Illicit Trade in East Africa: What Do We Really Know?

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1. Introduction

The rapid advancement of transportation and communication technologies has accelerated the globalization of the world economy, and has led to increase productivity and economic growth, and a higher standard of living in some countries. However, globalization has brought many side-effects, such as illicit trade and fraudulent financial transactions and tax evasion through offshore financial centers and tax haven, and massive capital flight.

This paper documents the typology, forms, scope, magnitudes, driver and impact of illicit trade in East Africa, with particular reference to Uganda. In addition to this paper, two other papers are available for Tanzania and Kenya, based on the findings from those two countries.

Illicit trade refers to commercial transactions that are inconsistent with established national and international laws such as property rights, tax and customs law. It spans a spectrum of activities ranging from counterfeiting, to smuggling and under-declaration of goods at customs. These activities take the form of smuggling; counterfeiting of products; concealment of information – about the quantity, value and even the real name of the product. By definition, illicit trade is not included in official national statistics and the national income convention. According to staff at British American Tobacco (BAT) in Uganda, illicit products are goods whose duty has not been (fully) paid for in the market where it is being sold; these include smuggled products, duty free product beyond allowable limits and counterfeit products. And to officials of Uganda Revenue Authority (URA), illicit trade is an outright smuggling, including goods in excess of allowable limits/quantity (duty free limits). Hence, illicit products are goods that have not been declared to customs at all. In this context, under-declaration of goods at customs is not considered to be an act of smuggling but is generally treated as a customs offence. However, smuggling and under-declaration of goods and customs seizures are such a small percentage of overall trade that is illegal.

Illicit trade is a serious concern in Sub-Saharan Africa as it has negative impact on capital scarce economies. There is loss of tax revenues for funding public expenditure on health, education and public infrastructure. In East Africa the most serious form of illicit trade activity is counterfeiting, seen at a scale analogous to the Peggy and Alan's (1999) graphic description of "Walk down any main street in Shanghai, Paris or New York [Kampala, Kigali, Nairobi, Dar es Salaam, or Bujumbura] and you will see evidence of the counterfeit goods trade." The U.S. International Trade Commission (1984, p.vii) defines counterfeiting as "the unauthorized use of a registered trademark on a product that is identical or similar to the product for which the trademark is registered and used." Counterfeiting undermines the functioning of the property rights system. Not only do consumers suffer the direct harm associated with the purchase of low-quality copies purporting to be originals, but the infringement on the legitimate firms' rights alters the incentives to invest in their reputations.

Illicit trade can have distorting effect of prices, with attendant consequences on competitiveness, employment and loss of revenues (as goods are sold below normal market prices) – thus source of disincentive to investment. In fact, this underground economy, if significant in magnitude, can make implementation of monetary and fiscal policies difficult. According to World Health Organization (WHO), substandard, spurious, falsely labelled, falsified and counterfeit medical products are by their very nature difficult to detect. They are often designed to appear identical to the genuine product and may not cause an obvious adverse reaction, however they often will fail to properly treat the disease or condition for which they were intended.

2. The East Africa trade relations

This section provides an overview of the EAC trade relations - exploring the trade relationship among the three EAC member states before and after the formation of the EAC and the effect of the integration process to cross border trade. It also highlights the roles of cross border trade to the economies of the member states, including issues such as damping, counterfeit and other trade practices that affect cross border trade.

The performance of regional integration can be known from the share of intra-regional trade to total trade. Increasing shares are associated with success, declining shares with failure. In EAC, however, official (recorded) intra-regional trade appears substantially lower than what actually takes place in the form of trade between its neighbours – notwithstanding the progress in this regards after the formation of the EAC.

Since the mid-1990s through 2003, available records show improvement in export performance for EAC countries, stimulated by increased openness of their economies. However, measured in relation to country's GDP, all the countries experienced decline in the export-to-GDP ratio (Table A1) - which shows the volume of exports has not expanded in proportion with economic growth in the EAC countries. The declines in export-to-GDP ratios for all the EAC countries are associated with inward-oriented strategies still applied by these countries, among other factors.

However, both Kenya and Tanzania witnessed improvement in their trade balance in relation to GDP except Uganda; although Uganda's imports/GDP (same as Tanzania) declined during this period. The difference is partly counted for by the differences in the real growth in GDP (which declined for the case of Uganda's and increased for the case of Tanzania's). Both countries have also witnessed significant improvement in their current account balance on account of some increases in their exports.

Increases in shares of bilateral trade (in total trade) between 1990 and 2003 (Table A1) are further indications of improved trade relations and increased trade flows between the EAC member states – though still unsatisfactory by the criteria mentioned above. Kenya is the net exporter in the EAC market and Tanzania is the net importer (Table 1).

Table 1 . EAC Countries: Bilateral trade flows (Averages, 1995-2000, and outcomes for 2002)

	Exports in % of country 1's total exports			Imports in % of country 2's total imports		
	Country 2			Country 2		
Country 1	Kenya	Tanzania	Uganda	Kenya	Tanzania	Uganda
Uganda	0.7/0.4	1.0/1.8	x	0.1/0.1	0.3/0.4	x
Tanzania	4.3/6.0	x	2.1/3.9	0.9/1.4	x	1.7/3.3
Kenya	x	8.5/4.4	16.6/18.2	x	10.1/6.8	38.2/45.6

Source: IMF/IFS; and Direction of Trade (DOT), 2003

While official statistics show 'unsatisfactory' performance of intra-regional trade to date, all agree that a substantial proportion of intra-regional trade in food items and merchandise takes place across the EAC borders that goes unrecorded. If regulated, this trade would form substantial intra-regional trade and a basis for economic integration in the region.

2.2 The structure and patterns of EAC trade

Overall, the EAC members have a similar trade pattern, with commodity exports focused on extra-EAC markets, especially the EU. An average of 3 to 10 percent of the exports of the EAC members have gone to African markets outside the EAC, and 31 to 82 percent to markets outside Africa. An average of 9 to 14 percent of the imports of members has been received from Africa outside EAC, while imports from the rest of the world ranged from 50 to 80 percent.

Detailed results of intra – and extra – EAC trade are presented in Tables 2 and 3 and Figures 1–3. Table 2 shows overall improvements in intra-EAC exports performance since the 2005, most likely attributable to increased openness of the EAC economies. Across countries, Table 2 indicates that in 2000–2004, Uganda accounted for 5 percent of intra-EAC exports, and a huge 57.5 percent of intra-EAC imports. In 2005–2008, Uganda's share of intra-EAC export rose substantially to 15.3 percent, while its share of intra-EAC imports declined to 44.4 percent. This means that Uganda's trade performance improved since the launch of the EAC Customs Union in 2005. The same applies to Tanzania and Burundi.

For the case of Tanzania, its share of total intra-EAC exports rose from 8.56 percent in 2004–2004 (i.e. before the Customs Union) to 14 percent in 2005–2008 (after the Customs Union). Its share of total intra-EAC imports declined from 19.25 percent before the Customs Union to 14.8 percent after the Customs Union.

Table 2. Intra-EAC trade flows (percent)

IMPORTING COUNTRIES	EXPORTING COUNTRIES					TOTAL
	Burundi	Kenya	Rwanda	Tanzania	Uganda	
	Trade flows 2000 - 2004 averages					
Burundi		2.70	0.12	2.71	0.71	6.25
Kenya	0.01		0.02	2.49	1.58	4.10
Rwanda	0.12	9.25		1.67	1.86	12.91
Tanzania	0.02	18.17	0.04		1.02	19.25
Uganda	0.01	55.69	0.12	1.68		59.49
Total	**0.15**	**85.81**	**0.31**	**8.56**	**5.18**	**100.00**
	Trade flows 2005 - 2008 averages					
Burundi		2.67	0.16	0.97	2.17	5.97
Kenya	0.18		0.13	6.67	4.24	11.23
Rwanda	0.46	11.40		3.35	8.33	23.53
Tanzania	0.01	14.29	0.01		0.53	14.83
Uganda	0.04	41.18	0.12	3.10		44.44
Total	**0.69**	**69.54**	**0.42**	**14.09**	**15.26**	**100.00**

Source: COMTRADE

Burundi saw a slight decline in its share of intra-EAC imports from 6.3 percent in 2000–2004 to 5.97 percent in 2005 – 2008 and a rise in its share of total intra-EAC exports from 0.15 percent in 2000–2004 to 0.7 percent in 2005–2008. Rwanda and Kenya's export-import status worsened in 2005–2008. However, Kenya dominates intra-EAC trade, with exports and imports share of 86 percent and 4 percent, respectively in 2000–2004 and intra-EAC exports and imports share of 70 percent and 11 percent, respectively in 2005–2008. Kenya's dominance in intra-EAC trade is reflected in its huge trade surplus with all the EAC countries.

Moreover, total imports from EAC, SADC and rest of COMESA to the EAC Partner States, collectively accounted for only 18 percent of total imports in the Partner States in 2005 – 2008, a slight fall from 21 percent in 2000 – 2004 (Table 3).

Table 3. Imports from EAC, rest of COMESA and SADC as a share of total imports

	Percentage of total imports from				Percentage of total Imports from			
	EAC	Rest of COMESA	SADC	TOTAL	EAC	Rest of COMESA	SADC	TOTAL
	(2000 – 2004 average)				*(2005 - 2008 average)*			
Burundi	25.8	6.3	8.6	40.7	19.3	4.3	5.4	29.1
Kenya	1.0	3.3	10.3	14.4	1.5	3.1	7.9	12.5
Rwanda	29.4	2.2	5.9	37.5	38.7	3.4	6.6	48.7
Tanzania	5.5	1.8	12.9	20.2	3.8	1.8	12.8	18.4
Uganda	27.0	1.6	8.8	37.4	16.3	1.9	7.5	25.6
Total	**8.0**	**2.6**	**10.6**	**21.2**	**6.6**	**2.6**	**9.0**	**18.2**

Source: COMTRADE

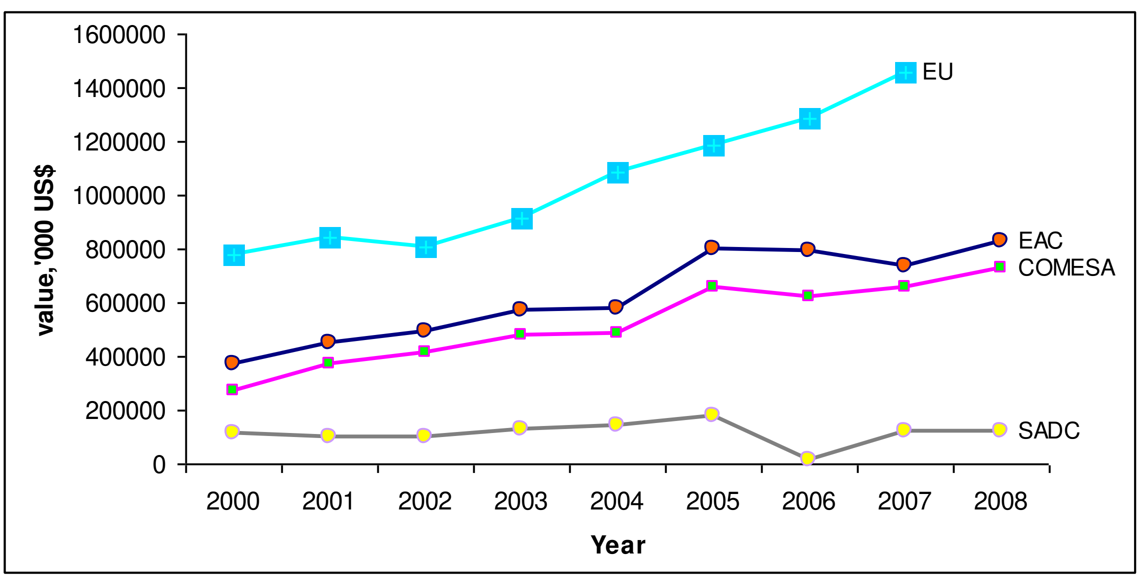
Note: *Rest of COMESA* excludes COMESA Member States that belong to EAC (i.e. Burundi, Kenya, Rwanda and Uganda). SADC excludes imports from Tanzania

2.2.2 Kenya's Trade with the EAC

We saw in Table 2 that Kenya dominates intra-EAC trade, with its exports accounting for as high as 86 percent of the total intra–EAC exports. Yet, its imports from EAC countries accounts for only 4 percent of the total intra-EAC imports. As a result, Kenya runs a huge trade surplus with all the EAC countries. Kenya has a stronger manufacturing base than any of its EAC partners, resulting in a higher capacity to export to the region.

Figure 1 shows that the European Union is Kenya's leading destination market and that Kenya's exports to the EAC and COMESA have been increasing but at a relatively slower pace than its exports to the EU especially after 2005.

Figure 1. Kenya's exports to selected regional destinations



Source: Based on COMTRADE database

Kenya's exports to EAC as a percent of its total exports declined from 23.4 percent in 2005 to 16.6 percent in 2008. Kenyan exports to COMESA followed similar trends. The share of Kenyan exports to the EU increased slightly from 34.7 percent in 2005 to 35.6 in 2008 (it was 43.6 percent in 1998, and 57.7 percent in 2004).

In the EAC, Kenya's merchandise exports are primarily oriented towards Uganda (followed by Tanzania, Rwanda and Burundi). Its major extra-EAC destinations are the United Kingdom, the United States, and the Netherlands. Petroleum products dominate Kenya's exports to the EAC, constituting an average of 39 percent of total exports to Uganda between 1998 and 2007, 18 percent of total exports to Tanzania, 52 percent to Rwanda, and 46 percent to Burundi during the same period. Other major Kenyan exports to the region include construction materials, particularly, cement and lime, as well as plastics articles, paper and paperboard, iron and steel products, medicaments, soap, cleansing and polishing products, vegetable fats and oils, footwear, and textile materials.

Trends in Kenya's merchandise imports from 2001 to 2008, presented in Figure 2 put European Union on top of all the regions that import into Kenya. One year after signing of the EPA Interim Agreement, imports from the EU increased dramatically. Under this agreement, Kenya with its EAC partners has agreed to gradually liberalise 80 percent of its trade for imports from EU covering mainly capital goods, raw material and intermediate / industrial goods over a period of 15 years (attaining full liberalization over a period of 25 years). Large proportion of Kenya's imports comprise capital goods and intermediate/industrial goods, and manufactured products such as machinery, transportation equipment, motor vehicles, and petroleum products.

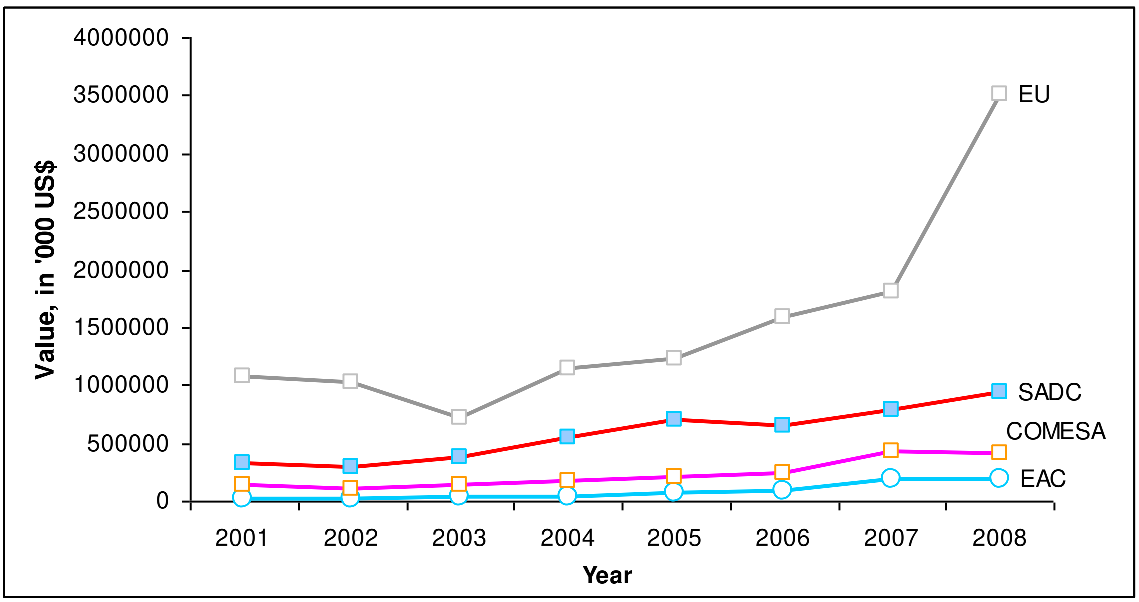
Besides EU, a large bulk of imports comes from the United Arab Emirates, India, China, and Saudi Arabia. In the neighbourhood, clearly, the EAC region is not a significant source of Kenya's imports (Figure 6). Imports from EAC accounted for 1.4 percent of the total imports in 2008.

From an insignificant share of 0.35 percent of total imports in 1998 and 2001, imports from EAC countries have grown to 1.4 percent in 2008. In value terms, Kenya's imports from EAC partners grew from US$ 13.874 million in 2001 to US$ 182.4 million in 2008. Imports from COMESA countries increased from 1.28 percent of total imports in 1998 to

3.5 percent in 2001, and 3.2 percent in 2008. Most of the imports originating from EAC actually come from Tanzania, followed by Uganda, with minute amounts from Rwanda and Burundi (accounting for only about 0.03 to 0.04 percent of total Kenyan imports respectively).

Kenya's major imports from the EAC partners include textile materials, wood, maize, paper and paperboard, cotton, cereals, medicines, vegetables, and unprocessed hides and skins. The imports from Tanzania and Uganda are mainly unprocessed agricultural products.

Figure 2. Trends in Kenya imports from selected regions



Source: Based on COMTRADE database

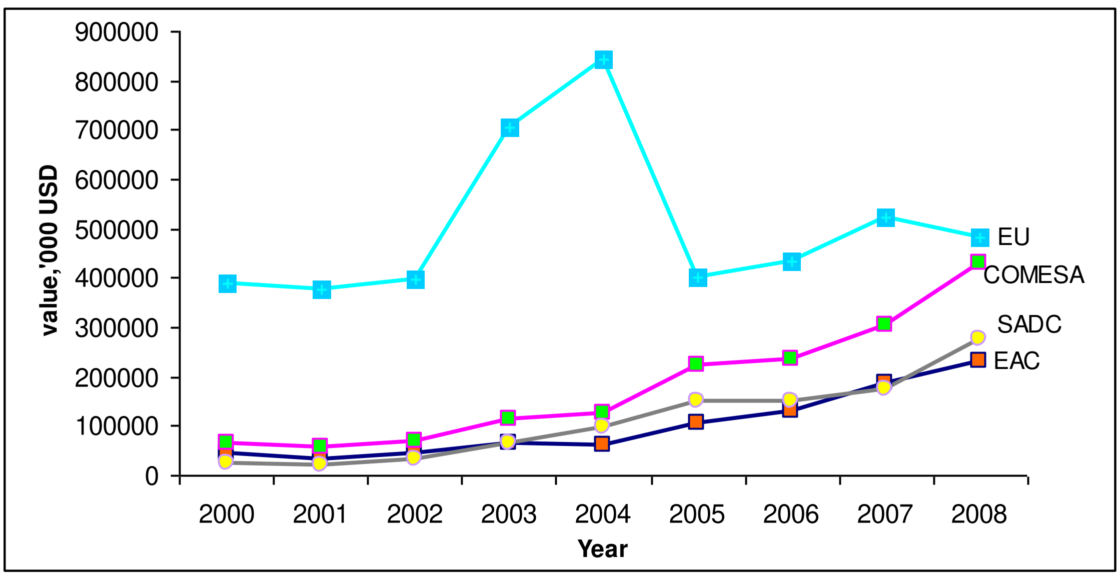
2.2.3 Tanzania's trade with the EAC

Tanzania is a member of several regional initiatives, including the Southern Africa Development Community (SADC), East African Community (EAC), Indian Ocean Rims-Association for Regional Cooperation (IOR-ARC), and Economic Partnership

Agreement with the EU.[1] In parallel, Tanzania has signed 11 bilateral trade agreements. None of these serves Tanzania's exports interest better than the agreement with the EU.

The EU is Tanzania's main destination market (Figure 3). In recent years, exports to EU have dropped to the levels of 2000–2002, partly due to fall in fish exports, but EU still remains the most important destination for goods from Tanzania.[2] Since the Lomé Convention/Cotonou (now EPA era), most of Tanzanian exports to the EU are exempt from import duties. In addition, Tanzania's goods enjoy non-reciprocal preferential access to the EU markets under Everything-But-Arm (EBA) initiative extended to LDCs in the ACP. Tanzania's other main trading partners are United Arab Emirate, Switzerland, Japan, India, Kenya, South Africa and Malawi.

Figure 3. Tanzania's exports trends in selected regional markets



Source: Based on COMTRADE database

Tanzania exports primarily agricultural products — mainly cotton, coffee, tobacco, tea, cashew nuts, and cloves. South Africa is Tanzania's largest trading partner in SADC, and the two countries have signed a memorandum of understanding on trade and industry programmes and a general agreement on economic, scientific, technical and cultural

[1] On November 23, 2007, Tanzania, along with other EAC Partners States, initiated an interim Economic Partnership Agreement (EPA) with the European Union; and is currently negotiating a full EPA.

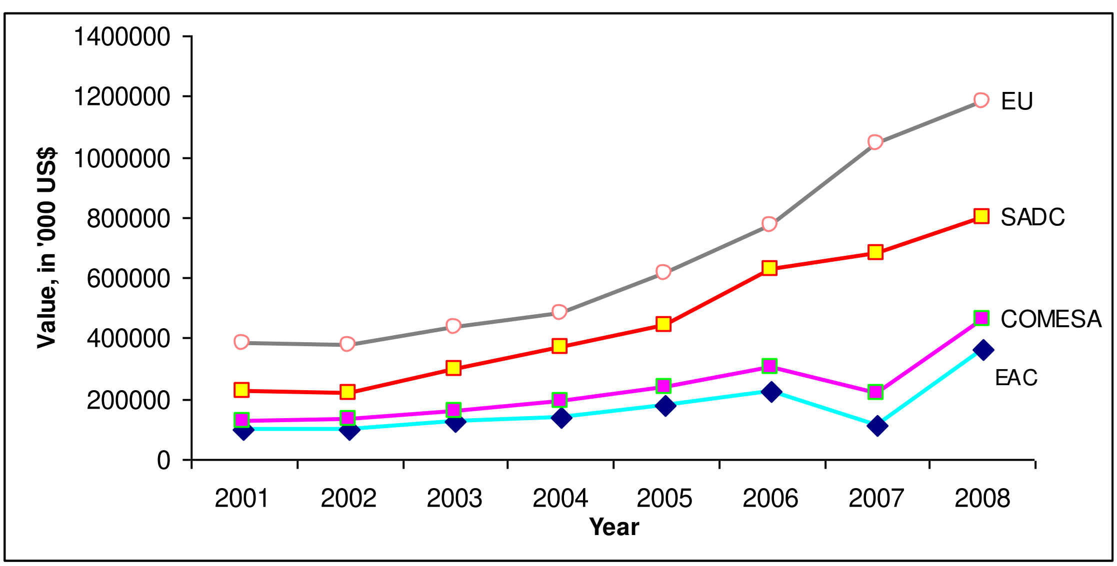
[2] Tanzania has a long history of exporting fish to the EU market. In 2005, fish export to the EU dropped by about a third the value of the previous years (COMTRADE) and since then hasn't picked up well. Some have attributed this to stiffening competition from Vietnam that also exports fish to EU market and declining number of fish (Nile perch) catch in Lake Victoria.

cooperation (as we saw in Table 6). In 2008, Tanzania's exports to South Africa amounted to US$73.1 million, from US$3.5 million in 2000. About a third (26.5 percent) of Tanzania's exports in 2008 went to South Africa, and about 10 percent of Tanzania's imports came from South Africa in the same year.

Though it stopped being a member of COMESA, Tanzania still exports more to COMESA than it does to SADC, where it currently belongs. In Figure 7, we see that Tanzania's exports to COMESA have grown faster than its exports to EAC or SADC in recent years — hence strong economic links with COMESA countries. While exports to SADC as a share of total exports increase by 0.6 percentage point between 2005 and 2008 (i.e. from 9% in 2005 to 9.6% in 2008), the shares of exports to COMESA increased by about 2 percentage point during the same period (from 13.3% to 15%). Exports to EAC as share of total exports increase from 6.3 percent in 2005 to 8 percent in 2008, which could have been attributed to reduction/elimination of intra-EAC tariffs upon introduction of the EAC Customs Union.

On the imports front, the EU is the largest importer into Tanzania (Figure 4). EU imports into Tanzania amounted to US$1.04 billion in 2007 (accounting for 17.6 percent of Tanzania's total imports that year). Other major sources of Tanzania's imports are South Africa (SADC), and United Arab Emirates.

Figure 4. Tanzania's import trends from selected regions, 2001–2008



Source: Based on COMTRADE database

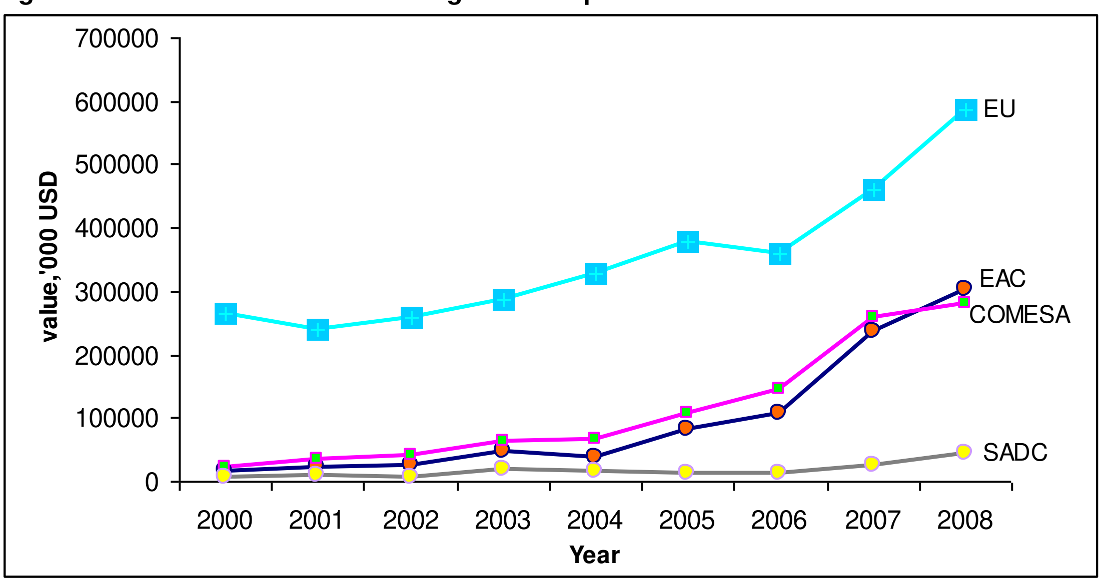
The EAC region is not a very significant source of Tanzania's imports, accounting for about 2 percent of the total imports in 2007.

2.2.4 Uganda's trade with the EAC

Uganda is a member of the EAC, COMESA, and the Intergovernmental Authority on Development (IGAD). Uganda initialed an interim Economic Partnership Agreement (EPA) with the European Union in 2007; and benefits from the EU's "Everything But Arms" initiative for the least developed countries (LDCs). Uganda also benefits from trade preferences under the Generalized System of Preferences (GSP) schemes with a number of developed countries, espcially the African Growth and Opportunity Act (AGOA) of the United States. However, the preferential trade agreements with the EU will continue to be the most important one for Uganda, for many more years to come.

As Figure 9 shows, the EU is Uganda's largest destination market, accounting for over 40 percent of Uganda's merchandise exports. Although between 2005 and 2008, Uganda's exports to EU experienced a 10 percentage point decline in total merchandise exports (i.e. from 37 percent of total exports in 2005 to 26.9 percent in 2008), in value terms, Uganda's exports to the EU rose by 55 percent during the same period.

Figure 5. Selected destinations of Uganda's exports



Source: Based on COMTRADE database

At the regional level, the EAC and COMESA countries are Uganda's most important trading partners. Exports to the EAC market rose dramatically between 2006 and 2008. This can be attributed to the launching of the EAC Customs Union. The EAC now accounts for 20 percent Uganda's merchandise exports.

Outside EAC and COMESA, SADC countries are not very significant importers of Uganda's goods. COMESA (excluding EAC countries) accounts for about 6 percent of Uganda's merchandise exports in 2008, while exports to SADC-only countries, that is, countries in the region that are neither members of COMESA nor EAC, such as South Africa and Democratic Republic of Congo, amounted to 2.6 percent of total exports in 2008.

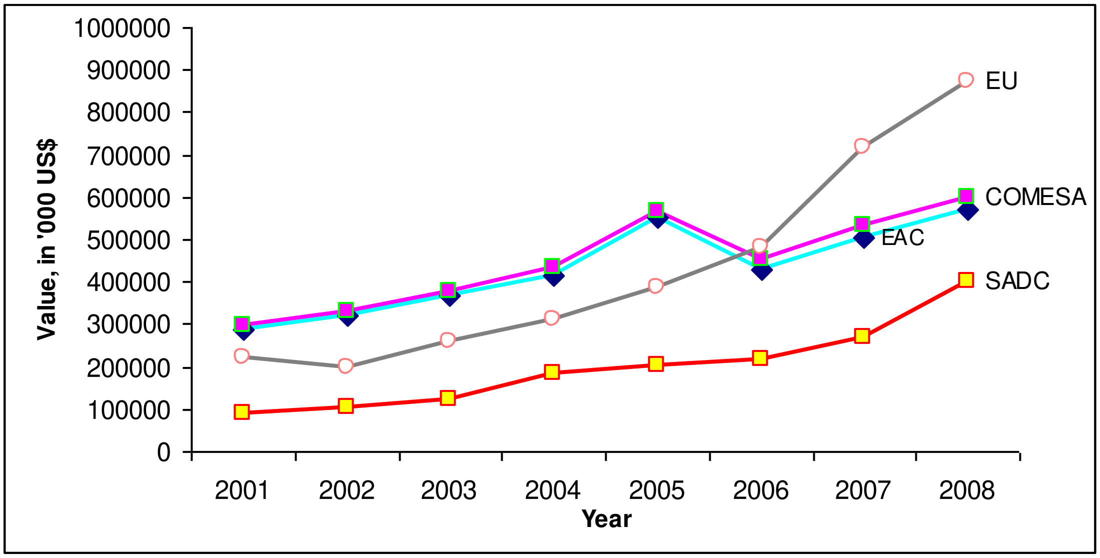
From trade flows, while Uganda's trade link with COMESA is strong, Uganda's major trading partners in COMESA, outside EAC borders (i.e. countries in COMESA, but not members of EAC) are very few in numbers. The only noticeable one is Sudan, which accounted for about 1 percent of Uganda's total exports in 2008. However, there is evidence of large volume of trade especially, agricultural food communities from Uganda to Sudan that go unrecorded. If such trade is taken into account, Sudan could account for over 2 percent of Uganda's exports in 2008, and perhaps much higher in 2009 (Uganda Bureau of Statistics and Bank of Uganda, 2008).[3]

Export to COMESA and SADC as share of total exports increased by 2.2 percentage points (from 10.6% to 12.8%) and 0.7 percentage point (from 1.3% to 2%) respectively, leaving room for further expansion in exports to EAC. Uganda's exports to EAC as a share of total imports rose from 8 percent in 2005 to 13.8 percent in 2008 (5.8 percentage point rise). This rise was also met my fall in share of exports to Asia from 7.5 percent in 2005 to slightly below 6 percent in 2008. This means that with the coming of the EAC Customs Union, Uganda is increasingly exporting more and more merchandise to the EAC than to any single regional market in Africa. Agricultural products constitute more than half of Uganda's merchandise exports (especially coffee, tobacco, cotton, and cut flowers).

[3] Uganda Bureau of Statistics and Bank of Uganda conducted informal cross-border trade survey in 2007 which established that Uganda's informal agricultural exports to Sudan amounted to US$ 57.1 million that year, equivalent to about 3 percent Uganda's total exports the same year.

Since 2006, the EU has dominated Uganda's imports, overtaking imports from EAC and COMESA (Figure 6). Imports from EU as a share of total imports increased from 18.8 percent in 2005 to 19.3 percent in 2008.

Figure 6. Trends in Ugandan imports from selected regions



Source: Based on COMTRADE database

Uganda's imports from EAC as share of total imports declined substantially from 26.8 percent in 2005 to 12.6 percent in 2008, also reflected in a drop in share of imports originating from COMESA (from 27 percent to 13 percent). Share of imports from SADC dropped slightly by 1 percentage point (i.e. 9.8 percent in 2005 to 8.8 percent in 2008). In recent years, SADC imports into Uganda have grown faster than Uganda's imports from EAC or COMESA. South Africa is Uganda's main trading partner in SADC. The two countries signed a bilateral trade agreement in 2002 (as we saw in previous chapter, Table 2).

2.2.5 Burundi's trade with the EAC

Burundi is a member of the Common Market for Eastern and Southern Africa (COMESA), the East African Community (since July 2007), the Economic Community for Great Lakes Countries (CEPGL)[4], and the Economic Community of Central African States (ECCAS). On November 23, 2007, Burundi, together with the other EAC Partners

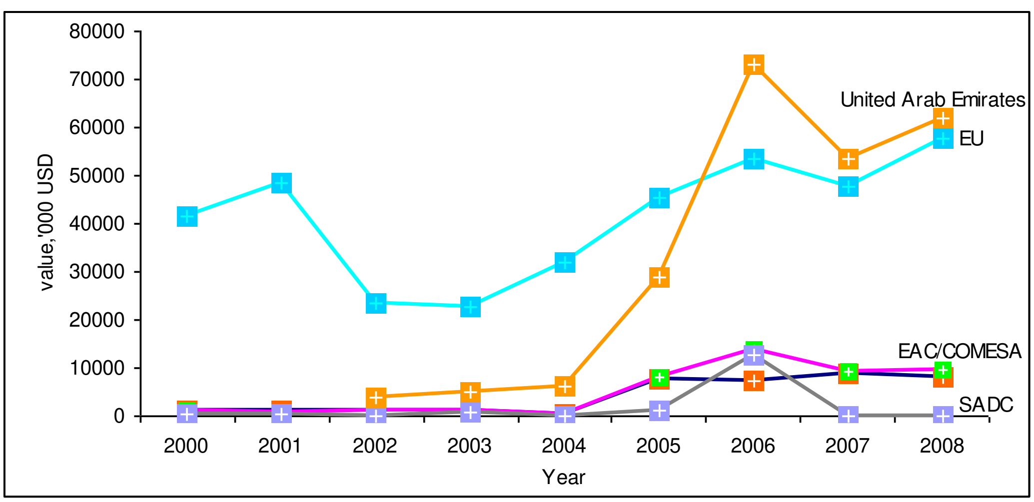
[4] Other members of CEPGL are Rwanda and the Democratic Republic of Congo

States, initialed an interim Economic Partnership Agreement (EPA) with the European Union; and is currently negotiating a comprehensive EPA. At the same time, Burundi enjoys preferential market access under the EU's "Everything but Arms" initiative for least developed countries. In addition, Burundi's exports still enjoy preferential access to the U.S. market under the African Growth and Opportunity Act (AGOA).

However, the utilization rate of US and EU preferences has been rather modest and their value negligible, compared to other countries in the region. It is constrained by limited supply capacity – being a country emerging from decades of conflict. Nevertheless, the European Union is still one of Burundi's most important destination market (Figure 7), accounting for 40.6 percent of Burundi's exports in 2008. In recent years, United Arab Emirates has been the most significant importer of goods from Burundi, accounting for 43 percent of Burundi's total exports in 2008.

Until recently, the EAC as a region has not been an important destination for goods from Burundi. In 2004 for example, only 0.5 percent of Burundi's exports went to EAC, but in 2008 this ratio rose to 5.8 percent. The EAC significance is being felt after Burundi joined the Community in 2007 with increase in exports to EAC, comprising mainly beer, cigarettes, sugar, and cotton fabric; and raw hides, ornamental fish, live plants, fruits, flour, and vegetables.

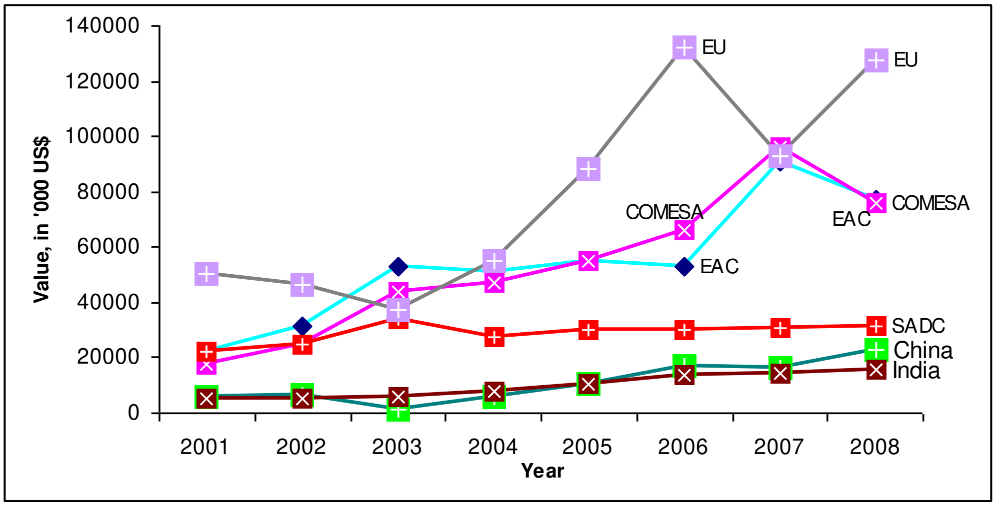
Figure 7. Selected destinations of Burundi's merchandise exports



Source: COMTRADE database
Notes: Burundi relies primarily on coffee and tea for exports.

With regards to imports, the EU is the largest importer into Burundi (Figure 8). After 2006 imports from the EAC rose sharply (corresponding to the period of joining the EAC) but only faced a slight decline in 2008.

Figure 8. Trends in imports into Burundi from selected trade partners



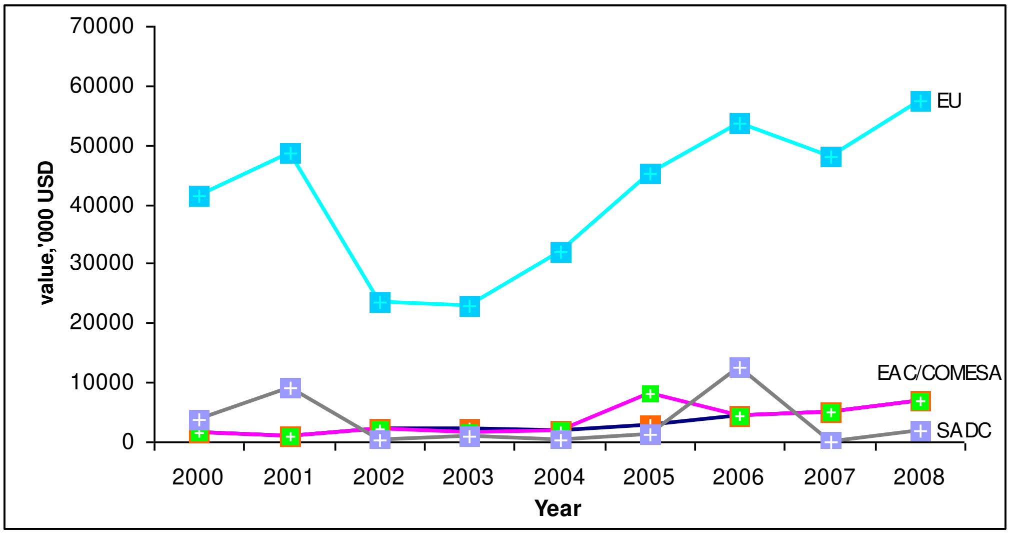
Source: COMTRADE database

Petroleum products (fuels), rolling stock and machinery, inputs (construction materials, metallurgical products, agricultural inputs), pharmaceutical products, and foodstuffs dominate Burundi's merchandise imports.

2.2.6 Rwanda's trade with the EAC

Since 2004, Rwanda has implemented a 100 percent tariff reduction on imports from the Common Market for Eastern and Southern Africa (COMESA), of which it is a member. This measure is now superseded by its joining the East African Community (EAC) in 2007 and the gradual adoption of EAC Common External Tariff (CET) for trade with the rest of the world. However, Rwanda commodity exports remain largely focused on extra-EAC markets, especially the EU (Figure 9). Rwanda enjoys a preferential market access to the EU under the EU's "Everything But Arms" initiative for the LDCs.

Figure 9. Selected destinations of Rwanda's merchandise exports



Source of data: COMTRADE
Notes: Rwanda's exports of primary commodities are largely dominated in value terms by coffee and tea.

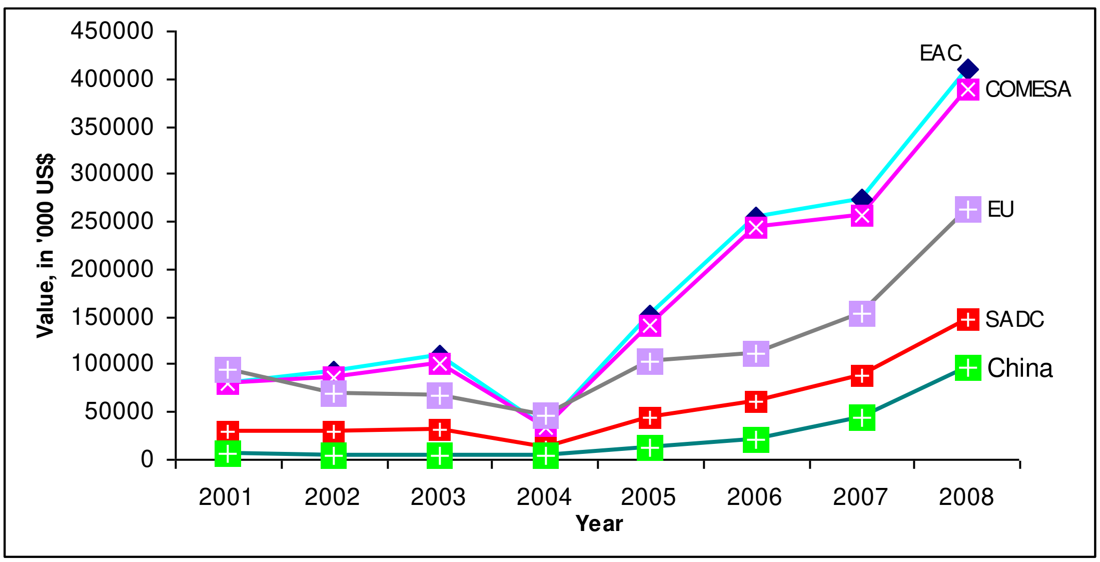
In 2008, Rwandan merchandise exports to the EU accounted for 23 percent of Rwanda's total exports that year, while its exports to EAC accounted for only 2.7 percent. However, when trade volumes are considered, Rwanda exports to EAC markets actually grew faster, compared to its exports elsewhere (by about 50 percent between 2006 and 2008 compared to the 7 percent exports growth gained in the EU markets during the same period). Though it is too early to judge (based on current results), the results nevertheless shows that Rwanda is increasingly making use of the EAC markets since it joined the Community in 2007 – which could see its share of intra-EAC exports increase substantially in the next two to five years.

In addition to being a member of COMESA and the EAC, Rwanda is also a member of the Economic Community of Central African States (ECCAS) and the Economic Community of the Countries of the Great Lakes (CEPGL). Its application is also pending to join the SADC. Rwand's exports to SADC market has more than tripled between 2005 and 2008 although its share of total exports still appears insignificant. Although Rwanda has been a beneficiary of the trade preferences under the Generalized System of Preferences (GSP) schemes, particulary the U.S' African Growth and Opportunity Act (AGOA) - since 2000, some sources have indicated that Rwanda has not been able to untilise it, and its exports to U.S. has remained insignificant (1 percent of its exports in 2008).

When it comes to imports, Rwanda shows a strong reliance on imports from EAC (Figure 10). In Table 4, we saw that the EAC accounted for 39 percent of Rwand's total imports in 2005 – 2008, compared with Kenya's (1.5%) and Tanzania's (3.8%) share of total imports in 2005–2008 coming from EAC countries. In Table 3, we also saw that most of Rwanda's imports are from Kenya (11.4% of total intra-EAC imports in 2005–2008), followed by Uganda (8.3%), Tanzania (3.4%), and Burundi (0.5%), while its largest regional destination market is Burundi, followed by Kenya, and Uganda.

The EU is still a signficant importer into Rwanda (surpassing the SADC region and China, for example), and its imports into Rwanda grown quite fast in recent years (Figure 10) - signifying an increasing economic ties Rwanda. In November 2007, Rwanda initialed an interim Economic Partnership Agreement (EPA) with the EU.

Figure 10. Trends in Rwandan imports from selected regions



Source of data: COMTRADE

3. Regional growth of illicit trade

3.1 Introduction

The global trade in counterfeit goods is growing at an alarming rate. Africa is increasingly being targeted as a destination for counterfeit goods according to the World Customs Organization's Counterfeiting and Piracy Unit.

Cross-border trade activities, depending on the way they conducted can be both beneficial and harmful to the economy. In many instances, they help to create employment (formal and informal) especially for the local population close to the borders areas. The increased presence of traders and movement of people and goods across-border has certainly created more demand for goods and services hence employment e.g. in hotels, lodges and restaurants, shops, money changing, etc. In a formal or law abiding situation (where official procedures are followed by operators) the economy gains through tax revenue. However, where illegal or illicit means are used cross-border trade can be detrimental to the economy.

3.2 Counterfeit trade

Dumping and counterfeits

The practice of offering products for sale abroad at prices lower than the nominal value (defined as the price charged by a firm in the home market) is known as dumping. Together with the provision of subsidies to domestic enterprises, dumping is considered to be an unfair trade practice, against which the WTO provides rules and remedies. Dumping is a serious problem in Uganda. Most dumped products are smuggled into the country through customs but declared as agricultural inputs, used clothes or any products that attract minimum taxes.

Dealings in counterfeit products are also very rampart in Uganda. A recent article in Uganda's local newspaper defines counterfeiting as "unauthorised use, on the same goods, of a trademark identical to a registered mark with the purpose of deceiving or defrauding unsuspecting buyers. It is also an imitation to pass the faked goods for an original or genuine (product)". Experiences of manufacturing firms in Kampala clearly show that the magnitude of the problem in Uganda cannot be underestimated.

In 2004, about 50 tonnes of counterfeit goods were impounded by the Uganda National Bureau of Standards (UNBS) because they failed to meet the minimum quality standards. These included foodstuffs, soft drinks, salt, cosmetics, clothes, building materials such as cement, and factory goods. According to officials at UNBS, counterfeit goods worth over Shs 600 million were either denied market in Uganda (returned) or destroyed by inspection units at various border points. Other affected products are pens (e.g. the case between Mulwana and Picfare), tiger head battery, textiles, and foam products (e.g. the case between Euro foam and Vita Foam), tooth brush (case between Mulwana ship toothbrush and another firm that produced the same from a German factory). In Uganda, it is believed that all the tiger head batteries being sold are counterfeit batteries. These are smuggled into the country (mainly from Taiwan through the Kenyan border) – though their importation was banned by government.

Cigarettes were also mentioned among the counterfeit products - describing the problem as perhaps more serious than batteries. Those interviewed in (in government and private sector) suspected tobacco agents in counterfeit deals. They seem to be equating counterfeiting to the similarities in the cigarettes package, colour on the stick, and aroma with those produced by BAT Uganda. They may also be thinking this way because of the past newspaper articles e.g. the legal battles between some tobacco companies. Certain sources claimed that Supermatch cigarettes in Ugandan market with 'made in Uganda' label could be coming from Kenya, only packed in Uganda. It is perceived that the packaging materials may be made in Kenya but the cigarettes are packed in Uganda.

According to Uganda Manufacturers Association, URA, BAT Uganda, and Uganda business operators, counterfeit activities are very difficult to eliminate. It is difficult because it is a global phenomenon; and it is a complicated issue in the legal sense. Besides, it is expensive to register everything about a product – colour and appearance including special features and designs on packaging materials, aroma, etc. The law says that it is upon the company whose trademark is infringed on to forward their complaints to the Registrar of Trademarks for appropriate action.

Moreover, Uganda, like many countries in the developing world lacks advanced equipment to detect counterfeited products and expertise to track down and stop counterfeiting schemes. The main sources of counterfeit products are Thailand, India, Korea, Taiwan, and most of the counterfeit products are absorbed in Africa markets because of inability to detect them.

Often, counterfeit products are discovered when they are already in shops. According to the opinion we gathered (and we think correctly so), efforts should be directed at strengthening the machinery for inspection of goods that enter the country. In Uganda, it is only the Bureau of Standards and Uganda Revenue Authority (Customs) that are legally mandated to inspect goods entering the country. But because of sophistication associated with differentiating between goods that are counterfeit and goods that are genuine, most counterfeited goods pass undetected.

Uganda Bureau of Standards uses mainly the quality criteria, but as one informer said, not all counterfeit products are inferior in quality; some are even of higher quality. The counterfeited tooth brush produced in Germany (purported to be products from Mulwana's factory in industrial area) which happened to be of superior quality is a good example – where quality criteria may not work all the time. In other words, quality criteria alone are inadequate.

Those talked to think that the customs is the weakest point in the link supposed to inspect the goods. They said that individuals at the customs who are supposed to play the biggest role in preventing counterfeits goods entering the country seem to succumb to bribes.

Otherwise, counterfeit practices are very damaging to the economy in terms of loss tax revenue. It distorts prices, and destabilises the market by substituting for products produced domestically and giving wrong signals to producers. A fall in domestic production can lead to loss of jobs and shortage in supplies in the long run and of course rising prices – absorbed by consumers. Quality of products is frequently compromised in counterfeit practices as they tend to employ ad hoc means or cheap systems on goods, often produced in a hurry, 'undercover'.

4 The supply of illicit trade: Countries of origin

In Uganda the most serious form of illicit trade activities is smuggling. A large part of this trade comprises day-to-day transactions between traders living in locations on either side of the national borders. Most commodities crossing borders are absorbed by the local markets along the border – usually delivered on bicycles and heads, and hands in ‘caveras’ (polythane bags) normally in small quantities. Identifying cross-border illicit traders of this nature is not so straightforward because they could easily be mistaken for goods for own personal use or gift from relatives. Besides, the region’s borders are inherited from a colonial era that split entire communities who shared historical trading, family and cultural links, which makes these small-scale types of transactions to attract less attention.

However, greater part of smuggling takes place in a well organised manner involving, in some cases, individuals working in a network. As such it is increasingly becoming more sophisticated. These are mainly associated with large transactions. Even small smugglers are upgrading slowly into handling huge consignments especially where they act as agents and commodity assemblers for big traders, who use them to avoid delays and costs associated with passing through the official border posts or customs. The opinion obtained in Uganda suggests that since small traders operate without many cost hassles associated with customs clearance, it is generally convenient and less expensive for traders to buy from them than to pass with large consignments through the customs.

Transactions involving agricultural commodities are aided by brokers found on both sides of the border. These individuals generally have the most current information and networks on commodity supplies and prices across the borders. For a more timely and successful transaction traders often use them (brokers) and pay them commission for soliciting for clients. For instance, Kenyan traders interested in agricultural commodities contract Kenyan brokers who then link up with their Ugandan counters - contracted by stockists - to initiate a transaction.

4.2 Causes of illicit trade

Differences in fiscal and trade policies were usually used by informants to explain the tremendous and perhaps unprecedented illicit trade in the EAC region. Another factor that has been used to explain illicit trade relates to colonial partitioning of the EAC into the countries – essentially historical factor. For example, it is argued that the creation of the borders was not based on any clear socio-cultural factors; rather it was arbitrary. As such, relatives were divided by borders and attached to different countries. These divisions disregarded the families so affected, who continued unabated with the social, cultural, and economic ties that existed prior to the creation of the borders.

Many think that this type of trade is continued not to circumvent official markets. Rather it is attributed to family links, ignorance and insufficient level of civic awareness, among other factors.

However, there is substantial evidence that illicit trade is on the increase. And the explanation given for its increasing magnitude and structure is the lack of harmony in policy. It has generally been acknowledged that differences in levels of tariffs and non-tariff barriers have inhibited growth of formal trade within EAC region. Recent initiatives aimed at liberalizing intra-regional trade, while progressive, remain constrained by institutional and administrative bottlenecks, misalignment in policies of the EAC member countries, restrictive border transit procedures, weak infrastructure and bureaucratic customs delays and tax differential.

Price disparity for identical products due to differences in taxes is one of the major incentives for this type of trade. A good example is tobacco products. Table 4 shows the wide disparity in the excise rates on the three brands of cigarettes in the three countries.

Table 4.Excise rate on cigarettes in East Africa

Brand	Excise rate in US$ Uganda		Excise rate in US$ Kenya		Excise rate in US$ Tanzania	
	Per 1000	Per pack	Per 1000	Per pack	Per 1000	Per pack
B & H	27.4	0.60	18.7	0.4	15.5	0.3
Sportsman	14.3	0.30	12.0	0.2	8.5	0.2
Safari	10.9	0.20	6.0	0.1	-	--

Source: BAT Uganda

In countries where excise rates are high, prices also tend to be high as is clearly demonstrated in Table 2; which shows that tax is the main driver of prices. For example, the rate of excise on the four brands of cigarettes: B&H, Embassy, Sportsman and Safari are apparently higher in Uganda compared to Kenya or Tanzania (Table 4). Consequently, prices of cigarettes are higher in Uganda than any of these countries (Table 5).

Table 5. Cigarettes prices in East Africa

Brand	Price per pack in US$ Uganda	Price per pack in US$ Kenya	Price per pack in US$ Tanzania
B & H	1.71	1.33	1.18
Embassy	1.43	1.07	0.73
Sportsman	1.14	0.80	0.63
Safari	0.57	0.51	-

Source: BAT Uganda
Notes: Exchange rate: US$ 1= UShs 1,750 (Uganda), KShs 75 (Kenya), TShs 1,099 (Tanzania)

It appears financially lucrative to smuggle cigarettes from Kenya, even Tanzania into Uganda. Available information indicated that Kenya is the main source of smuggled cigarettes sold in Uganda.

Different system of taxation adopted by the EAC countries certainly affects the prices. Uganda levies ad valorem rates of 130 percent on cigarettes. Instead, Kenya imposes specific rates based on average retail price bands. Kenya levies taxes essentially on ex-factory price while Uganda includes overheads.

Another good example where smuggling has thrived because of tax disparity is gasoline. The specific excise duty rate for gasoline in Uganda is twice as high as that in Kenya or Tanzania (Table 6), which makes fuel cheaper in Kenya and Tanzania, even in Rwanda, than in Uganda. As a result Uganda is the main destination of smuggled fuel in the EAC region.

Table 6. Excise duty for petroleum products in EAC countries (per 1000 liters) in 2003/04

	Uganda		Kenya		Tanzania		Rwanda
Gasoline	USh	US$	KSh	US$	TSh	US$	Rate (%)
Premium	660,000	365	19,445	253	146,000	140	37
Regular	660,000	365	19,055	247	135,000	129	37
Diesel	410,000	227	10,005	130	127,000	122	37
Kerosene	200,000	111	5,755	75	122,000	117	37

Source: Ministry of Finance, Planning and Economic Development (Uganda); Ministry of Finance and Kenya Revenue Authority; Tanzania Revenue Authority and Ministry of Finance (Kenya), Ministry of Finance and Economic Planning Republic of Rwanda (adopted from Ayoki et al 2005)

Though it is sometimes argued that high prices of gasoline in Uganda are due to high transportation costs to deliver gasoline to Uganda, we find this not convincing because how comes that Rwanda's fuel that passes through Uganda is cheaper in Rwanda than in Uganda.

Beverages are another category of products where tax regime differs across the EAC countries (Table 4). Uganda imposes ad valorem rates on beer while Kenya and Tanzania levy specific rates. In addition, Uganda has low rate for local beer while Tanzania excise all beers at the same rate. Wine and spirits are charged ad valorem rates in Kenya and Uganda, but specific rate in Tanzania. Also, unlike Kenya and Tanzania, Uganda levies a special excise duty or surcharges on a number of imported goods. Likewise, these have made border prices to vary on these products – creating incentives for smuggling – mainly into the Ugandan market.

Table 7. Excise duty rates on alcoholic beverages and soft drinks in EAC countries in 2003/04

	Uganda	Kenya		Tanzania		Rwanda
Alcoholic beverages	*USh/liter*	Brand	KSh/liter		*TSh/liter*	Rate (%)
Beer	60	Stout/porter	49	All beer	232	
	20 (local)	Malt	38			57
		Non malt	24			
Wine 1/	70%		45%		*367=	70
Spirits	70%		65%		1,102=	70
soft drinks						
Mineral water	10%		10%		37.5=	39
Sodas	13%		20%		.na.	39
Cider	70%		35%		.na.	

Source: Ministry of Finance, Planning and Economic Development (Uganda); Ministry of Finance and Kenya Revenue Authority; Tanzania Revenue Authority and Ministry of Finance (Kenya), Ministry of Finance and Economic Planning Republic of Rwanda; and Ministry of Revenue, Government of Ethiopia (adopted from Ayoki et al 2005)
Notes: 1/ TSh 743 if domestic grape content is less than 75 percent

These simple examples can actually confirm that smuggling activities, which is large in magnitude (see next section), arises as more of a reaction to misalignment in the macroeconomic policies especially tax regimes. Policy harmonization and effective implementation of the trade liberalization scheme of the EAC would at least minimize this form of illicit trade.

4.3 Magnitude of illicit trade

This section makes the observation that there is a substantial amount of trade between neighbours that goes unrecorded, a lot of it in small scale using several methods of transportation, including bicycles. The bulk of this trade takes place in and around established townships and customs posts along the borders. Here we have attempted to examine the extent to which illicit trade is practiced in Uganda (and Kenya). It should, however, be noted that, the fact that illicit trade is considered an illegal or 'underground' activity – conveyed through unofficial channels, or 'under the table' makes estimations of its magnitude, direction, conformity to relative comparative advantages and effects on the country revenue base, price of the affected sectors and employment, particularly difficult to make.

Illicit trade between Uganda and Kenya is certainly thriving as available evidence shows. Uganda is the main source of smuggled agricultural commodities: the commonly traded commodities include maize, beans, bananas and fish; while Kenya is the main source of smuggled industrial products to Uganda. Ayoki *et al* (2008) reports high rate of cross-border smuggling of petroleum products, cigarettes, sugar, steel and leather products, textiles, bicycles, and chemicals into Uganda markets, from Kenya. Much of the petroleum products and cigarettes are smuggled across Lake Victoria. In certain instances, part of the smuggled cigarettes are offloaded in Kampala under the pretext that consignments are export goods and then transported to the DR of Congo or sold in Kihihi and Rukungiri, Ntungamo, Mbarara, Ishaka and Kasese.

The Uganda Revenue Authority (URA) estimated that 20 percent of the cigarettes on the Ugandan market are smuggled (URA, 2004, and personal communication). BAT estimates this at 15 percent – that is about 1.8 billion sticks of cigarettes per annum - equivalent to annual loss of about UShs 2 billion in tax revenue from one product (cigarettes) alone.

There were several indications that manufactured products entering Uganda are sometimes declared at customs as raw materials or agricultural inputs when they are actually finished products. For example:

In February 2004 an agro company in Kampala imported 4,400 tons of Tiger Head Batteries worth US$87,296. The goods were declared as hoes and pangas (agricultural implements are tax exempted in Uganda). The goods were detected at the railways goods shade in Kampala… (Ayoki et al 2005).

Under-declaration and false declarations are said to be common. At times, goods are allowed to enter the country without any documentation or with documents which indicate an intension to cross the country in transit (e.g. destined for Kigali in Rwanda or Kinshasa in the Democratic of Congo), although the goods end up being sold in Kampala or other major towns in Uganda. From some of the examples provided by URA and BAT Uganda, big consignments of cigarettes would reach designated market mainly DR Congo at different times but get re-routed (in same quantities) back into Ugandan market.

While statistics on magnitude of illicit trade is hardly available, besides several cases that that have appeared in local newspapers of impounded goods – mainly cigarettes, recent surveys have established that illicit trade occurs in bigger magnitudes than had previously been assumed, and is also inexorably linked to the trade and tax policies of Uganda and Kenya and their neighbours.

For example, the Regional Trade Analytical Agenda (RTAA) conducted a series of surveys on informal (illicit) cross-border trade between selected Eastern and Southern African countries between 1994 and 1998. The survey monitored all major agricultural and industrial commodities that crossed the border during the two randomly selected weeks each month, and estimated the total annual illicit cross border trade between Kenya and Uganda at about $ 140 million, 63 percent of which was in agricultural products. This figure is equivalent to about 2 percent of Kenya's 1994 gross domestic product and close to 60 percent of the value of formal trade between the two countries.

Kenya had an illicit (informal) trade surplus of $22 million, with exports to and imports from Uganda of $81 million and $59 million respectively. About 42 percent of Kenya's illicit exports were of agricultural origin, mostly sugar, wheat flour and bread.

Sugar was Kenya's most valuable illicit export, worth about $20 million, while her most important illicit imports were fish, maize and beans (mostly from Uganda).

Another survey was conducted between October 2003 and January 2004 by the Uganda Bureau of Statistics, covering two weeks in each month of border monitoring that lasted 4 months. The survey estimated total informal cross border trade between Kenya and Uganda during those 4 months at US$ 5.4 million. The total estimated value of illicit trade between Uganda and her neighbours during the review period was about US$ 8million, although this may actually represent less than 30 percent of the true value of illicit trade. If night-time cross-border trade and trade that was not captured by the monitoring (at non-sample sites, for instance) is included, the total informal trade would be closer to $40 million over the same period.

Uganda's most important trade trading partner in all these surveys was Kenya. And when the trade flows across Uganda-Kenya borders were considered, Uganda was found to have an illicit trade surplus – with total illicit exports valued at $ 4.7 million and imports of $0.7 million during the same period. Secondly, Uganda was found to be the net food exporter to all the neighbouring five countries (Kenya, Tanzania, Rwanda, DRC, and Sudan), Kenya being the largest importer of food from Uganda (with a net balance estimated at about $3.5 million) – with food import comprising about 53 percent of all exports.

The study further revealed that 44 percent of total expenditure on Uganda industrial imports comprised commodities from Kenya compared to about 17 percent of total foreign exchange earnings receipts accrued form exports of these products to Kenya. However, Uganda earned more foreign exchange from exports of industrial products to Tanzania than Tanzanian's foreign exchange earning with its exports dealing in these products with Uganda.

The leading industrial commodities that were traded across the border include second hand shoes (comprising 7.5% of industrial products to Uganda), Botique (Bitenge) with a share of 6.7 percent of industrial exports, second hand or used clothes (6%) and cement (3%). The commonly traded agricultural commodities included maize, beans, other grains, bananas and fish. Foreign exchange earnings from individual agricultural commodities exported to Kenya was estimated at $ 1.3 million for maize, $ 1.1 million for beans, and $ 1.1 million for exports of all industrial products (combined) during the monitoring period.

4.4 Case studies of damping of tobacco products and counterfeit batteries

According to the people interviewed and various sources including media reports, smuggling and dumping of cigarettes into Ugandan market is a serious threat to the tobacco industry and government revenue, which has caused Government to look for all the possible ways of dealing with the problem. Evidence suggests that cigarette brands such as Supermatch, Sportsman, Filer Star, Marlborao, Boss, etc., find their way into Ugandan market in various quantities illegally, but the most serious problem (authority said) is Supermatch.

Supermatch cigarettes are manufactured by Mastermind Tobacco, owned by a Rwandan proprietor (Tribert Rujugiro) with operations in South Africa, Burundi, Democratic Republic of Congo (DRC) and Uganda. The contraband is said to pass through Kenya-Uganda border, purportedly destined for neighbouring countries, only to be smuggled back into the local market. The selected newspaper articles (excerpts) quoted below gives an indication of the trends and momentum that this illegal practice has taken.

Smuggled cigarettes impounded

"Six vehicles loaded with smuggled Super match cigarettes from Kenya have been impounded by the Special Revenue Protection Services (SRPS) operatives… the vehicles were impounded on their way from Malaba and Busia borders where the cartons had been loaded. … about 100 cartons of Super Match estimated at Shs 30 million were on board. … the vehicles, mostly saloon cars, have been identified as UAD 283W, UAA 367S, UAB 241C, UAD 361T, pick up trucks UAA 3555 and UAY 291…"

Monitor, 13 May 2005, p7

SPRS impounds cigarettes

"The special Revenue Protection Services (SRPS) on Saturday night impounded 30 cartons of contraband Supermatch cigarettes worth sh7.5m. … at Budumba sub-county headquarters in Bunyole, Tororo District … (in) Toyota Corolla (Registration) number UAD 375M…"

New Vision, 30 March 2005, p9 by Nathan Etengu

URA to destroy 942 cartons of cigarettes

"The Uganda Revenue Authority (URA) will destroy 942.2 cartons of Super-Match cigarettes impounded from smugglers by Special Revenue Protection Services (SRPS) …"

New Vision, 7 May 2004, p7 by Vision Reporter

SPRS burns contraband cigarettes

"The special Revenue Protection Services (SRPS) yesterday destroyed 942 cartons of assorted cartons of contraband cigarettes worth Shs 235.5 million. The … cigarettes included Supermatch, Boss and elite Gold brands. … The cigarettes were impounded between 2002-04 from Jinja, Iganga, Mbale, Busia and Masaka districts……"

Monitor, 6 May 2004, p6 by Isaiah Kitimbo

SPRS seize…

"The special Revenue Protection Services (SRPS) on Saturday impounded smuggled Supermatch cigarettes valued at over sh7m. …"

New Vision, 11 April 2005, p4 by Charles Kakamwa

Frw 14m cigarettes go up in smoke

"Rwanda Revenue Authorities last week cracked yet another whip against suspected smugglers this time by torching Frw 14m (about US$23,728) worth of assorted cigarettes … none had the required tax stamps… The cigarette brands included Filer Star, Supermatch, Aspen, Boss, Premium, Best, Sportsman, Yes, Marlborao, Lights, Rothmans and SM. Supermatch cigarettes are manufactured by Mastermind Tobacco, owned by a Rwandan tycoon, Mr. Tribert Rujugiro with operations in South Africa, Burundi, Democratic Republic of Congo (DRC) and Uganda. Other brands, such as Filer, Boss, Premium and Sportsman are also said to have been smuggled from Burundi, DRC while others, including Aspen, Yes, Marlboro Lights and Rothmans are smuggled from Malaysia… The contraband is said to pass through Rwanda, purportedly destined for neighbouring countries, only to be smuggled back into the local market…"

Procurement News, June 28 – July 4 4, 2004, p16

Tobacco firms urge govt to stop smugglers

"The tobacco industry is pressurizing the government to swiftly stop rampant smuggling along the Kenya – Uganda – D.R. Congo border … Representatives from the British American Tobacco – Uganda (BATU) and Leaf Tobacco Uganda (LTU) said recently that their efforts to curb smuggling in the country had been rendered futile by unchecked flow of contrabands from Kenya and the DRC. The Head of Corporate Affairs … said government was still losing Shs 2 billion through smuggling. He said Supermatch company of Kenya exports its brand to eastern DRC through Uganda. However, some smugglers end up dumping huge quantities of cigarettes in Uganda's market…"

Monitor, 17 September 2004, p20

SPRS seizes 34 vehicles

"The Special Revenue Protection Services (SRPS) has so far impounded 34 motor vehicles for being conveyors of smuggled goods… 1,029 cartons of smuggled contraband cigarettes worth

Shs 1.1bn were recently incinerated in Jinja. The cigarettes had a pre taxation value of Shs 350m and a tax value of Shs 750m…"

Monitor, 17 August 2002, p4

SPRS in another buster

"Just two days after the Special Revenue Protection Services (SRPS) destroyed 1,092 cartons of contraband cigarettes, another group of daring smugglers Friday morning fled from the SRPS leaving behind more a batch of cigarettes worth over Shs 20m. …SPRS has been monitoring ungazzetted landing sites on Lake Victoria that are used for off loading the cigarettes from smugglers boats originating from Kenya…"

New Vision, 12 August 2002, p46

Sh 1bn impounded cigarettes burnt

"Contraband cigarettes worth over sh 1bn and five bags of marijuana recently impounded by the Special Revenue Protection Services (SRPS) and Uganda Revenue Authority (URA) were last week incinerated in Jinja… The 1,029 cartons of 32 various cigarettes brands from the USA, Pakistan, Europe, Sudan, Kenya and Democratic Republic of Congo, were burnt…The smugglers used mainly small cars to ferry the cigarettes…"

New Vision, 13 August 2002, p9

Security impounds Pakistan cigarettes

"Security agencies and the Special Revenue Protection Services (SRPS) are holding about 1,200 carons of cigarettes worth over shs 500m imported from Pakistan. The cigarettes of the Boss brand imported by a Ugandan registered company…"

Newspaper article, unknown/undated source

Concerning dumping of counterfeit batteries we did not find many cases that have been pounded except a few examples that are quoted below:

"Two trucks: reg. no. KAN 301V/ZB 6512 and KAN 987K/ZB 5109 that were carrying 2,220 tons of Tiger Head Batteries (valued at USh 77,583,153) purportedly heading for the DRC was found offloading goods in Kampala. Tax revenue of Ush 33,011,631 was recovered, on top of a fine of Ush 23,274,946 and another fine of Ush 10,000,000 on the trucks..."

(Ayoki et al 2005)

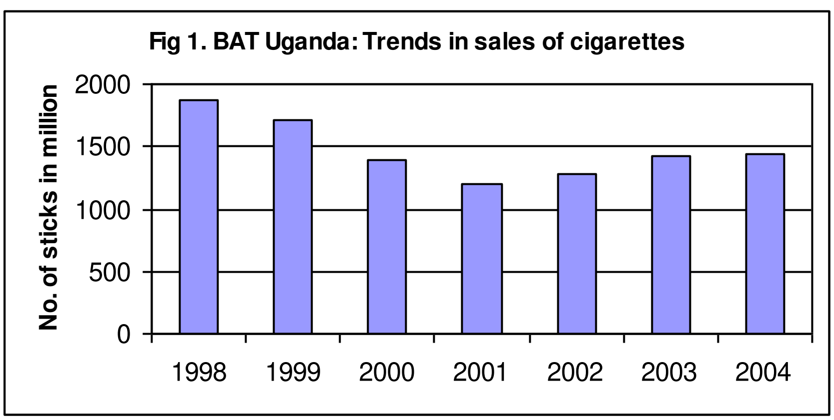
In February 2004 an agro company in Kampala imported 4,400 tons of Tiger Head Batteries worth US$87,296. The goods were declared as hoes and pangas (agricultural implements are tax exempted in Uganda). The goods were detected at the railways goods shade in Kampala… (Ayoki et al 2005).

5 Economic impact of illicit trade

This section attempts to give an overview of the impact of illicit trade on the economy in terms of revenue, employment, affected sectors, consumers and even prices and the overall business environment. However, we shall limit ourselves to giving a general perspective on this subject because as stated earlier, the underground nature of illicit trade makes assessment of its conformity to relative comparative advantages and effects on the country revenue base, price of the affected sectors and employment, particularly difficult.

It is observed that illicit trade has severe consequences for the country's social and economic development as it denies the country of much needed revenue, and retards the growth of private sector and flow of investment through price distortion, among other effects. From a BAT Uganda experience alone, government losses about Shs 2 billion per annum in taxes due to cigarettes smuggling besides the impact on sales turn over experienced by the tobacco company (which itself has effect on government revenue). This problem can be attributed in part to the scenario in Figure 11, which illustrates that sales (by BAT Uganda) have generally dropped in recent years.

Figure 11. BAT Uganda: Trends in sales of cigarettes



Source: BAT Uganda

As estimated by the 1994 and 1998 survey by RTAA, $ 35 million in earnings to illicit traders operating between Uganda-Kenya borders, annually. Knowing that such a large component of national income is systematically missing in annual estimates in particularly worrying. The ratio of illicit trade to formal trade means that official exchanges can be markedly different from those used by the formal traders.

In 1994, the Standard Newspaper reported that about 25 percent of fuel (petrol, diesel and paraffin) consumed in Uganda were smuggled from Kenya, costing the Ugandan Government a significant loss in tax revenue of about US$ 1.2 million annually.

It is well acknowledged that the illicit traders are clearly of sizable numbers, yet not included in national statistics – in the employment estimates. Equally important are the implications for revenue – in terms of revenue losses arising from the evasion of import duty alone for the period were estimated to he potentially as high as $15 million for Kenya alone. This is more significant for Uganda with high reliance on import taxes for government revenue (28 percent of total tax revenue in 2004).

The revenue loss to Uganda as a result of illicit trade is perceived to be substantial (although no firm figure is given), some rough estimate equates it to over 2 percent of the national budget. Combined with fiscal indiscipline, this can lead to a lower quality of infrastructure and social services in the short term, and adverse budgetary and monetary implications in the long term.

Moreover, the efforts to build competitive private sector cannot be realised by wide spread illicit trade. The existence of illicit trade implies that granting investment incentives and removal of tariffs and non-tariff barriers may not be sufficient to spur private sector investment and intra-regional trade unless illicit are brought under 'control'.

Despite these particular concerns, however, illicit trade has spontaneously been able to respond to food shortages across borders. This is because trade in food commodities such as beans, rice, maize and fish all stimulated the output of these products by providing ready markets for surplus production. This ensured that access to the commodities in food deficit areas not only increased but has also stabilised over time. Illicit trade has also been able to stabilise seasonal variations in food prices across different countries. Among the key drawbacks, illicit trade has on occasion been responsible for the transmission of livestock and food pests across borders (UBOS and BOU, 2004).

6 Legal and regulatory framework for dealing with the illicit trade

This section looks at how Uganda deals with illicit trade; the policies, laws, regulatory frameworks and institutions being used to deal with the problem.

2.1 Definition and overview

According to BAT Uganda, illicit products are goods whose duty has not been (fully) paid for in the market where it is being sold; these include *smuggled* products, *duty free* product beyond allowable limits and *counterfeit* products. In URA, illicit trade is simply referred to as outright smuggling, including goods in excess of allowable limits/quantity (duty free limits). Hence, illicit products are goods that have not been declared to customs at all. In this context, under-declaration of goods at customs is not considered to be an act of smuggling but is generally treated as a customs offence.

As such smuggling and under-declaration attract different punitive actions. While impounded smuggled goods and the means used to convey them (e.g. vehicles) are forfeited to the state, the penalty is less severe for the case of under-declared goods. In other words, illicit or illegal trade (as some prefer to call it), includes all trade activities carried out with the purpose of evading taxes, gaining 'abnormal' profits and taking unfair advantage over law-abiding participants in the same industry. These activities take the form of smuggling; counterfeiting of products; concealment of information – about the quantity, value and even the real name of the product. By definition, illicit trade is not included in official national statistics and the national income convention.

Uganda lacks well-defined policies on illicit trade. For example, in the East African Community Customs Management Act, 2004, one of the banned items is counterfeit. Yet, the law does not even provide for a definition of *counterfeit.* In addition to EAC instrument, the law dealing with illicit trade is mainly found in the Smuggling Statute of 1980 and 1987, Foreign Exchange Act, and the Customs and Excise Act. It is also contained in the Penal Code.

In the case of counterfeit, legal enforcement is a big problem as it is upon the holder of the copy right or trade mark to prove that his right has been violated; URA can not do much but only able to act on a court order as summarised by the statement in the (URA legal counsel's) recommendation below:

> "The onus of proving and enforcement of a trade mark or copy right or any other entitlement squarely lies on the holder of that right. Customs ought therefore to restrict itself to its statutory duties and can only assist holders in execution of court orders"

In the case of smuggling, the significant effort has been the introduce tax stamp on cigarettes packets. This implies that any cigarettes package in the market without tax stamp is a smuggled one. However, we heard of several examples where smuggled cigarettes had tax stamp, which means that tax stamp may not be the most effective way of 'blocking' smuggling.

Other common feature that could put the product (for the case of cigarettes for example) in suspect is if the package does not bear declaration of source, and/or health warning. These too are not deterrent factor, given that this is an organised crime with the capacity to operate to the level of sophistication that the task so demand.

The law though in place, has done little to curb illicit trade activities. The *Penal Code*, like Smuggling Statutes provide for conditions for exportation and importation or allowing of goods from or into the country, including licensing and amounts where licence may not be required, disclosure or declaration requirements. These pieces of legislation were evidently designed on the assumption that people will be honest, and law abiding and will obtain license before exporting or importing goods, and will be honest to declare goods that are not acquired as gifts items, or for personal use.

Section 301A(1) states "the exportation and importation of goods from or into Uganda is hereby prohibited except under licence granted by the Minister responsible of any through such places of exit or entry as may be prescribed from time to time for that purpose… Provided that no licence shall be required for the exportation or importation of any goods which are: (a) for the personal use of the person exporting or importing them; or (b) gift, and are in either case in quantity reasonable for the respective purpose …" (Statute 3 of 1980).

Section 301B (1) of the Penal Code (Smuggling Statue 5 of 1987) states: "Any person who exports or imports any goods from or into Uganda (a) in contravention of section 301A; (b) in such manner that the goods are concealed in any way; packed in any package (whether or not with other goods) in a manner calculated to deceive any authorised officer; contained in any package of which the entry or application for carriage out or within Uganda does not correspond with such goods; or in any manner by which he evades the control of customs over such exportation or importation … commits the offence of smuggling and shall, on conviction, be sentenced to a term of imprisonment of not less than three years and not more than fourteen years and shall, in addition, pay a fine of not more than five million shillings …"

The Customs and Excise Act also contains a number of provisions which can be used to combat illicit trade activities. Provision is made to deal with incidents of smuggling. Persons entering or leaving Uganda are required to declare at the time of entry, all goods in their possession which were purchased or acquired outside Uganda, which are prohibited, restricted or controlled under any law. On departure, all goods being exported must also be declared. Such persons are required to comply with any request or instruction of a customs officer and, where necessary to pay the relevant duty.

Foreign Exchange Act 2004 provides a framework for exchange management and how to deal with offences which may be committed in this sector. The Bank of Uganda is responsible for the administration of the Act, which puts restriction on carrying on foreign exchange business. For example, section 9 (1) states "except with the prior permission of the Bank of Uganda, no person shall engage in foreign exchange business. Section 17 considers an offence for any person who 'engages in the business of dealing in foreign exchange without a licence issued under section 5; which states "except as permitted by any other law, no person shall engage in the business of dealing in foreign exchange without a licence issued under this Act".

Under these laws, the Government is obliged to take all necessary measures to prevent illicit trade activities, but most of them appear outdated in terms of current Ugandan social reality. The law has a lot of loopholes. For instance; 'personal use' and 'quantity reasonable' as they apply to cross-border exports and imports can be interpreted rather loosely. When the Penal Code and the other laws were passed, illicit trade activities did not have the harmful effect and the magnitude it has today. As such, none of the legal instruments addresses the phenomenon to the extent that is required under current circumstances.

Government has tried to involve other stakeholders in an effort to curb the problem of illicit trade. Among these is Uganda Manufacturers Association (UMA), and to some extent BAT Uganda, augmented by a paramilitary unit: Special Revenue Protection Services (SRPS)/ Anti-smuggling Protection Unit to increase surveillances of the border areas and seizing suspects. While government motives for this is essentially to protect tax revenue, stakeholders feel enforcement related to curbing illicit practices to improve welfare of businesses in the country is the primary responsibility of government.

They feel that government aught to make it as difficult and unprofitable as possible for illicit activities and to ensure that those who engage in the same know that is not only illegal but extremely risky. Companies that are most affected by this kind of trade particularly BAT is interested in giving all the necessary support possible including proving information, facilitation, and even reward and recognition for any effort towards curbing illicit trade activities.

Already BAT has instituted an internal anti-illicit trade team, which is charged with the responsibility of developing and approving strategy for combating illicit trade. Besides, BAT Uganda, URA and Kenya Revenue Authority (KRA) have gone ahead to hold (regular) cross-border meeting to sensitize enforcement authorities about the problem and suggest possible solutions. The last meeting was held in February 2005. BAT Uganda has also, apart from facilitating SRPS (to assist them in enforcement), has endeavored to coordinate their activities together with its sister company in Kenya (BAT Kenya) and Congo (BAT Congo). Through this relationship they have been in position to share information and to come up with suggestions on matters of policy concerns.

7 Conclusions and recommendations

The necessary pre-conditions for illicit trade in EAC go beyond differences in trade policy to include inflation differentials, differences in relative value of the EAC member currencies, weak governance and corruption, and investment climate. Hence, measures to reduce illicit trade need to be looked at in the broad context of trade policies and macroeconomic policy issues and governance.

Uganda and Kenyan governments have instinctively responded to illicit trade by cracking down on the illicit traders as a means of minimising the revenue losses accruing from evasion. Eliminating illicit trade will require cross-border concerted effort.

First, progressive liberalisation and harmonisation of the region's trade and tax policies, greater harmonisation of trade and transit procedures, and a breaking down of the bureaucratic obstacles to trade at the border points. The adoption of the customs union and free trade areas will inevitably diminish illicit trade and will also lead to lower goods and commodity prices in the region in which the trade is currently thriving. However, if the bureaucratic obstacles and non-tariff barriers continue to hinder the movement of goods across the customs, illicit trade will continue to thrive.

Second, strengthened coordination with business community and relevant stakeholders to design effective policies and programmes to ensure effective enforcements including making sure that all consignments transiting through the country reach their indicated destinations. In order to avoid product that is in transit through Uganda being dumped into the Ugandan market, some stakeholders suggested the introduction of transit bonds. For example, all cigarettes through Uganda designated for say DR Congo would be required to pay a transit bond at point of entry say Malaba, Busia, etc. based on the excise value of the consignment. The bond would then be refunded to the exporter on satisfactory demonstration that the cigarettes have exited the country.

However, URA feels that transit bond, while good, can be bogged down by four major implementation challenges. First, it delays the transaction. Second, it is very expensive as it would require advance payment of tax equivalent. Third, Uganda is a landlocked country, and it would be difficult to enforce. And fourth, payment procedures are long and cumbersome since payments have to be made through the bank followed by process of cross-checking and verification before refunds can be effected.

Among other suggestions given, participants in the tobacco industry feel it is important to make it obligatory for exporter to produce (i) a proof or evidence of demand in the destination market, that the exporter/importer is able to trade in the destination market; and that the product complies with market legal requirements e.g. health warning clauses, tax stamps, tar and nicotine declarations, for sale in (country); (ii) evidence of c.i.f exportation to destination market, and a system in place to facilitate reconciliation of such exports. Accordingly, fob sales should be discouraged.

These statutory requirements would be reinforced by enforcing pack and stick labelling requirements especially for cigarettes brands commercialised in Kenya; as well as improving controls, for instance, discouraging shipments at night or on weekends, and increasing penalties for offences.

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