inclusive economy by 2030 – much of which is mirrored in the SDG targets.¹²

However, the socio-economic impacts of illicit trade present significant deterrence to all 17 of the SDGs – holding back progress, increasing costs and pushing achievement of the goals further away. Across the board, illicit trade undermines achievement of the economic goals for poverty reduction, decent jobs and economic growth (SDGs 1, 2, 3, 4 & 8), and robs governments of taxable income that can be invested in public services (SDGs 9 & 17). When it generates revenue for organized criminal and terrorist groups, illicit trade undermines goals for peace and stability (SDG 16). Most forms of illicit trade plunder natural resources (SDGs 6, 14 & 15), abuse supply chains and ultimately expose consumers to fake and potentially harmful products (SDG 12).¹³

South Africa’s structural capability to address illicit trade

To better understand the regulatory environment and economic circumstances that enable illicit trade – and to help identify and formulate strategies to address the serious threats posed by illicit trade – the Transnational Alliance to Combat Illicit Trade (TRACIT) commissioned the Economist Intelligence Unit (EIU) to produce the *Global Illicit Trade Environment Index*. Along with more than 80 other countries, South Africa was evaluated on a number of policy, legal, regulatory, economic, trade, institutional and cultural indicators reflecting its structural capability to effectively protect against illicit trade.

Rank /84	G20 Economy	Score /100	Rank /84	G20 Economy (BRICS*)	Score /100
2	UK	85	40	Turkey	62
3	US	83	42	South Africa*	62
5	Australia	81	44	China*	61
10	Germany	79	Global Average		60
14	Japan	78	49	India*	59
15	Canada	77	50	Saudi Arabia	59
17	South Korea	75	51	Mexico	59
19	France	74	59	Brazil*	51
37	Italy	64	62	Russia*	49
38	Argentina	64	68	Indonesia	45

G20 Country Rank and Scores from the Global Illicit Trade Environment Index

South Africa’s scores are mixed, ranking 42nd out of 84 countries evaluated, with an overall score of 62.0 (out of 100). This is just above the global average (60.0), but still leaves South Africa in the bottom half of its peers in the Group of Twenty (G20). Notably, South Africa is ranked first among BRICS countries.

Amongst the four categories in the Index, South Africa registers its strongest performance in the area of government policy, where it ranks 37th of 84. However, the country struggles in almost all other categories including supply and demand, where perceptions of organized crime lower its overall performance.

As the sole African country in the G20 and BRICS economic groupings, South Africa has a natural leadership role in promoting the interests of Africa and the Global South. It is crucial South Africa gets the regulatory balance right and serves as a positive role model for the region. This is a matter of urgency and government efforts to fight illicit trade should be considered investments that pay tangible dividends to economic development and global security.

Regional integration: opportunities and challenges

Deeper regional integration under the African Continental Free Trade Agreement (AfCFTA) presents both opportunities and challenges to address illicit trade. In terms of numbers of participating countries, the AfCFTA will be the world's largest free trade area, bringing together all 55 member states of the African Union and covering a market of more than 1.2 billion people, and a combined gross domestic product (GDP) of more than US\$3.4 trillion.

AfCFTA has potential to boost trade and economic growth, reduce poverty, while strengthening integration among African countries. However, increases in legal trade can also be accompanied by increased trade in illegal goods.

A number of factors will complicate the regions ability to guard against illicit trade, including: political instability; vast natural resources; porous borders; limited coordinated border security; outdated legislation and weak enforcement mechanisms; limited lack of and national/regional policy and strategy on combating illicit trade; and unawareness by the consumers on the risks involved in the use and consumption of illicit goods. The success of the AfCFTA will also be hampered if nothing is done to address rampant and endemic corruption, particularly at the entry points, which is a key facilitator of illicit trade. Notably, AfCFTA does not have anti-corruption provisions to promote integrity in customs and trade practices.

Given that smuggling and fraud in excise goods is one of the more common and lucrative methods of illicit trade, it will be important that the AfCFTA properly review members' treatment of the excisable goods category, particularly if internal duties or domestically imposed levies have the same effect that customs or excise duty may have on increasing the price of goods, thus creating incentives for illicit actors.

Moreover, AfCFTA's impact on the trade in counterfeited and pirated goods in Africa remains uncertain. The AfCFTA Protocol on Intellectual Property Rights (IPR) will be negotiated during Phase II, with draft legal text submitted to the January 2021 Session of the AU Assembly for adoption.

Illicit trade outlook

The scope and depth of illicit trade presents challenges for South Africa's continued economic development. Nonetheless, there have been some positive developments in recent years suggesting progress in addressing some of the country's underlying vulnerabilities to illicit trade.

Notably, the South African Revenue Service (SARS) capacity to address illicit trade is gradually being built up again after many of its enforcement functions were greatly reduced during its reconstruction. Other positive developments include improved interagency cooperation between SARS and SAPS (South African Police Services). President Cyril Ramaphosa's pledge to root out corruption, if delivered upon, can also have a valuable impact as corruption is a key facilitator of illicit trade.

But any successful strategy against illicit trade will require concerted, sustained and joined up efforts between all the responsible government bodies, and must be supplemented with adequate budget allocations and clear objectives to ensure long term successful implementation of anti-illicit trade efforts. This includes investing in more equipment for SAPS and having a clear role for the Directorate of Priority Crime Investigation (DPCI) in its mandate to target organized crime, economic crime, corruption and other serious crimes.

Much of the legislation necessary to address illicit trade is in place. Consequently, the primary challenges will be enforcement and coordination between the various agencies – particularly between SARS and SAPS, where improved exchange of information, coordination of raids and activities could have significant impacts. Similarly, it will be important to define the roles and relationship of agencies responsible for health, security, and finance, such as the Department of Agriculture (DOA) and the South African Health Products Regulatory Authority (SAHPRA), and how these should coordinate with police and customs in the fight against illicit trade.

The Government must also equip SARS, the Reserve Bank, the Financial Intelligence Centre and other regulatory bodies with the resources they need to pursue criminal profits generated from illicit trade.

It is also important to strengthen cooperation with neighboring countries and address informal cross-border trade, smuggling, tax policies and subsidy alignments in the course of deliberations during forthcoming bilateral and multilateral trade negotiations. In particular, the role of FTZs as a platform for moving illicit goods across the continent needs to be addressed. A lack of oversight, indifferent customs controls, particularly on goods in transit, and light regulation in FTZs can contribute to trade in fake goods. Rights holders have reported that several FTZs in South Africa play an important role in facilitating IP infringements, including Coega, Richard Bay, East London, Saldanha Bay, Dube Port.¹⁴

Any long-term solution to the societal threat of illicit trade in tangible and intangible goods, both online and offline, will be dependent on sustained collaboration between the government and the private sector. Business can contribute by continuing to develop technical solutions that protect the integrity of supply chain. The South African government, however, needs to improve regulatory structures, set deterrent penalties, rationalize tax

policies, strengthen capacity for more effective enforcement and international cooperation, and educate consumers. The judiciary too has a role to play in applying and interpreting the law to make it hard for illicit traders to operate, e.g. by imposing deterrent penalties and dealing with cases expeditiously.

Combatting illicit trade is therefore necessarily linked with the need for a stable economic, political and social environment, that encourages investments and innovation in the local economy. Failure to address the structural problems that allow illicit trade to flourish will weaken growth prospects and hamper efforts to reduce unemployment and inequality. It could also trigger a decline of confidence and a pullback of foreign investments.

Policy recommendations to combat illicit trade

To encourage an effective policy response to illicit trade in South Africa, TRACIT has prepared a set of policy recommendations inspired by the thematic categories upon which the *Global Illicit Trade Environment Index* was constructed. These recommendations provide a “checklist” of fundamental measures that the government can implement to improve its ability to defend against illicit trade.

Priorities for South Africa

- **Strengthen cooperation with neighboring countries** to address informal cross-border trade, smuggling and alignment of tax and subsidy policies. Regional cooperation mechanisms including the African Union Continental Free Trade Agreement (AfCFTA) and the Southern African Development Community (SADC), along with projects sponsored by international organizations such the World Customs Organization (WCO), provide valuable methods for cross-border collaboration. These efforts can serve as a reference to further develop regional law enforcement capacities against illicit trade, with support from relevant partners, including Interpol/Afrapol.
- **Strengthen interagency and inter-departmental cooperation at the national level**, particularly by improving law enforcement capacities between SARS (South African Revenue Service) and SAPS (South African Police Services). Increased coordination across agencies responsible for health, economic, security, finance and customs is critical for addressing the multifaceted problem of illicit trade. For instance, South Africa’s Department of Agriculture (DOA) is an important stakeholder in combatting illicit alcohol, as the DOA issues import certificates, ensures compliance with product standards (the Liquor Products Act) and inspects alcohol imports. Similarly, the South African Health Products Regulatory Authority (SAHPRA) has an important role in combatting pharmaceutical crime by overseeing the regulation of health products and their use.
- **Appoint an Interagency Anti-Illicit Trade Coordinator**. A successful strategy against illicit trade will require concerted, sustained and joined up efforts between all the responsible government bodies. To oversee the interagency cooperation, South Africa should consider appointing an “Anti-Illicit Trade Coordinator” with high-level

authority within the national government. Objectives would include raising the profile on illicit trade, allocating necessary financial and personnel resources (such as ensuring that SARS is sufficiently resourced) and more aggressively enforcing anti-illicit trade regulations, especially in the areas of Intellectual Property Rights violations and untaxed and unregulated parallel (grey) market imports.

- **Include anti-illicit trade policies as part of national plans to achieve the SDGs.** As governments go about formulating policies and implementing programs to achieve the UN Sustainable Development Goals (SDG), a first order consideration should be to reduce the deterrent forces of illicit trade and plug the fiscal leakages associated with it. This approach has the immediate effect of adding resources and revenues back into the global economy, putting more policy tools back on the table, and reducing timelines, costs and other hurdles to achieving the goals. Consequently, a more level playing field, without the economic drags of illicit trade, can improve the efficiency and effectiveness of policies and programs governments are taking to stimulate growth, employment and investment to achieve the SDGs.
- **Strengthen IPR enforcement.** While key IPR legislation is in place, including those required by the WTO agreement on Trade-Related Aspects of Intellectual Property (TRIPS), the enforcement of these provisions, however, remains a concern. In addition, measures are needed for stricter penalties for counterfeiting; authorization for customs officials to perform inspections and make provisional seizures of counterfeits, including goods in transit/transshipment; plans to combat digital piracy; measures to govern the destruction of counterfeit/illicit goods; and, closer scrutiny of producers and importers of counterfeit goods.
- **Tackle pervasive corrupt practices** that continue to facilitate illicit trade, notably at the level of customs, law enforcement authorities and the judiciary. South Africa's 'war on corruption' introduces valuable measures that can reduce illicit trade, but as long as corruption persists within government agencies, any attempt to strengthen border policing and control will have limited effect. Increased automation in customs procedures can be effective in mitigating opportunities for corruption. Addressing corruption at all levels of government must be tackled head on if strategies to combat illicit trade are to have any chance for success.
- **Strengthen criminal penalties.** Raising standards for criminal penalties across the region should be a priority to prohibit illicit traders from exploiting countries and markets with the weakest penal regimes. In addition to court-imposed penalties and fines, consideration should be given to rescinding business licenses from retailers, manufacturers and distributors involved in illicit trade.
- **Tighten controls on money laundering.** Denying access to entities and mechanisms used to launder proceeds of crime—and thereby depriving criminals and their networks of related profits—is one of the most effective ways to deter illicit trade. This requires a holistic, comprehensive anti-money laundering regime including the ability to trace, freeze, seize and confiscate assets related to illicit financial flows. It

will also be important to equip SARS, the Reserve Bank, the Financial Intelligence Centre and other regulatory bodies with the resources they need to effectively pursue and combat illicit financial gains.

- **Rationalize tax policies and subsidies** to ensure that they do not incentivize illicit trade, smuggling, adulteration and theft. For example, excessive tax levels can reduce affordability of legitimate products and drive demand for illicit substitutes. Tax and subsidy policies need to account for various demand-related factors including overall consumption, price, income levels and the ensuing affordability of products. Addressing both the supply and demand side of illicit trade will require increased regional coordination and greater harmonization between South Africa and its neighbors in terms of tariffs, tax levels and subsidies. Priority attention should be given to examine and respond to changes in illicit trade flows resulting from expanded intra-African trade and reduced import duties under AfCFTA.
- **Take proactive measures to protect South Africa from illicit goods transiting through Free Trade Zones (FTZ).** Take strong and proactive measures to protect FTZ from illicit traders, including risk profiling of suspect shipments; ex-officio checks on goods stored and services conducted in zones; Customs supervision of the zone perimeter and entry and exit points; validate identity of zones operators and their clients; implement “Know Your Customer Policy” and “Due Diligence” measures.
- **Ensure track & trace, fiscal marking and other technology considerations are carefully scrutinized for proportionality between costs and expected benefits.** Proposals should also be deliberated in consultation with legitimate industry players, especially those most impacted by illicit trade, so as to benefit from their market knowledge, technical expertise, supply chain parameters, import/export challenges and understanding of the full costs of implementation. Moreover, industry is often most knowledgeable in determining best practices within a set of standards defined by the government. Governments should also conduct transparent public procurement processes to guard against corruption, ensure that program objectives are clear to consumers and to government agencies responsible for implementation.
- **Promote the creation of local private-public partnerships** to bring key industry and government stakeholders together to define strategies, share know-how, intelligence and data, improve risk assessment, strengthen border control and improve awareness. Private sector platforms, such as American Chamber of Commerce in South Africa (AMCHAM) and the Consumer Goods Council (CGCSA) can be valuable partners with government in these areas.
- **Improve public awareness and education on the threat of illicit trade.** Efforts to address illicit trade are hampered by a lack of public awareness on its dangers, which has led to a degree of social acceptability. To this end, local and regional educational campaigns and community-level awareness activities are essential to help shift public perception and understanding of the negative impacts of illicit trade.

Notes

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TO COMBAT ILLICIT TRADE**

TRACIT.ORG

Transnational Alliance to Combat Illicit Trade
One Penn Plaza, New York, NY | +1.917.815.2824
email: info@TRACIT.org | TRACIT.org