



**ORGANIZED CRIME, CORRUPTION
AND ILLICIT TRADE**

SPOTLIGHT ON SOUTH AFRICA

ABOUT TRACIT

The Transnational Alliance to Combat Illicit Trade (TRACIT) is an independent, private sector initiative to drive change to mitigate the economic and social damages of illicit trade by strengthening government enforcement mechanisms and mobilizing businesses across industry sectors most impacted by illicit trade.

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I. INTRODUCTION

South Africa is one of the largest and most diversified economies in Africa, and it is the only African country represented in the G20 and BRICS economic groupings. However, despite being an important contributor to growth and trade regionally and on the global economic stage, it also faces challenges from illicit trade on multiple fronts, including but not limited to, alcohol, cigarettes, fishing, mining, counterfeit electronics, pharmaceuticals, food, and apparel.

The magnitude of the losses is staggering, draining revenue and resources from an economy that could usefully benefit from increasing investment in infrastructure and improving living conditions for citizens. For example, the South African Revenue Service (SARS) estimates that illicit trade costs the South African economy a R100 billion (USD 5.9 billion) every year.¹ In terms of lost tax revenues, Business Leadership South Africa (BLSA) estimates that the country loses around R250 million (USD 15 million) a day.² Furthermore, the OECD estimates that South Africa is losing \$3.5 billion to \$5 billion a year, or more than 1% of its GDP, to illicit financial flows.³

In an effort to stem the negative impacts of illicit trade, the government of South Africa has recently taken important steps towards rooting out corruption,⁴ increased the amount of successful cases against serious

organized crime,⁵ recovered R8.2 billion in revenue from criminal and illicit economic activities in the 2021-2022 financial year – up 331% from the previous year,⁶ and instituted a new Border Management Authority to strengthen efforts against the importation of illicit goods into South Africa.

In order to support these efforts and encourage the government to intensify its initiatives to mitigate illicit trade, TRACIT delivered a report and a set of policy recommendations⁷ to the International Law Enforcement Intellectual Property Crime Conference, hosted by INTERPOL in Cape Town in 2019. The findings were also shared with South African government agencies, with the aim to develop better capabilities to strengthen enforcement, raise criminal penalties, improve cooperation with the private sector, protect borders and persevere against corruption and criminal forces.

The purpose of this report is to provide an update on South Africa and to refresh the set of legal, regulatory and policy recommendations designed to strengthen its fight against illicit trade. Such an update though, necessarily must account for several structural adversities that have emerged since TRACIT's 2019 report.

II. SOUTH AFRICA'S STRUCTURAL CAPABILITY TO ADDRESS ILLICIT TRADE

To better understand the regulatory environment and economic circumstances that enable 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
2	UK	85
3	US	83
5	Australia	81
10	Germany	79
14	Japan	78
15	Canada	77
17	South Korea	75
19	France	74
37	Italy	64
38	Argentina	64
40	Turkiye	62
42	South Africa	62
44	China	61
Global Average		60
49	India	59
50	Saudi Arabia	59
51	Mexico	59
59	Brazil	51
62	Russia	49
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 and is chairing the BRICS grouping in 2023.

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.

Given its economic clout, membership in the G20 and BRICS, and its influence among the G-77 countries, 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 for addressing the threat that illicit trade poses to economic development of the continent. 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.

In addition to ongoing structural challenges, the booming illicit economy is being turbo charged by several new and ongoing challenges such as inflation, unemployment, corruption, and lasting effects of the COVID-19 pandemic.

Inflation

South Africa has been facing inflationary pressure similar to that which has plagued economies around the world over the past year. Annual headline inflation rose to

7.6% in October 2022, breaching highs last seen during the energy crises of the 1970s.⁸ Among the cascading effects of inflation on the South African economy is the negative impact it has on the market dynamics that drive illicit trade. Specifically, elevated levels of inflation can have a negative impact on consumer purchasing power. In turn, reduced purchasing power coupled with increased poverty reduces consumer 'product affordability', which is widely regarded as the primary driver of illicit trade. When prices rise faster than incomes, people can afford to buy fewer goods and services; and cheaper goods, including illicit and black-market products become more tempting. On top of this, South African consumers were already experiencing a cost-of-living squeeze, according to Deloitte's latest *Global Consumer Tracker*. At the end of October 2022, half of all surveyed consumers in South Africa said that they were delaying large purchases due to the economic situation, with 40% indicating their financial situation had worsened over the past year.⁹

Unemployment

While illicit trade is not a problem unique to South Africa, its effect becomes more pronounced in the context of exceedingly high levels of unemployment. By the third quarter of 2022, the official unemployment rate of 32.9% ranked third highest in the world, due to *inter alia* sluggish economic growth, strict labor laws and bureaucratic hurdles, persistent inequality, lingering effects of the COVID-19 pandemic.¹⁰

The inflow of fake and smuggled goods contributes to the country's unemployment challenge because domestic job opportunities are lost when fakes manufactured elsewhere in the world are imported and sold in South African markets. Moreover, higher unemployment reduces consumer purchasing power and incentivizes purchases of cheaper illicit products.

Impacts of COVID-19

When the COVID-19 lockdown regulations were introduced in March 2020, the country was already reeling from several years of economic stagnation and persistently high levels of unemployment, which, as discussed above, can incentivize consumers to choose cheaper, illicit alternatives. On top of this situation, the pandemic provided wide opportunities for illicit traders to significantly expand their operations as government lockdowns, bans and other restrictions disrupted markets and created shortages. In the case of alcohol and tobacco, government-imposed bans enabled criminal groups to exploit the situational supply shortages and entrench and expand their positions in illicit markets.¹¹ At the same time, efforts to tackle illicit trade were diminished as law enforcement agencies were forced to redirect resources to COVID-19 related activities, such as enforcing quarantines. The COVID-19 impacts on South Africa were widespread:

- The head of the South African Revenue Service (SARS) warned that the ban on sale of alcohol and tobacco products during the COVID-19 lockdown allowed criminal networks to gain a foothold in the market and cautioned that it would take years to reverse the impact.¹²
- Business Leadership South Africa estimated that the tobacco bans during the lockdown cost the government as much as R35 million a day in lost excise and other tax revenues.¹³
- The COVID-19 pandemic saw a surge in fake and substandard medicines and medical equipment. In November 2020, the South African Police Service (SAPS) discovered a massive shipment of fake COVID vaccines and seized approximately 2,400 doses, alongside a large shipment of counterfeit N95 masks.¹⁴

- Counterfeit goods and manufacturing equipment worth almost USD 1 million were seized in one inspection as part of Interpol's 2021 Operation Afya II that targeted trafficking of illicit health products.¹⁵
- In the midst of the first Omicron wave in late December 2021, SAPS arrested several individuals who had converted a residential building into a manufacturing facility for counterfeit instant yeast products.¹⁶
- Copper theft spiked during the COVID-19 pandemic. Transnet Freight Rail reported that hundreds of thousands of meters of cables were stolen in 2020, leading to the cancellation of multiple train routes and forcing the company to employ security drones and helicopters to stop criminal gangs from stealing the copper cables.¹⁷
- The pandemic and associated lockdowns caused significant revenue reductions in the national park authority's budget, which is funded primarily by tourism. The fall in revenue had a severe impact on the capacity to detect and combat trade in illegal wildlife.¹⁸

Corruption

Corruption and increasingly sophisticated organized crime networks continue to aggravate South Africa's efforts to combat illicit trade.¹⁹ South Africa's highly developed and diverse criminal landscape is reflected in the 2021 edition of the Global Initiative Against Transnational Organized Crime (GI-TOC) *Global Organized Crime Index*, where South Africa ranks 19th in the world for criminality – ahead of both Brazil and Russia in the BRICS grouping.²⁰ The nexus of illicit trade with corruption and other criminal activities creates a triple threat to the economy by crowding out legitimate economic activity, depriving the government of revenues for investment in vital public services and undermining the integrity of the very state institutions tasked with addressing the problem.

The proliferation of illicit trade poses a significant, “top 5” risk to the South African economy, according to the World Economic Forum.²¹ Therefore, mitigating illicit trade must become a priority for government officials at all levels. This starts with addressing the structural problems of inflation, unemployment and corruption that allow illicit trade to flourish. Given the dynamics where these factors incentivize consumers to choose cheaper, illicit alternatives, the South African government must be even more vigilant in its efforts to defend its economy from illicit trade. Failure to do so will weaken growth prospects and hamper efforts to reduce unemployment and inequality.

In the near term, rampant illicit trade threatens President Ramaphosa's Economic Reconstruction and Recovery Plan by robbing the government of tax revenue that otherwise could be invested in creating jobs, re-industrializing the economy, accelerating economic reforms, and fighting crime and corruption. Addressing the significant revenue leakages caused by illicit trade and its negative impact on domestic resource mobilization is thus critical for financing key structural reforms, as well as for putting public finances on a more sustainable path, both key for restoring confidence in the South African economy.²²

Investment

Given illicit trade's negative impact on private sector investment in the economy and the development of a domestic manufacturing sector, it is critical that the South African Government prioritizes and increases efforts to combat illicit trade, and the underlying conditions that facilitate it. The production and trade of illicit goods do not contribute to socioeconomic development or economic transformation, nor do they create jobs or generate tax revenue.

Unmitigated illicit trade could also trigger a decline of confidence and a pullback of both foreign and domestic investments, directly impacting consumer well-being by limiting the range of quality and affordable products and services available to them, and in the long run, affecting economic growth.²³

Similarly, failure to address financial crimes and corruption could compound economic challenges for the government. In October 2021 the Financial Action Task Force (FATF) – a global money-laundering watchdog – gave South Africa 18 months’ notice that the country would be grey-listed if authorities do not raise measures to combat money laundering and terrorism financing to the level of international standards.²⁴ To be grey-listed by the FATF means a country is subjected to increased monitoring and has to deal with adverse economic consequences for trade and transactions with other countries. According to IMF research, on average, grey listings result in a decrease of capital inflow of 7.6% of GDP and a decrease in foreign direct investment of 3% of GDP.²⁵ To avoid delivering another blow to South Africa’s already troubled economy, the President should expeditiously sign into law the recent Bills passed by the South African Parliament aimed at addressing the deficiencies identified in by the FATF.²⁶

At the same time South Africa’s ability to fund these reforms is hamstrung by a series of downgrades to its sovereign credit rating, making the cost of borrowing more expensive and dampening its attractiveness to foreign investment. In this regard a

2021 study by TRACIT demonstrates that correcting the regulatory environment and economic circumstances that enable illicit trade can pay tangible dividends to a country’s credit rating.²⁷ **Prioritizing and increasing efforts to combat illicit trade, and the underlying conditions that facilitate it, should therefore be viewed by South Africa as a fiscal imperative.**

Pandemic lessons

Finally, to restart and grow its economy, South Africa must also draw on experience from the pandemic when formulating policies and implementing programs aimed at deterring and precluding illicit traders from consolidating roots in the post-pandemic economy. For example, severely restrictive regulations, such as the temporary alcohol and tobacco bans introduced during the pandemic must be avoided. In addition, policymakers must ensure that new regulatory measures do not create unintended consequences or incentivize consumers to choose illicit alternatives to available, legitimate products. These are valuable lessons, showing that crisis-driven regulations, however well-meaning, can have unintended and long-lasting negative impacts on driving illicit trade, the economy and society. Prioritizing investment in capacity building and strengthening enforcement measures are critical to ensure that illicit trade activities caused by the pandemic do not become permanent features of the post-pandemic economy.

III. ILLICIT TRADE IN SOUTH AFRICA

Overview

South Africa faces challenges from illicit trade on multiple fronts, including but not limited to, alcohol, cigarettes, fishing, mining, counterfeit electronics, pharmaceuticals, food, and apparel. The problem is significant enough that the proliferation of illicit trade poses a significant, “top 5” risk to the South African economy, according to WEF.

Under President Ramaphosa’s leadership, South Africa has taken some steps to improve the country’s ability to tackle illicit trade, demonstrating the government’s ambition and commitment to root out this illegal activity. Nonetheless, the scope and depth of illicit trade presents significant challenges for South Africa’s continued economic development.

At the structural level, there is not yet a strategic, overarching anti-illicit trade framework with clear leadership responsibilities and accountability to guide enforcement of existing laws or to coordinate responsibilities between agencies.

Governance

Overall, South Africa’s regulatory bodies, institutions and enforcement agencies are well rounded and in line with international standards. Similarly, existing legislation and regulations aimed at deterring illicit trade are generally viewed as adequate. The primary challenges lie instead with the application of laws, shortages in capacity and skills, and a lack of coordination between the various agencies responsible for enforcement efforts.

At the structural level, there is not yet a strategic, overarching anti-illicit trade framework with clear leadership responsibilities and accountability to guide enforcement of existing laws or to coordinate responsibilities between agencies. Coordination efforts are further hampered by the ad hoc nature of new initiatives, often politically driven in response to public outcries over accusations of corruption. Without any single entity overseeing the broader institutional security apparatus, temporary interventions can overlap and compete with existing arrangements.

Corruption

Corruption is a facilitator for illicit trade everywhere, most notably in law enforcement and border control agencies. In South Africa, allegations of corruption, police misconduct and collusion between law enforcement and criminal groups are frequent. As recently as November 2022, six police officers in Limpopo were arrested for accepting bribes to create a “safe passage” for smugglers to enter the country illegally in possession of illicit cigarettes.²⁸ The same month, the Western Cape Police Ombud handed over a report investigating claims that gang members had infiltrated the top management structures of the SAPS in the Western Cape, accessing key documents and strategies on crime fighting.²⁹ This problem was foreshadowed by former Independent Police Investigative Directorate (IPID) Executive Director Robert McBride who claimed in 2018 that, “the biggest threat to national security is corruption in the SAPS ... We are no longer able to effectively contain crime.”³⁰

Similar concerns were also registered by the FATF in its 2021 evaluation of South Africa, where it noted that the country's structural capability to address illicit trade has suffered from systemic forms of corruption, undermining key agencies with roles to combat such activity.³¹

Limited resources

Persistent capacity constraints and skills shortages continue to impede effective enforcement. Even though SARS is rebuilding capacity to address illicit trade, vacancies and lack of expertise remain acute.

- In December 2022, the national head of the Directorate for Priority Crime Investigation (DPCI) reported that it was at 52% capacity, with about 1,500 posts remaining vacant.³²
- Despite an escalation in plant poaching, with hundreds of thousands of plants being stolen from South Africa annually, plant crime specialists report that the government lacks the personnel to effectively police the vast open spaces where rare plants are poached, with even fewer police and customs officers having the necessary expertise to correctly identify endangered species.³³
- The judiciary has an important role in fighting illicit trade, by dealing with cases expeditiously and by imposing deterrent penalties. However, the National Prosecuting Authority (NPA) suffers from a shortage of skilled and capable investigators and prosecutors,³⁴ leaving it focused on "easy wins" instead of prosecuting complex cases.³⁵ The recent decision to make the Investigating Directorate a permanent anti-corruption agency in the NPA is a welcomed development and will hopefully pave the way for more successful prosecutions and deterrent sentences.³⁶

Illicit trade by sector

Illegal mining

Mining has historically been a major source of illicit activity in South Africa. Illegal miners, known as Zama Zamas, can be highly organized and generate significant illicit financial proceeds that are usually exported. This unlawful system literally robs the government of significant and essential tax revenue; and it costs legitimate mining companies billions in production loss and security expenditures.

- A 2017 report by the Minerals Council South Africa estimates that the annual commercial value of illegal mining and illicit dealings in precious metals and diamonds is about R7 billion, including heightened security costs to protect mines from incursions by syndicates.³⁷
- There are between 8,000 and 30,000 illegal miners reported to work in South Africa, including common reports of child labor and other human rights abuses.³⁸
- Illegal gold mining operations have become a major challenge for legitimate companies, with as much as 5% of South Africa's annual gold production lost to illicit activities.³⁹
- South Africa is facing billions of rand in losses due to the rampant theft of copper from state-run firms Eskom and Transnet, much of which is exported abroad. Eskom attributes R5-7 billion lost annually due to "unrelenting" copper theft, plus R2 billion to replace stolen the cables. Transnet Freight Rail reports a 177% increase in copper theft incidents over the past five years, with an especially pronounced surge during the COVID-19 pandemic.⁴⁰
- South Africa is the world's largest producer of platinum and chrome ore, however, these valuable resources are subject to rampant theft. While declining global prices in 2013 had a mitigating

effect on illegal activities, large-scale pilfering persists today.⁴¹ Estimates place the illegal mining and export of chrome ore at nearly 1 million tons per year – more than 10% of South Africa’s legal chrome output.⁴²

- A lucrative illicit market for sand has emerged due to the high demand of this resource from the construction industry. Unlike other minerals such as gold or platinum, sand requires relatively little effort to launder its sale into legitimate markets. The problem is exacerbated by inadequate enforcement efforts, hampered primarily by an insufficient number of officials assigned to monitor compliance activities.⁴³

Counterfeit goods

Counterfeiting has become a major criminal activity that presents unfair trade to almost every consumer products sector in South Africa.⁴⁴ This contributes to trapping employment in the informal sector, robs government of revenues from sales taxes and exposes consumers to poor quality products and health and safety risks.

- The proliferation of counterfeit goods distorts the domestic manufacturing market for the sale of genuine products and generates billions of rands in illicit profits annually. The Consumer Goods Council of South Africa (CGCSA) estimates that counterfeiting could account for as much as 10% of the South African economy.⁴⁵
- The total value of all the goods confiscated by SARS between 1 April 2018 and 31 March 2019 exceeded 3 billion rand across 6,828 raids, an increase of more than 1,900 from 4,800 raids in 2018. In the 2019-20 financial year, SARS performed more than 1,300 seizures of counterfeit goods valued at R1.1 billion.⁴⁶
- Although the trafficking of fake goods is driven by transnational syndicates, there

is also extensive domestic production. The primary hub for counterfeiting is found in the Johannesburg Central Business District (CBD), and there is also significant activity in Belville, Western Cape; Marabastad, Pretoria; and Durban CBD.⁴⁷

- Investigators have noticed a troubling new trend where large shipments of counterfeit goods are shipped to Mozambique, Namibia or Zimbabwe and then split into small consignments before being smuggled into South Africa. Once across the border, the goods are consolidated again, making them harder to detect as well as limiting the impact of individual enforcement efforts. As a result, there has been a significant decrease in the quantities of products per seizure (both in border and in-market cases) over the past 2-3 years.
- Organized crime syndicates run the illicit trade operations, often utilizing illegal immigrants as a front for illicit products through areas such as Johannesburg CBD. Limited investigations and minimal deterrence penalties enable the criminal networks to continue operations with low risk of discovery.
- The costs for storage and destruction of seized goods are borne by the rights holder during criminal legal proceedings. While some cases are processed within a few months, it is not uncommon for cases to take several years. As a result, the accumulation of storage costs of seized goods, which in most cases is much higher than destruction costs, represents a significant financial burden on rights holders. The costs for storage and destruction are so high that some brand owners may decide against bringing criminal charges, even when there is overwhelming evidence of an infringement.

Substandard and falsified medicines

South Africa's pharmaceutical sector has seen remarkable growth, with sales eclipsing USD4.6 billion in 2021.⁴⁸ However, this success has been accompanied by the prevalence of counterfeited and low-quality drugs made available in domestic markets by transnational syndicates that have exploited regulatory and monitoring gaps.⁴⁹ Pharmaceutical products, including veterinary medicines, are increasingly being targeted by counterfeiters who deal in inferior and in some instances toxic counterfeit goods.⁵⁰

- The growing phenomenon of substandard and falsified medicines puts people's lives at risk and causes profound public health challenges. A WHO report shows that continental Africa accounts for 42% of globally detected cases of substandard and fake medical products.⁵¹
- The COVID-19 pandemic saw a surge in fake and substandard medicines and medical equipment in South Africa. In November 2020 and again in March 2021, law enforcement seized thousands of fake COVID-19 vaccines near Johannesburg.⁵²
- In April 2022, the South Africa Health Products Regulatory Authority (SAHPRA) together with SAPS, seized prescription medicines sold on the street in Cape Town.⁵³

South Africa's pharmaceutical regulatory framework is on par with international standards and surpasses those of other countries in sub-Saharan Africa. However, a lack of comprehensive strategic framework for dealing with counterfeit and substandard medicines, as well as no clear and defined responsibilities for enforcement efforts, makes the pharmaceutical value chain and the health care system vulnerable to the infiltration of substandard and falsified medicines.⁵⁴ Moreover, regulations stemming from the *Medicines and Related Substances Act 101 of 1965*, do not reflect the

emergence of modern internet platforms as a mechanism for ordering and obtaining counterfeit medicines.

Illicit trade in fuel

Illicit trade in fuel is a growing challenge in Southern Africa. Over the past decade, countries along the Maputo Corridor (South Africa, Eswatini and Mozambique) have become a regional hotspot in the illicit fuel trade, which is driven by organized criminal networks.⁵⁵

- Transnet, the manager of South Africa's fuel pipeline system, has seen a sharp surge in theft since 2020. Over 20 million litres of petroleum products worth nearly R250m were stolen between 2019-2021.⁵⁶ Fuel theft, exacerbated by diesel shortages, is jeopardizing South Africa's diesel-dependent agricultural sector.⁵⁷

Wildlife trafficking

South Africa's position as the third most biodiverse country in the world has also made it a target for wildlife traffickers. Weak penalties and poor legal enforcement have made wildlife crime a lucrative and low-risk activity for criminal syndicates. While the trafficking of large animals, such as rhino,⁵⁸ lion and elephant poaching receive international media attention, South Africa also suffers from poaching and illicit trade in a range of lesser-known flora and fauna, with alarming declines the populations of the most sought-after species.

- The increase in illegal harvesting and trade in abalone – the world's most valuable shellfish – is driving an ecological crisis in South Africa and robbing the economy of around R628 million annually.⁵⁹ In 2021, South African authorities jailed two Chinese nationals caught with over USD60,000 worth of illegally fished abalone. The country's coasts have lost more than 96 million abalone over the past two decades, with 9.6 million poached in 2016 alone.⁶⁰

- South Africa's West Coast Rock Lobster is subject to massive levels of illegal fishing, threatening the jobs of approximately 4,200 small-scale and recreational fishers that rely on Rock Lobster fishing for their livelihood.⁶¹
- South Africa is experiencing an enormous surge in illegal harvesting of *Conophytum* plants, rare succulents coveted by ornamental plant collectors in China and Korea.⁶² Poaching has also severely impacted the distinctive Pearson's aloe, with 85% of the population lost in the past five years.⁶³
- South Africa was ranked as the 13th worst country globally for illegal, unreported and unregulated (IUU) fishing, according to the 2021 edition of the IUU Fishing Index.⁶⁴ Hake, South Africa's largest export fishery, is subject to high levels of illegal fishing. In Hout Bay harbour, for instance, long-line vessels are known to collude with corrupt fisheries inspectors to offload as much as half their catch, undeclared, onto delivery vehicles that subsequently 'disappear'. This illegal activity is a major concern for the sustainability of South Africa's legal fishery industry.⁶⁵

Illicit tobacco

South Africa has a long-standing market for illicit cigarettes, by some estimates potentially the world's largest black market for cigarettes.⁶⁶ While smuggling of illicit tobacco into South Africa has always been a problem, the illicit market is now in large part driven by under-declaration, where local manufacturers have been accused of evading excise taxes by under-declaring the number of cigarettes produced.⁶⁷ Cigarette manufacturers are required to pay VAT and excise tax on cigarettes, the minimum collectable taxes (MCT) or "taxes owed", as defined by the Minister of Finance annually.

For 2022, this translates to R22.79 per pack. Yet, it is common to find cigarette packs sold for as little as R5-R10 per pack.

This situation was significantly impacted by the government's temporary ban on cigarette sales as part of its COVID-19 lockdown policies. These government-imposed market restrictions drove many consumers to access cigarettes through informal retail outlets.⁶⁸ The entrenchment of illegal cigarette suppliers combined with growth in consumer demand during the pandemic was so significant that it has overtaken much of the progress SARS has made in rebuilding its capacity to tackle illicit tobacco trade, following the erosion of its investigative capacity between 2014-2018.⁶⁹ The consequences of the ban are likely to be felt for many years, as law enforcement must now tackle a larger illicit industry for illicit tobacco and must reverse new consumer interest and demand in illicit alternatives.

- The disruption of the legal cigarette market due to the government-imposed COVID-19 supply restrictions disproportionately benefited existing illicit manufacturers, who were able to further entrench themselves and rapidly grow their share of the illicit cigarette market.⁷⁰ Before the bans were put in place, as much as 35% of the total cigarette market in the country was illicit.⁷¹ In 2020, the illicit share increased to at least 54% according to independent research, and remained at that extremely high level through 2021.⁷²
- Instead of excise revenues from tobacco sales going into the government's coffers, they were lost to the black market. It is estimated that the government lost approximately R6 billion in excise duties on cigarette sales during the 20-week sales ban.⁷³

- SARS has taken steps to mitigate this problem of overproduction and underreporting. For example, in 2020 they started requiring counting devices to monitor cigarette production. However, this measure has not shown to be overly effective, primarily because the mechanism can be tampered with and much of the responsibility for recording and reporting of data remains with the manufacturers themselves. In 2022 they required installation of CCTV cameras, and similarly, this has not yet shown to be effective.
- SARS, on 26 August 2022, was granted an order to freeze all Sasfin bank accounts and assets of the Gold Leaf Tobacco Company (GLTC) and subsequent investigations into allegations of intentional tax evasion of around R3 billion underscores the role that large-scale money laundering schemes have in facilitating the illicit tobacco trade.⁷⁴
- SARS seized more than 300 million illegal tobacco sticks during the pandemic with a total value of R430 million.⁷⁵

Illicit alcohol

South Africa's market for illicit alcohol is historically large, with SARS estimated to be losing out on R11 billion in excise tax revenue a year due to illicit alcohol trade. In comparison, this represents the largest fiscal loss from illicit alcohol out of the 7 African countries measured in Euromonitor's global study on illicit alcohol trade.⁷⁷

South Africa's nationwide ban on domestic and export sales of alcohol products and production and transportation of alcohol products during the pandemic had a significant effect on alcohol consumption patterns and provided a massive boost to organized criminal involvement in the production and supply of illicit alcohol.⁷⁸

- Illicit traders seized the opportunity to provide cash-strapped consumers

with easy access to cheaper alternatives, almost doubling their market share in less than a decade. A survey on alcohol consumption in South Africa found that in July–November 2020, the majority of respondents purchased alcohol illegally while COVID-19 restrictions were in place.⁷⁹ By volume, illicit sales currently represent 22% of the South African alcohol market,⁸⁰ undoing a decade-long drive to formalize the alcohol sector in South Africa and bring it under regulatory control.⁸¹

- The growth of the illicit market is driven by a significant price gap between legal and illicit alcohol. After the dry sales ban in 2020, illicit prices were on average 43% lower compared to legal products.⁸² The demand for cheaper, unregulated illicit alternatives is amplified by high levels of unemployment and reduced disposable income due to inflation.
- In the face of widespread restrictions, the smuggling of alcohol across borders into countries with more restrictions increased, with numerous arrests of traffickers smuggling alcohol from Zimbabwe to South Africa.⁸³
- During the first and second alcohol ban, SAPS reported approximately 476 liquor outlet robberies. There were also examples of manufacturers being directly targeted and criminals stealing thousands of bottle caps with a view of refilling used, branded bottles with illegal alcohol, reseal them and then sell to consumers as genuine branded product.⁸⁴
- South African authorities intercepted a consignment of counterfeit labels arriving by air as part of Interpol's OPSON VIII and IX campaigns. During the subsequent raid six Chinese nationals were apprehended and large quantities of counterfeit labels and alcohol targeting the domestic market were seized.⁸⁵

IV. POLICY RECOMMENDATIONS TO COMBAT ILLICIT TRADE

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, properly staffed and with clear objectives to ensure long-term successful implementation of anti-illicit trade efforts.

In addition to the specific recommendations provided below, coordination and cooperation is imperative. For example, it will be important to define the roles and relationship of agencies responsible for health, security, trade and finance. Agencies such as the Department of Trade, Industry and Competition (DTIC), Department of Agriculture (DOA) and the South African Health Products Regulatory Authority (SAHPRA) must have effective pathways for coordinating with police and customs in the fight against illicit trade.

The Government must also equip SARS, the Reserve Bank, the Financial Intelligence Centre (FIC), SAPS Directorate for Priority Crime Investigation (DPCI) and other regulatory bodies with the resources they need to pursue criminal profits generated from illicit trade. The FATF has, for example, praised FIC for producing operational financial intelligence to help investigate predicate crimes and trace criminal assets, but that a shortage of skills and resources among law enforcement agencies was preventing the proactive identification and investigation of money laundering cases.⁸⁶

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 Free Trade Zones (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.

It is hoped that South Africa's new Border Management Authority (BMA) can serve as an important platform for coordination between different Government Departments involved in preventing the importation of illicit goods into South Africa. The BMA seeks to implement an integrated and coordinated approach to border management by removing the previous fragmented multi-agency approach comprising multiple authorities with different mandates under a single authority.⁸⁷

As a key player in the continental and global import and export supply chain, South Africa is also uniquely positioned to serve as a positive role model in addressing the threat that illicit trade poses to economic development of the African continent. In particular, South Africa can play a leadership role in facilitating trade and guaranteeing that the safety, quality and security of goods is maintained in the face of the African Continental Free Trade Agreement (AfCFTA). The fight against illicit goods must be a collective effort and it's critical that implementation of AfCFTA includes counter measures to protect businesses across the continent from losing billions of dollars in revenue due to illicit trade, or else risk that Africa becomes a large market for the production, import and trade in counterfeit goods.

Finally, 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. Genuine partnerships with the private sector can play an important role in improving enforcement actions. With real-time access to commercial data and private sector intelligence, enforcement agencies can improve the effectiveness of their operations and risk assessment techniques. Rights holders can also be more effective partners in investigations when they are informed by authorities of potential illicit trade affecting their brands, resulting in more deterrent criminal proceedings. Business can also contribute by continuing to develop technical solutions that protect the integrity of supply chains.

Priorities for South Africa

Improving governance and coordination

Strengthen interagency and inter-departmental cooperation at the national level, particularly by improving law enforcement capacities between SARS (South African Revenue Service), SAPS (South African Police Services), Department of Trade, Industry and Competition (DTIC) and the National Prosecuting Authority (NPA). Increased coordination across agencies responsible for health, economic, security, finance and customs are 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 independent, specialized "Anti-Illicit Trade Coordinator" with high-level authority within the national government supported by an anti-illicit trade framework with clear leadership responsibilities and accountabilities. Objectives would include raising the profile on illicit trade, allocating necessary financial and personnel resources (such as ensuring that SARS, NPA and SAPS are 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.

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.

Improve public awareness and education on the threat of illicit trade. Efforts to address illicit trade are hampered by a lack of public awareness of 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, including

highlighting the health risks to consumers and the drain that lost tax revenues have on public budgets and the government's ability to mobilize sufficient domestic tax revenue to provide for critical public services, infrastructure and healthcare.

Improving enforcement

Strengthen criminal penalties. Raising standards for criminal penalties across the country should be a priority to prohibit illicit traders from exploiting markets with the weakest penalty 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. More than half of reported crimes in South Africa fall into categories that generate criminal proceeds.⁸⁸ 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.

Engage in international law enforcement and customs cooperation, both bilaterally and within available multilateral mechanisms such as through the World Customs Organization (WCO) and the Organization for Economic Co-operation and Development (OECD), which has a specialized task force to counter illicit trade. Forging close operational links within the international law enforcement community and setting up functioning

criminal intelligence and information sharing platforms is critical for detecting and enforcing laws against international money laundering.

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.

Improving border controls

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.

Post Covid policy measures

For South Africa to restart and grow its economy, it must formulate policies and implement programs that deter and preclude illicit traders from consolidating roots in the post-pandemic economy. For example, severe, overly restrictive regulations, such as the temporary alcohol and tobacco bans introduced during the pandemic, must be avoided. In addition, policymakers must ensure that new regulatory measures do not create market inefficiencies or incentivize

consumers to choose illicit alternatives over available, safer, legitimate products. The following are valuable lessons learned from the pandemic that can help to avoid unintended and long-lasting negative impacts on illicit trade, the economy and society:

Avoid prohibition laws and extreme legislation and regulation that artificially reduce supply of safer legal products and create incentives for readily available illicit substitute products to enter markets. The adoption of evidence-based policy and legislation is recommended to avoid unintended consequences.

Ensure availability and access to legitimate products without inducing demand for illicit substitutes.

Ramp up implementation of enforcement measures to ensure that illicit trade activities caused by the pandemic do not become permanent features of the post-pandemic economy.

Avoid the imposition of “emergency tax” increases on products vulnerable to illicit trade so as to avoid lower consumption of legal products, smaller pools of tax collections and an increase in demand for untaxed, cheaper illicit alternatives.

V. CONCLUSION

This study shows that illicit trade is one of the biggest threats to stability and economic growth in South Africa. While the country has taken steps under President Ramaphosa to root out illegal trade and associated activities like corruption and money laundering, the scope and depth of the illicit economy poses a significant threat to the health and wellbeing of South African citizens and a persistent drain on the overall economy.

In providing an update on longstanding structural challenges, the report underscores how recent inflationary pressures, high levels of unemployment, widespread corruption, sophisticated organized crime networks and lingering effects from the COVID-19 pandemic have turbo charged the illicit economy. In particular, the COVID-19 pandemic provided wide opportunities for illicit traders to adjust and expand their operations during a time when government-imposed lockdowns, bans and other restrictions disrupted legal markets and created shortages.

For South Africa to restart and grow its economy, it must formulate policies and implement programs that deter and preclude illicit traders from consolidating roots in the post-pandemic economy. Left unaddressed, illicit trade and its associated criminal activities will continue to rob the government of essential tax revenue and deter investments in the country.

Tackling this challenge will require sustained political will of government officials at all levels to prioritize the problem, actively pursue solutions and invest in enforcement measures. It is our hope that this report can serve as a roadmap to help policy makers identify areas that merit greater attention and to formulate effective strategies to address the serious threats posed by illicit trade. As such, a set of policy recommendations are presented for which the South African government is encouraged to consider as it continues its work to rid the economy of illicit trade.

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