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Enhancing Africa's response to transnational organised crime

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African illicit financial flows

Designing and prioritising responses

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Summary

Africa is estimated to lose billions of dollars annually to illicit financial flows (IFFs). While the numbers are immense, even they do not capture the full range or degree of harms resulting from IFFs. Furthermore, international definitions, measures and regulatory frameworks are not always appropriate for the African context. As such, a stronger understanding of how IFFs are generated and moved and their impact is needed to better respond to African IFFs and prioritise action against the flows and activities that are the most harmful.

Key points

- There is a lack of consensus on definitions and methods to estimate the scale of IFFs which, driven by northern hemisphere countries, at times do not reflect the African context.
- Because the scale of an IFFs for does not always correlate with the severity of the harm, it is necessary to utilise harm frameworks and not rely on financial figures alone.
- IFFs tend to be cyclical in nature, both a product of and driver of insecurity and undermining rule of law.
- While a wide range of crimes contribute to African IFFs, natural resource crimes are particularly immense and harmful.
- The movement and laundering of IFFs includes the use of shell companies, trade based money laundering (TBML), and the use of money value transfer systems (MVTS).
- There is a pressing need for greater political will and investment into responses which go beyond technical compliance with international standards.

Contents

While London's luxury real estate market may seem far removed from the poverty and security issues that plague the oil-rich Niger Delta, both are intimately linked to African illicit financial flows (IFFs). Increasingly kleptocrats are laundering and concealing their illicit gains by purchasing high-end real estate in London, a practice enabled by weaknesses in the international financial system.[1]

Luxury London homes are at the centre of corruption investigations into Nigeria's former minister for petroleum resources, Diezani Alison-Madueke. Born into Nigerian royalty in the Niger Delta and the first female head of the OPEC oil cartel, Alison-Madueke is alleged to have leveraged her influence as minister to corruptly award lucrative government contracts to shell companies owned by Nigerian businessmen.[2]

The illicit funds were used to finance a lavish lifestyle, which included real estate in the UK and Nigeria. Properties included a UK mansion and two central London flats, bought for a total of nearly £10-million in 2011.[3] Two of the flats were bought by anonymous briefcase companies registered in the Seychelles and paid for with loans from a Nigerian bank.[4] The Federal High Court in Lagos ordered the interim forfeiture of $21.4-million-worth of properties and over $20-million in cash that allegedly resulted from illegal activities.[5]

> Enabled by weaknesses in the international financial system, kleptocrats are increasingly laundering and concealing their illicit gains by purchasing high-end real estate in London

Alison-Madueke continues to reside in the UK, despite an extradition request by Nigeria, an indication of the difficulty (or arguably lack of political will) faced by both African and destination states to prosecute crimes linked to corruption and IFFs.[6]

In sharp contrast to Alison-Madueke's extravagant lifestyle and spending, conflict and poverty are deeply entrenched in the Niger Delta, where the crude oil profits originate. Estimates of Nigeria's annual IFF losses are in the billions while public services like health care, education and infrastructure remain woefully underfunded.[7] Furthermore, IFFs undermine democracy and the rule of law. For example, according to Nigerian prosecutors, Alison-Madueke used $115-million to bribe officials to secure a victory for her party in the 2015 elections.[8]

While the scale of IFFs is remarkable on its own, the impact of IFFs on African development, the rule of law, and security is further multiplied, and truly remarkable in the most undesirable ways.

Introduction

Estimates of the value of African IFFs are phenomenally high. The United Nations Economic Commission for Africa (UNECA) estimates that net IFFs between Africa and the rest of the world from 2000 to 2015 averaged $73-billion (at 2016 prices) per year from trade misinvoicing alone.[9] This equals nearly 5% of Africa's GDP ($1.7-trillion in 2018) and dwarfs official development assistance, with sub-Saharan Africa receiving about $49-billion in official development assistance in 2017.[10]

It is widely agreed that IFFs are a critical threat to sustainable development in Africa. IFFs not only result in financial losses, but also thwart development in a plethora of other ways, including a reduction in security and stability. The Organisation for Economic Co-operation and Development (OECD) report *Illicit Financial Flows: The Economy of illicit Trade in West Africa* found that IFFs are a potent negative force that contributes to the degradation of livelihoods and ecosystems, undermines institutions, reinforces clientelist politics and enables impunity, in a variety of ways.[11] Furthermore, IFFs tend to be cyclical in nature, perpetuating the conditions which facilitate illicit activity.

Since the mid-2010s, a flurry of policy dialogue has called for curbing IFFs. The African Union (AU) committed to halve IFFs by 2023;[12] Sustainable Development Goal 16.4 calls for significantly reducing IFFs by 2030;[13] the Addis Ababa Action Agenda commits to substantially reducing IFFs by 2030;[14] the AU's Agenda 2063 cites curbing IFFs as a key tactic to achieving domestic resource mobilisation as a source of finance;[15] and the African Development Bank has adopted a strategic framework and action plan to prevent IFFs in Africa.[16]

Due to the immense and diverse nature of African IFFs, making these commitments operational requires a nuanced understanding of IFFs and a multi-faceted response. However, responses to date have tended to be limited and siloed, restricting their impact.

Given the magnitude of the IFF challenge and the reality of limited resources, it is inevitable that policy-makers will have to prioritise how and where they allocate anti-IFF resources. Thus, in order to prioritise interventions and mitigate the IFFs that do the most damage, it is critical to assess harm and seek to unpack how criminal markets work and the way in which they interact with local communities and formal and informal power structures.[17]

Conceptualising African IFFs

IFFs are often described as 'money illegally earned, transferred or used/utilised'.[18] Definitions tend to be vague and capture a wide range of undesirable activity and flows. When they are differentiated, a common framework to distinguish between IFF types is:

- Commerce: tax- and trade-related activities
- Crime: the proceeds of criminal activities and terrorist financing
- Corruption: the proceeds of theft, bribery, graft and embezzlement by government officials.

IFFs also differ in the ways in which they are illicit. IFFs include financial flows from activity universally recognised as illegal (i.e. cocaine trafficking), activities which are illicit but include some subsistence or informal livelihood component (i.e. crimes related to mineral resources), and the trade in normally legal goods which have broken regulations during circulation (i.e. tobacco trafficking).[19]

Beyond legality: accounting for legitimacy

The lack of clarity has implications beyond academic debate; it obscures nuances relevant for effective policy and programmatic responses.[20] The implications are heightened for African countries. For example, a challenge in the African context is that 'licit' and 'illicit' are often blurred, owing to an expansive informal economy. Due to a lack of viable livelihood opportunities in the formal economy, various forms of trade and industry, albeit illicit, provide invaluable subsistence-level activities. Often these activities are better classed as informal, rather than illicit.[21]

> While the scale of IFFs is remarkable, their impact on African development, the rule of law, and security is further multiplied in the most undesirable ways

Thus, when analysing IFFs and designing responses, it is important to account for legitimacy defined as social acceptability based on the norms, values and beliefs of large groups in society. Differentiating between legality and legitimacy is especially valuable in countries with large informal institutions that govern behaviour. If policies are not aligned with informal institutions, they may have the unintended impact of driving individuals to engage in the informal or illicit economy.[22]

Measuring the scale of IFFs

While there is debate over definitions, measures of the scale of IFFs are even more contentious. Still true today, a 2011 UN Office on Drugs and Crime study on IFFs found that 'there is currently no single method that would give clear, unambiguous, and indisputable results.[23]

Current prominent measures of IFFs are based on data-driven models which focus on a select number of indicators – namely, discrepancies in trade and balance of payments data as proxies for all forms of IFFs. First-generation estimates of the scale of global IFFs have played a critical role in drawing attention to the issue of IFFs. However, to date, no single measurement model has been able to generate reasonable, consistent and robust estimates of all types of IFFs. Methodologies have been subject to criticism due to a lack of reliable data and practical weaknesses. Also, because they rely on trade data and do not disaggregate between IFF types, they inherently give greater weight to 'commerce' IFFs.[24]

The research bias has significant implications for prioritising policy responses. Measures which inherently give greater weight to 'commerce' IFFs risk underestimating the contributions of corruption and criminal money to global IFFs.[25] This is reflected in the focus on tax-related IFFs in international policy dialogue.[26]

Further challenges to valuing African IFFs are large, cash-based economies and the wide use of informal financial networks, such as *hawala*.[27] Cash-based economies with large informal sectors are able to absorb large volumes of cash, both legitimate and ill-gotten, without any formal records. For example, a World Bank study on IFFs within and out of Malawi and Namibia found ample opportunities to spend or transfer illicit funds without entering the formal financial system, such as buying and selling real estate privately using cash.[28] Additionally, the Financial Action Task Force (FATF) mutual evaluation report for Ghana reports that the dominance of cash transactions, combined with a large informal sector, increases Ghanaian vulnerability to money laundering and terrorist financing.[29]

While aggregate estimates have been powerful as advocacy tools, it is critical to disaggregate IFFs by type in order to prioritise interventions and evaluate the efficacy of policy responses.[30] Furthermore, measuring IFFs solely in monetary terms gives disproportionate importance to the highest-value flows, without recognising that the underlying criminal activities of lower-value IFFs can have more severe negative impacts on African nations.

Impacts of IFFs: accounting for harm

Frameworks of harm

Departing from typical assessments of IFFs, which tend to focus on volumes, the OECD study of IFFs in West Africa, published in 2018, focuses on how they impact on development. The report puts forth a harm framework that revolves around five areas critical to development. These types of harm can be analysed and felt at the individual, community, national and international levels, with differences based on demographics, gender and specific vulnerable groups. They are:

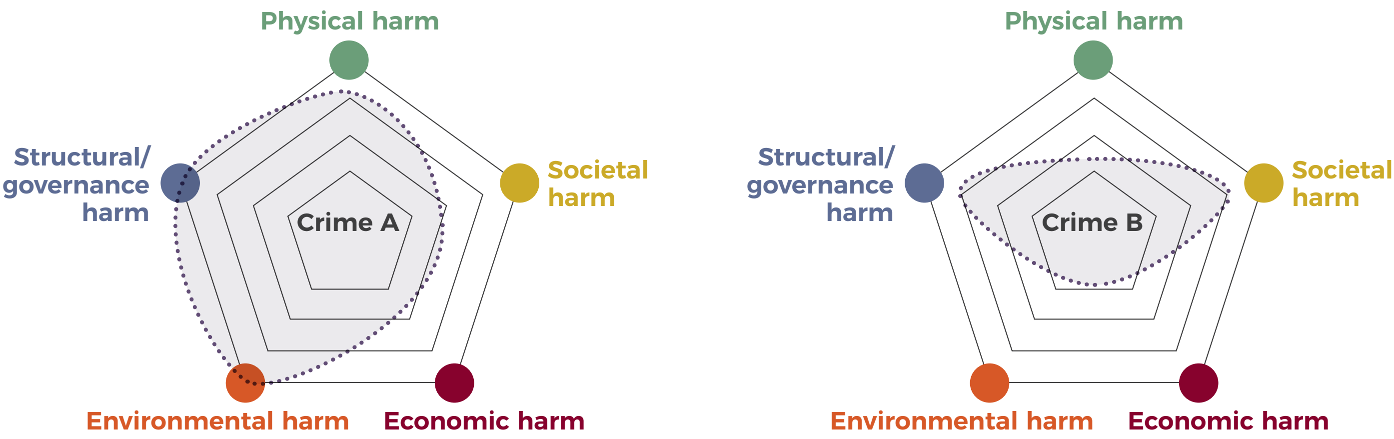
- **Physical harm:** Harm to persons or physical infrastructure
- **Societal harm:** Harm which creates or exacerbates societal tensions, including inciting conflict or violence, and/or economic or social marginalisation
- **Economic harm:** Direct or indirect harm to the economy
- **Environmental harm:** Harm to the environment, and
- **Structural/governance harm:** Harm to the quality of governance or the rule of law as a result of corruption, and through the erosion of the state's reputation, legitimacy and authority.[31]

In assessing harm, it is important to understand how IFFs are generated, the levels of local protection, and where vested interests lie. Questions provided by the OECD that can guide this type of analysis are:

1. **Where is the good sourced, and is there a local market?** If a good is sourced or used locally, communities may have a vested interest in perpetuating the commodity flow and groups trafficking the goods may have gained legitimacy. It also helps to assess how externally sourced goods might affect the legitimate economy.[32]

2. **Who are the actors and networks involved?** Criminal consortia are defined as the intersection of politics, business and crime, controlling and exploiting

Figure 1: **Application of the harm framework***



** Illustrative only, not actual assessment*

markets for their own ends.[33] The concept of criminal consortia reflects the often-interconnected nature of politics, governance and illicit activity in Africa.

Key figures in business and government can serve as pivotal nodes in networks that perpetuate criminal behaviour, initiating or organising transactions domestically and with international markets, protecting flows from seizure and network members from prosecution, and laundering money through legitimate businesses or international trade.[34]

> Key figures in business and government can serve as pivotal nodes in networks that perpetuate criminal behaviour

Political economy analysis is important to understanding these relations. It examines the interaction of political and economic processes in a society, the distribution of power and wealth between different groups and individuals, and the processes that create, sustain and transform these relationships over time.[35]

3. **Where are the IFFs earned and invested?** This helps to understand the extent of local communities' vested interests, the implications for local power hierarchies and corruption, and the net loss for states. IFFs that remain in the community, country or region contribute to informal economic activity. However, they also tend to play heavily into local power hierarchies, enabling and strengthening those controlling the flow.

   IFFs that are mostly accrued or invested abroad are a net loss to the state and its citizens. This is particularly true of natural resource crimes. IFFs that pass through countries and have a limited local market tend to contribute to elite corruption at a scale commensurate with the value of the flow – for example, narcotics trafficking.[36]

IFFs as drivers of insecurity

There is a cyclical relationship between IFFs, weak political institutions and insecurity. IFFs provide individuals engaged in organised crime, corruption, and rent-seeking the opportunity to realise and move illicit profits, which in turn fuel even more IFFs.[37] Thus, while they are facilitated and exacerbated by a diverse range of factors, the question 'who are the actors and networks involved?' is key to understanding the drivers and impacts of IFFs in Africa.

To protect illicit rents, criminal consortia will establish and maintain protection economies, which are characterised by the use of corruption or violence, often in some combination, to secure their profits.[38]

Corruption: Across Africa, corruption is used to secure protection economies. In turn, governance and electoral politics become invested in protecting illicit rents, rather than citizens. The framework developed by Mark Shaw and Tuesday Reitano in their study of global illicit flows and local conflict dynamics, published in 2017, is helpful in positioning state actors in criminal economies. Control ranges from full state control, to the state acting as a gatekeeper, to mixed control (where state actors have some presence locally but need to negotiate control with powerful actors who also have a degree of local control), to state weakness or absence. If there is a total absence of the state, local militias or warlords provide protection in its entirety.[39]

IFFs can also politically empower criminals. The ability to secure rents and provide livelihoods, whether licit or illicit, can translate into local authority and legitimacy.[40]

Conflict dynamics: Conflict dynamics are also integral to IFFs. Natural resource wealth provides financing opportunities to both state and non-state actors, which can alter the dynamics and sites of conflict, as well as sustain and prolong conflict.[41] As such, IFFs serve as both a means to an end (effecting violence and political change) and an end in and of themselves (maximising profits). When framed in this way, organised crime may be best understood as a 'strategy' adopted by a range of conflict actors (including the state) to achieve their objectives.[42]

When conflict persists, the economic interests of groups taking advantage of the economic opportunities resulting from instability become more entrenched and those involved become more invested in protecting the illicit income streams, including through violence.[43]

Involvement in conflict economies may also lower the incentives for insurgent groups to enter into ceasefires or peace agreements and, when easily accessed directly by cadres, natural resource wealth can prolong conflict by creating discipline problems that make it difficult for leaders to impose a settlement on followers.[44]

Democratic Republic of the Congo (DRC): One of the most infamous examples of IFFs fuelling conflict is the DRC gold trade. According to the UN, conflict gold provides the largest source of revenue to armed actors in eastern Congo. Hundreds of millions of dollars' worth of gold is thought to be smuggled out of the DRC each year, the vast majority of this to Uganda (and increasingly Rwanda).[45]

Belgian tycoon Alan Goetz is a prominent actor allegedly profiting from and enabling the trade in gold mined in eastern DRC conflict regions. A 2018 investigation by The Sentry investigative and policy team raises concerns that Goetz has processed gold at his African Gold Refinery in Uganda and then exported it to international locations, including Dubai, Europe and the US. Following the refinery's opening, Uganda has exponentially increased its gold exports, from exporting approximately $443 000 worth of gold in 2014 to an estimated $377-million in 2017. In this way, in addition to funding conflict actors, IFFs are thought to enrich criminals who benefit from an ongoing conflict which enables illicit gold flows to continue unimpeded.[46]

IFFs in Africa: acquisition and movement

Predicate crimes that enable IFFs

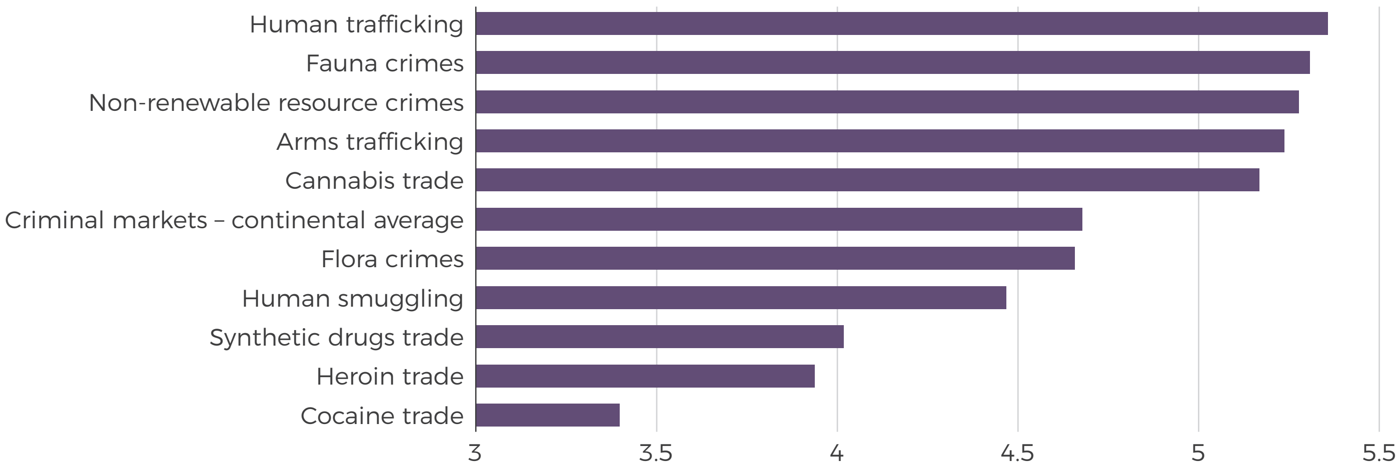
IFFs are acquired through a wide variety of means. They range from illegal activities (i.e. drug trafficking, kidnapping for ransom, maritime piracy, cybercrime, migrant smuggling, human trafficking, and the trafficking of substandard or counterfeit medicines), to the illicit trade in legal goods (i.e tobacco, firearms, and counterfeit and stolen goods), to the exploitation of natural resources (from minerals to flora and fauna).

In September 2019 the ENACT programme (Enhancing African capacity to respond more effectively to transnational organised crime) launched its Organised Crime Index. The Index is modelled on: i) the scope, scale and impact of criminal markets, ii) the structure and influence of criminal actors, and iii) countries' resilience to organised crime. The ranking of countries and accompanying maps and analysis help in assessing the scale and impact of various types of crime in Africa.[47]

It is important to note that IFFs resulting from lower-ranked types of crime can still have a detrimental impact on the countries where the IFFs are earned and invested. This is the case for higher-value drugs, such as synthetic drugs, heroin and cocaine. While those had the lowest average scores of the criminal markets assessed, the low rankings are a reflection of the concentration of the markets in a few countries and does not reflect the scale or impact of the IFFs in the countries where they exist. Also, although the illegal trade in protected flora ranked relatively low due to the lack of species in many African countries, in the handful of countries in which there is an illicit flora market it has a severely detrimental influence.[48]

FATF mutual evaluations also provide guidance on the scale and impact of IFFs from various predicate crimes in Africa which give rise to the illicit finance. While FATF

Figure 2: ENACT Organised Crime Index, scoring of criminal markets in Africa



Source: ENACT, 2019[49]

mutual evaluations have only been conducted for a small number of African states, reports include:

- In Ghana the most prevalent predicate crimes are fraud, stealing, robbery, tax evasion, corruption, and drug trafficking. Cybercrime was also commonly reported. Other predicate offences that pose medium money laundering threats include human trafficking, migrant smuggling, arms trafficking, counterfeiting of currency, counterfeiting and piracy of products, environmental crime, and forgery.[50]
- Mauritania faces several money laundering risks, such as corruption, illicit drug trafficking, smuggling and falsification of substances and products, kidnapping, illegal restraint and hostage-taking, trafficking in human beings and smuggling of migrants, and tax crimes.[51]
- Money laundering risks for Madagascar include corruption, the trafficking of natural resources (fauna, flora, mining resources), customs and fiscal offences, and drug trafficking.[52]
- A 2015 assessment of Zimbabwe found the predicate offences generating the most proceeds included smuggling, illegal dealings in precious stones, corruption, and fraud.[53]

IFFs from natural resource exploitation

IFFs linked to the exploitation of natural resources (i.e. minerals, oil, and flora and fauna) are especially problematic in Africa.

While it's difficult to value losses, IFFs linked to natural resource crimes are estimated to amount to billions of dollars annually. Of the West African criminal economies valued by OECD, IFFs linked to the gold and oil sectors far outweigh other illicit activities.[54] Research undertaken by UNECA points to mining and the extractive industries as among the main sources of IFFs.[55] This is reinforced by an ENACT study of the artisanal and small-scale gold sector, which estimates that billions of dollars worth of gold are smuggled out of the African continent annually.[56] Illegal activity in the oil sector heavily contributes to Nigeria's IFFs, which is estimated to suffer the greatest losses via IFFs of any African country.[57] As at 2014, illicit resource flows from oil bunkering were estimated at $110 billion.[58] Also, the value of IFFs generated from the illegal wildlife trade across eight Southern African countries between 2006 and 2014 is estimated to be $1.6 billion.[59]

IFFs linked to natural resource crimes are estimated to amount to billions of dollars annually

The impacts of natural resource IFFs

While the value of IFFs linked to natural resource crimes is significant, the negative impact go far beyond lost rents. The structural and governance harms resulting from natural resource IFFs are detrimental. Criminal consortia are heavily entrenched in natural resource crime, perpetuating kleptocracy, political instability, and weak tax administration, all of which enable IFFs to thrive.[60] They are not only significant in their own right, but also play a critical role in catalysing illicit activity and amplifying other types of harm. Large resource revenues facilitate rent-seeking and patronage, resulting in higher levels of corruption, the diversion of time and talent from productive activities, inefficient public spending, and low political accountability.

Structural and governance factors that enable criminal consortia to capture and exploit the natural resource sectors include:

- High-level discretionary political control: Control over resource sectors is often exercised by a small group of political elites. Political leaders' autonomy from the population and external donors reduces their accountability and their openness to reform.
- Blurring of public, shareholder, and personal interests: State companies, especially in the oil and gas sectors, may serve the personal interests of their political patrons.
- Limited competition: This results in fewer checks and balances in these sectors compared to other more competitive sectors.[61]

Also, the environmental harm from natural resource crimes is far greater than the crime itself. From the destruction of river systems and spread of mercury caused by illicit activity in the mining sector, to the loss of wildlife populations, like the rhino, the destruction of Africa's natural habitat by criminal economies is widespread and relentless. IFFs are key to these criminal economies, providing both a motivation and the means for criminals to exploit various natural resource sectors.

IFFs linked to natural resource crimes can also be linked to serious physical harm. Criminals may use violence to establish and secure protection economies. This includes non-state (and state) armed groups using violence to secure illicit rents. At least 63 African wildlife rangers lost their lives protecting wildlife reserves and nature sanctuaries in the 2016/2017 reporting period.[62] Also, one estimate of deaths linked to illegal mining in South Africa placed the number at 312 between 2012 and 2015, making it more conflict-affected than places in the DRC.[63]

Violence also continues to plague the Niger Delta. While armed groups take advantage of governance vacuums to engage in criminality and launch attacks with little resistance from the state, politicians use conflict as cover to pursue their own criminal activities. Promisingly, there are signs that levels of violence are dropping and it has become more difficult to amass and move oil revenues since Nigerian President Muhammadu Buhari has prioritised tackling corruption in the oil sector.[64]

A barrier to responsible sourcing

IFFs can also make it difficult for formal, legal buyers to compete and to support responsible sourcing practices. This is acutely felt in the African gold sector. Gold is attractive to illicit actors not only as an illicit income stream, but also as a money laundering vehicle. Prices paid for gold by informal and illicit actors are regularly near or above market price, making it impossible for formal, legal actors to compete in the sector. This is a major barrier to establishing and upscaling good practices in the artisanal and small-scale gold mining sector, a sector currently associated with the enrichment of illicit and corrupt individuals who exploit the sector for personal gain.[65]

Gold is attractive to illicit actors not only as an illicit income stream, but also as a money laundering vehicle

Madagascar: Similar effects are being felt in Madagascar's vanilla sector, a situation that is due to illicit rosewood logging in the country. *The Economist* reports that in 2010 the international community, concerned about deforestation, pushed the Madagascan government to close a loophole allowing rosewood exports. In turn, criminal actors turned to the vanilla sector to launder the vast sums of money being made from the rosewood trade. The brokers of illegal rosewood sales often operated in vanilla regions and had connections to vanilla collectors. Thus laundering illicit profits from the illegal rosewood trade via the vanilla trade was an easy form of hiding the source of the money.

This is thought to have fuelled the country's recent vanilla boom. By laundering rosewood profits via the vanilla sector, illicit actors artificially inflated vanilla prices. As a US-based vanilla trader told *The Economist,* in 2017 the quality of vanilla beans plummeted, yet prices were higher than they had ever been.

This jeopardises the ability of legal buyers to compete in the market, and foreign traders are now working to strengthen direct relationships and cut out the middlemen who are manipulating the market.[66]

In both contexts, weak regulatory bodies and perverse incentives created opportunities for arbitrage and exploitation, contributing to undermining the rule of law and creating or perpetuating the conditions necessary for IFFs to thrive.

Moving IFF: money laundering

The key to moving and spending illicit profits is money laundering. Money laundering methods in Africa are diverse and constantly evolving, often involving numerous financial institutions from many jurisdictions, and increasingly using non-bank financial institutions. UNECA reports that the use of non-financial businesses and markets for laundering appears to be increasing, including the creation of shell companies.[67] For example, money laundering linked to the Nigerian oil sector is facilitated by tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts, and trade mispricing.[68]

Vulnerability to money laundering

Countries with well-developed, international financial sectors are thought to be vulnerable to money laundering, acting as a gateway between Africa and the global financial sector. This is reflected in the scores of some of Africa's socio-economic capitals on the ENACT Organised Crime Index. Only three countries – Kenya, Nigeria and South Africa – were found to have both high criminality and high resilience to organised crime. The three countries are also thought to be hubs for IFFs, both generated domestically and as recipients of regional flows.[69]

In addition, the Seychelles has been linked to a number of international money laundering scandals in recent years,[70] and is well represented in the Panama Papers database.[71] However, committed investment by the country is thought to be reducing the scale of IFFs transiting through the country, an indication that the quality of governance and determined political will can effect change.[72]

Seychelles: Foreign businesses present the major source of money laundering threats to the financial integrity of the Seychelles. On many occasions, the business relationships and transactions involve non-resident customers, including high net-worth clients such as politically exposed persons (PEPs) and private actors, who are being serviced by intermediaries.[73]

While it is thought IFFs through the country have been reduced, the presence of cryptocurrency exchanges in the state raises red flags indicating that certain forms of money laundering may persist. Lax regulations and oversight are thought to make the country an attractive base for cryptocurrency exchanges seeking to offer anonymous services. For example, BTC-e, a cryptocurrency trading platform based in the Seychelles and Cyprus, allegedly cultivated an identity as a safe haven for criminal activity. BTC-e and its Russian executive have been indicted in multiple countries, including the US and Greece, for money laundering.[74] Additionally, in a recent report economist Nouriel Roubini, a professor at New York University, took aim at BitMEX, 'an unregulated trillion-dollar exchange of crypto derivates' domiciled in the Seychelles. Roubini claims that BitMEX insiders told him that the exchange is used daily for money laundering on a massive scale.[75]

Money laundering and IFF's typologies

Shell companies: The abuse of corporate vehicles, commonly referred to as shell companies, to move IFFs and launder money in and out of Africa is widespread. For example, the government of Sudan uses dozens of front and shell companies that enable individuals to circumvent sanctions.[76] In fact, corporate vehicles have been used in every single major international corruption and money laundering case in recent years. The rise in shell companies makes identifying the true beneficial ownership of companies an important component of anti-money laundering regimes.

Central to establishing beneficial ownership is the 'know your customer' principle, which requires banks and other financial institutions to establish the true identity of customers and ascertain that the proposed account or transaction fits with the claimed legal purpose of the account. While the global anti-money laundering system has made progress, identifying beneficial owners remains a challenging task, especially when individuals (such as PEPs) wish to remain hidden or hide the origins of their wealth. Furthermore, many corporate vehicles have complex, multiple layers of ownership and shareholders and span multiple jurisdictions. The use of 'gatekeepers' (i.e. persons nominated as the controlling party of the legal entity, sometimes corporate service providers or lawyers) and frontmen/women (often close associates, relatives, etc.) further frustrates 'know your customer' efforts.[77]

Republic of Congo: A recent example of the use of shell companies to launder money comes from the Republic of Congo. An investigation by Global Witness revealed that the children of President Denis Sassou-Nguesso seemingly stole over $70 million from the Congolese treasury by setting up complex and opaque corporate structures in multiple countries. The president's son Denis Christel Sassou-Nguesso and daughter Claudia Sassou-Nguesso, who are both also elected members of the Congolese parliament, are thought to have stolen over $50 million and nearly $20 million respectively. In the case of Denis Christel, to disguise the provenance of the funds, the money travelled via secrecy jurisdictions, such as the US state of Delaware and the British Virgin Islands, before reaching shell companies in Europe. Denis Christel was the hidden owner of at least five EU-based shell companies (located in Cyprus, Estonia and Spain) and used the money to make payments to companies in Poland, Portugal, Spain and Switzerland.[78]

Trade-based money laundering (TBML): This is one of the main methods by which IFFs are disguised, moved and integrated into the formal economy. TBML is defined by the FATF as 'the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins'. This often involves the over-invoicing or under-invoicing of the value of goods, depending on the direction of the IFFs. TBML has increased in attractiveness as controls have tightened on other forms of money laundering, such as moving finances through formal financial institutions and the physical movement of cash.

African extractive industries are especially vulnerable to TBML. For example, gold smuggled into Uganda from neighbouring DRC is reportedly paid for with commodities that can range from cars and motorcycles to construction materials. The transactions are intentionally done outside formal banking channels and render the entire process paperless. Similar practices are reported across the continent, from the Sahel to southern Africa.[79]

Globalisation has also enabled TBML. Trade regulation in many countries has struggled to keep up with the exponential growth of global trade, with states finding it hard to bridge the gap between realising the benefits of trade while effectively combatting TBML.[80] In particular, there is a significant crossover between free trade zones and TBML threats. Free trade zones are designated areas within jurisdictions in which incentives are offered to support the development of exports, foreign direct investment, and local employment. A 2010 FATF study identified a number of systematic weaknesses that make free trade zones vulnerable to money laundering, including relaxed oversight, lack of transparency, absence of trade data and systems integration.[81]

Gold smuggled into Uganda is reportedly paid for with commodities that can range from cars and motorcycles to construction materials

South Africa: One example of TBML comes from investigations into the Gupta family, a name synonymous with corruption in South Africa. The Guptas are at the centre of South Africa's Judicial Commission of Inquiry into Allegations of State Capture. The commission is holding hearings on the Gupta family's role in grand corruption during former president Jacob Zuma's time in office from 2009 to 2018.

Investigations have revealed that in one instance the Guptas engaged in TBML to launder kickbacks from Transnet, a company owned by the South African government. Uncovered by the amaBhugane Centre for Investigative Reporting and by Scorpio, the investigative unit of the *Daily Maverick*, in 2012 and 2013 Transnet bought seven of the world's most expensive cranes at an inflated price from Chinese supplier Shanghai Zhenhua Heavy Industries (ZPMC) as part of a 'kickback' contract. ZPMC had a contract with Dubai-based company JJ Trading (a shell company allegedly used by the Guptas to launder money) which stipulated that JJ Trading would handle the bid but would only get paid if the ZPMC won the contract. When ZPMC won the contract, the cranes were worth no more than $81-million (R570-million then), but the company was paid an inflated price of $92-million (R650-million then) to make room for 'commissions and fees'. Thus, as a result of over-invoicing, JJ Trading pocketed $12-million (R84-million). It is implied this payment went to the Guptas in return for securing the Transnet contract for ZPMC.[82]

Sierra Leone: In Sierra Leone, a Judicial Commission of Inquiry into State Plunder and Fraud during Ernest Bai Korma's tenure as president (2007-2018) revealed a TBML scheme where taxable goods were declared as non-taxable goods, such as water and rice. A percentage of the savings was given as bribes to senior officials. In 2007 $24-million worth of rice was imported. This figure more than doubled in 2008 to $59.2-million and in 2017 Sierra Leone reported importing $191.3-million in rice. Rather than evidence of a rice craze taking over the nation, it was concluded that imports such as cement (which had reportedly declined in spite of an increase in corruption), were being declared as rice. This is thought to have resulted in about $390-million in unpaid duties.[83]

Alternative and informal financial systems

Money or Value Transfer Systems (MVTS), such as internet and mobile money transfer services, and traditional banking systems, like *hawala*, are also commonly used for money laundering and to move IFFs.[84]

MVTSes are widely used across Africa, the result of vast informal economies and low levels of financial inclusion. Access to the formal banking system is out of reach for the majority of ordinary people and operators who transfer money for them tend to be prohibitively expensive. For example, the mobile money system M-PESA is used by millions of Kenyans and is growing both in user numbers and geographic spread. Thus, MVTSes serve a critical financial role for vast segments of the population.

However, because MVTSes operate outside the purview of formal financial institutions, the ability of financial intelligence units to identify money laundering and combat IFFs is limited. In particular, concerns have been raised about the use of M-PESA to launder money.[85]

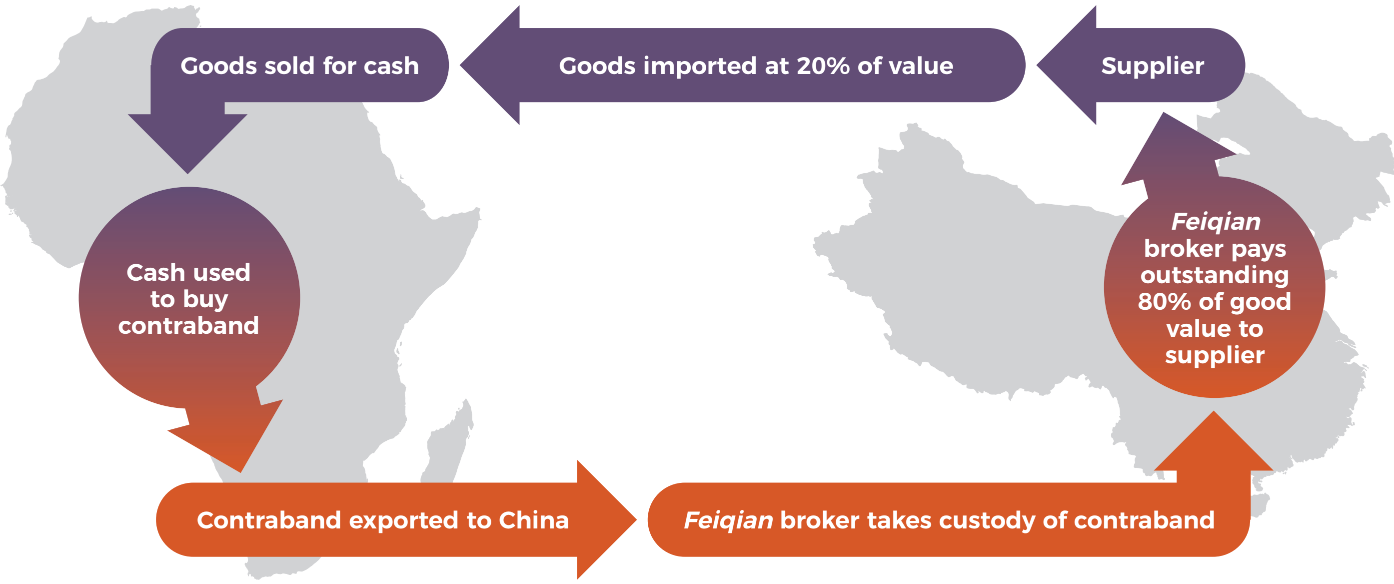
MVTSes highlight the challenge of developing effective responses to IFFs, while encouraging development and minimising harm. Anti-money laundering regimes, including those aimed at mobile-money operators, may have the unintended effect of undermining efforts to combat IFFs. More comprehensive financial sector regulations and record fines levied against banks in recent years have pushed banks to adopt 'de-risking' practices. When 'de-risking', financial institutions limit their risk exposure to certain countries, often developing countries or those experiencing conflict, and disengage with high-risk sectors and activities in a wholesale fashion. This has direct implications for many African states and sectors prone to IFFs, such as extractives. Thus, anti-money laundering regimes may negatively affect financial inclusion, contributing to the growth of MVTSes and an environment conducive to IFFs and money laundering.

Kenya: Identified as a money laundering hot spot in 2018 by the US Bureau of International Narcotics and Law Enforcement, Kenya remains vulnerable to money laundering, in particular via MVTSes. Kenya is at the forefront of mobile banking. As the financial hub of East Africa, its banking and financial sectors are growing in sophistication, and it is at the forefront of mobile banking. Most of Kenya's 165 900 mobile-money agents use Safaricom's M-PESA system, and there are 14 million accounts on M-Shwari, a mobile lender. These services remain vulnerable to money laundering activities. For example, M-PESA is thought to have been used as a substantial financing vehicle to fund the al-Shabab attack on the Dusit Hotel complex in Nairobi on 15 January 2019 which killed at least 21 people.[86]

Feiqian – 'flying money': An MVTS which has received less attention is the ancient Chinese MVTS *feiqian*, or 'flying money', which is thought to be enabling the multi-billion-dollar illicit environmental trade. Similar to the *hawala*, *feiqian* relies on a network of brokers which enables the trade of illicit commodities without money ever leaving China. An 18-month investigation by Namibian journalist John Grobler as part of the Money Trail programme found that in practice the system relies on the systematic under-invoicing of Chinese imports into Africa and a seamless chain-of-payments system in which accounts are settled through the transfer of high-end — and often illicit — goods such as abalone, rosewood, rhino horn and ivory.

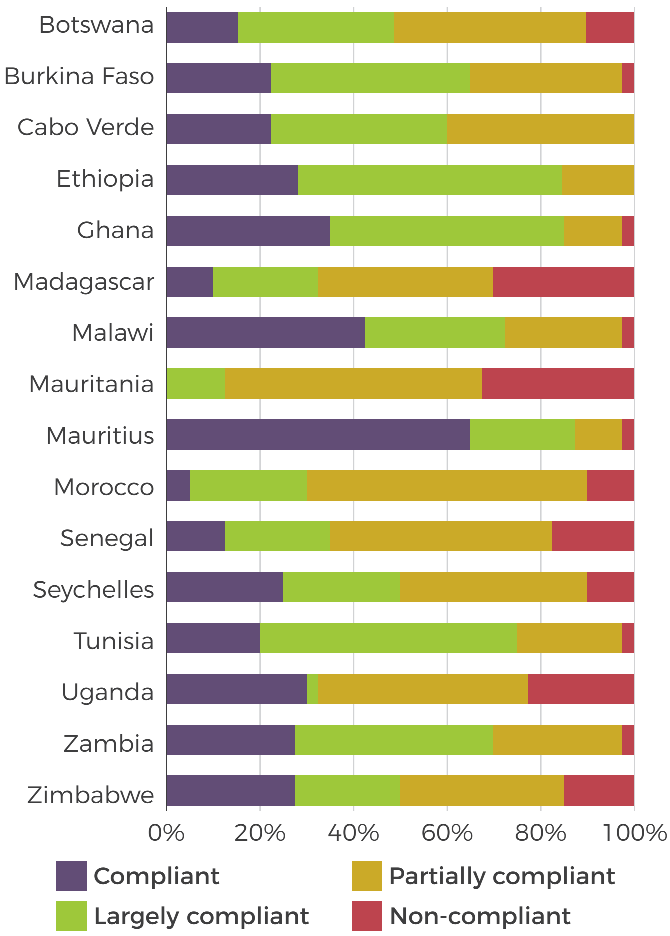
Operators mostly seem to be older, well-established women working in a closed network of mutually trusted contacts, making the system incredibly difficult to detect and regulate. Once the initial investment returns to China, it is doubled by buying cheap goods which are then exported to Africa at under-declared value, thus further perpetuating IFFs, the detrimental impacts on the environment and the undermining of the rule of law.[87]

Figure 3: Visualization of *feiqan* and TBML IFFs*



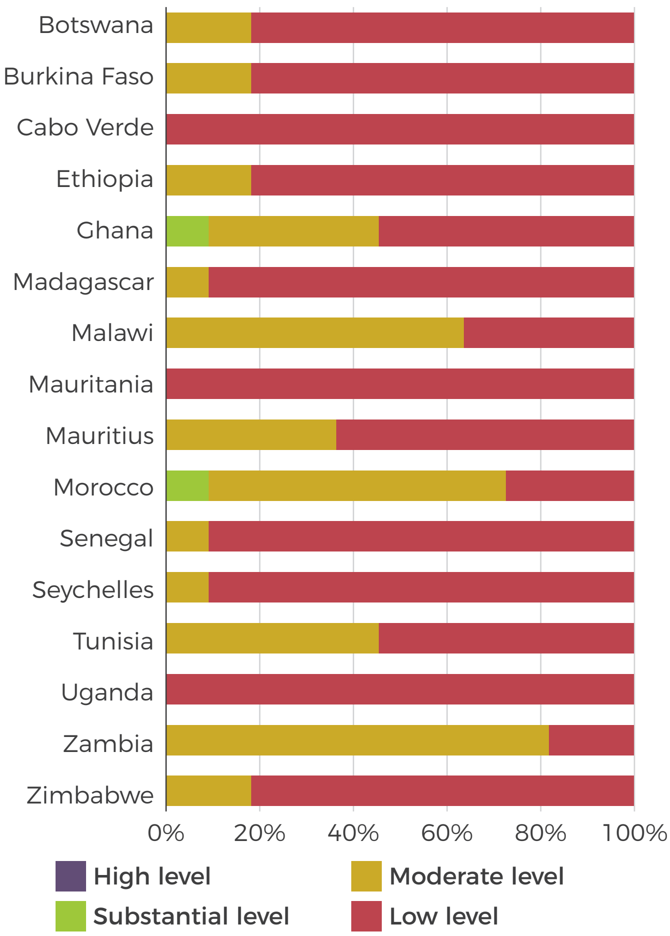
** Adapted from Grobler, 2019*[88]

Figure 4: FATF technical compliance ratings (40 indicators)



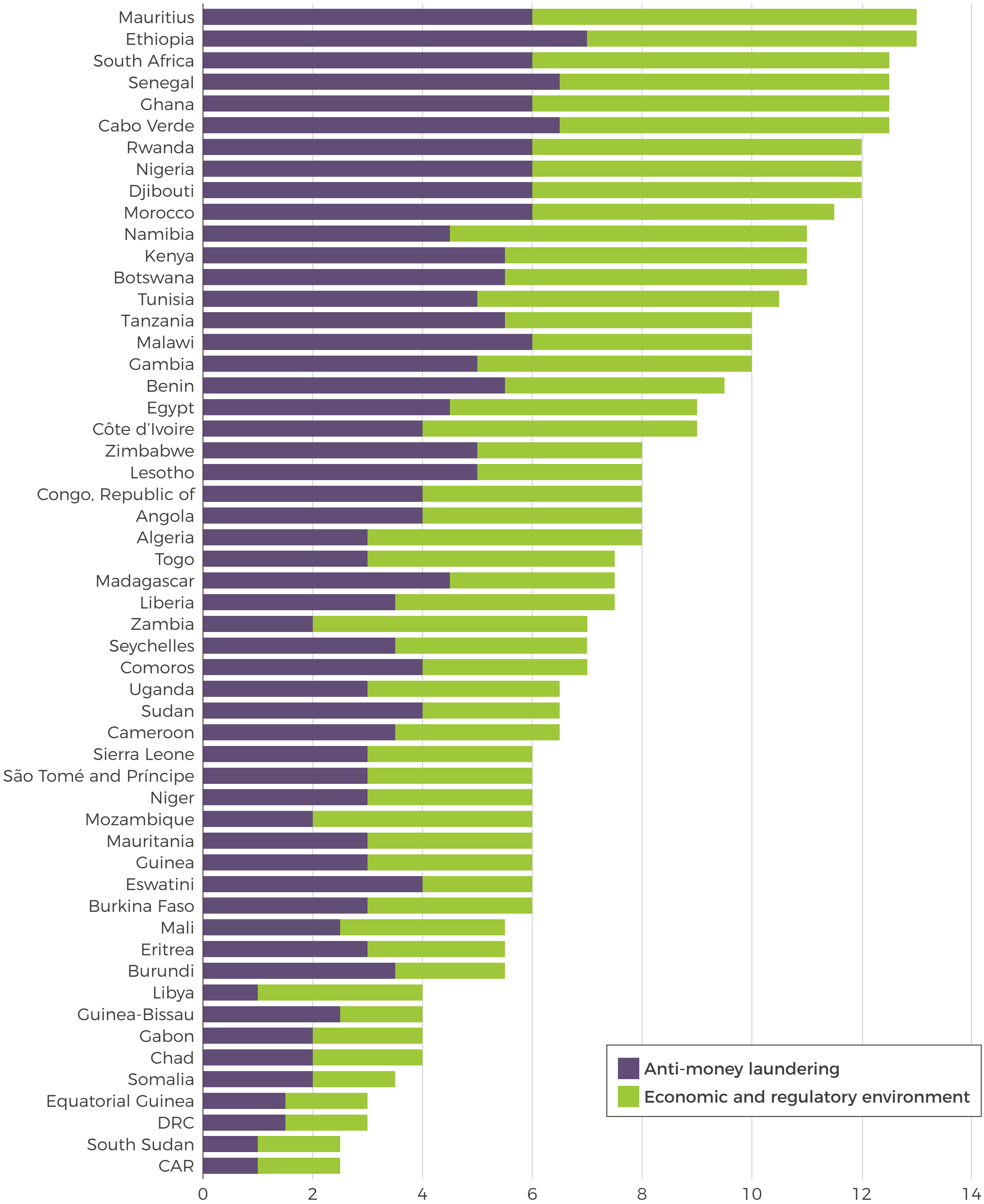
Data source: FATF, 2019[89]

Figure 5: FATF effectiveness ratings (11 indicators)



Data source: FATF, 2019[90]

Figure 6: Economic and financial resiliency scores



Source: ENACT, 2019

In particular, *feiqian* has become visible in the smuggling of hardwood from African countries that have deep forest resources but nonconvertible currencies. For example, when the oil price collapsed in 2014, foreign banks refused to sell US dollars to Angola until all outstanding debts had been settled. As a result, some Chinese traders in that country started converting their worthless kwanza to rosewood logs that were (mostly) smuggled via Namibia to China, where they were sold for very convertible yuan.[91]

Also, in South Africa *feiqian* seems to be at the heart of the multi-billion-rand drugs-for-abalone trade. Yet, efforts by law enforcement to link intercepted shipments and Chinese buyers have proved fruitless.[92]

Combatting IFFs

African IFFs are immense and diverse, requiring a multi-faceted response. However, to date, responses have tended to be limited and siloed, restricting the impact of responses.

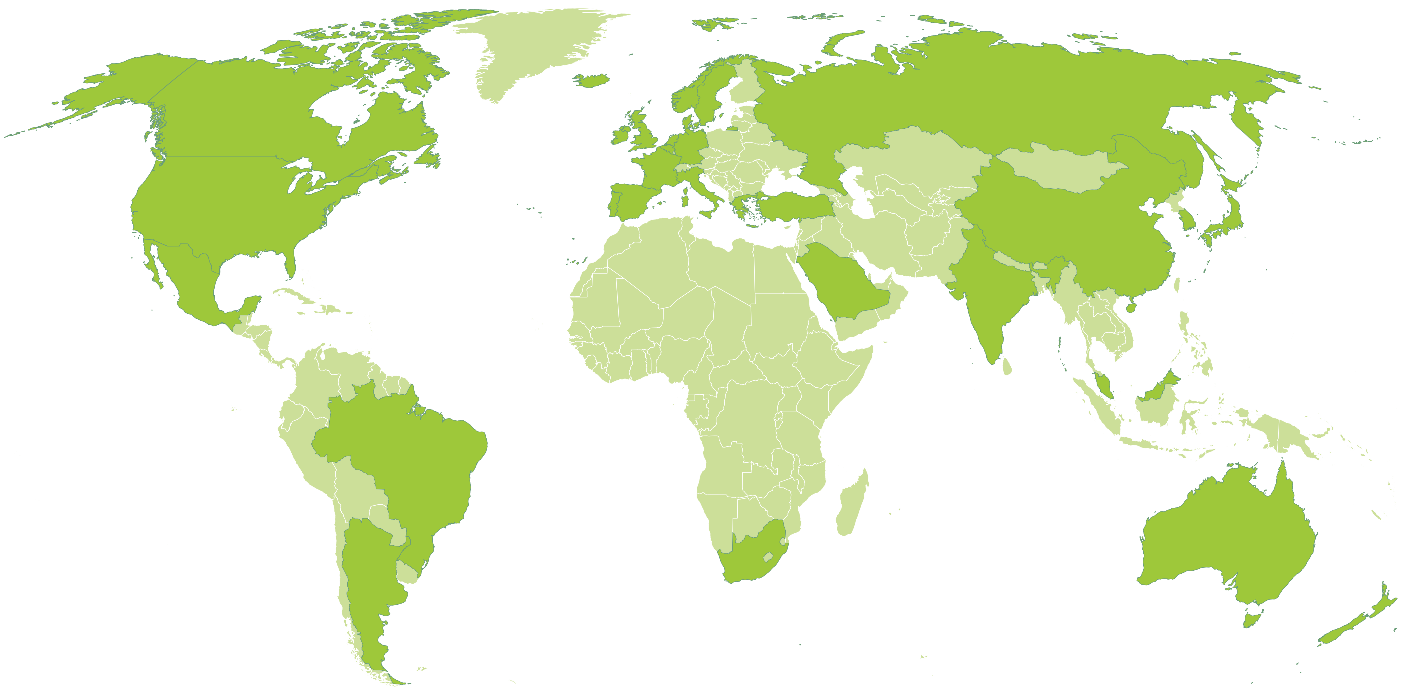
In dealing with organised crime more broadly, the greatest investment appears to have been made in building up the architecture, which suggests that some political will is in place. However, its weak implementation undermines its effectiveness, and in turn countries' resilience to organised crime. This is reflected in responses to IFFs. While progress has been made in complying with FATF recommendations, even states that are largely compliant have very low effectiveness ratings.

This may be due in part to International action against IFFs largely being driven by actors outside the continent, which may in turn not respond to the IFF types that have the most detrimental impacts on the continent or the most effective strategies in the African context.

In particular, the FATF has set global anti-money laundering standards since 1989. Currently the FATF only includes one African nation, South Africa. Despite major money laundering scandals uncovered in some member states, the FATF has yet to 'name-and-shame' one of their own. In contrast, there have been accusations that the ratings of non-member countries are the result of political jockeying among members. While economically powerful countries can use trade and investment relations to influence decisions, most African states do not have the economic weight to influence their money laundering risk rating or to shape anti-money laundering regulations.[93]

Furthermore, due to the immense informal economies in Africa and blurring between legal and illegal activity, responses to African IFFs must account for the legitimacy of actions and flows. This includes both illegal activity

Figure 7: FATF member states



which is viewed as highly legitimate (i.e. informal) and legal activity that is viewed as highly illegitimate (i.e. predatory). However, by virtue of analysis being driven by northern hemisphere destination markets, analysis of global IFFs has tended to focus on the scale of IFFs, and less on who has enabled the flows and their impact. By judging the legitimacy of flows from a local perspective, decision makers are better positioned to appreciate local and long-term developmental impacts.[94]

Recommendations

1. Prioritise responses which target the most harmful IFFs and most influential actors

To maximise the effectiveness of anti-IFF efforts, responses ought to be prioritised and designed to target the most harmful IFF types and most influential actors. Importantly, assessments should centre on levels of harm and not be based solely on the value of IFFs, especially since the two are often not correlated. By assessing how and where IFFs are invested and analysing the harm produced by all types of IFFs, interventions are likely to be more effective in reducing the negative impacts of IFFs and in supporting the achievement of developmental aims. In the African context, IFFs linked to natural resource exploitation have an especially detrimental impact, in particular resulting in structural and governance harm which exaggerates other types of harm and perpetuates the conditions conducive to IFFs.

2. Build political will and state capacity to combat IFFs

Holistic strategies that account for and respond to the unique set of threats and harm IFFs pose to African states are needed. Past experience has shown that when state and legislation are adequate, effective responses fall short in the implementation phase. In particular, a reduction in IFFs will fail to deliver returns in development if elite corruption continues. Political will and the commitment of sufficient resources are critical to reducing IFFs. These require strengthening the integrity of financial and trade systems and directly tackling criminal networks, while also working to alleviate the governance and developmental conditions that give rise to IFFs. By leveraging both state and non-state actors, and working at international and local levels, exposure, awareness raising and activism can promote or discourage behaviour.[95]

a) Strengthen and empower prosecutorial bodies

For legal frameworks to be effective, investigative and prosecutorial bodies must be empowered. Financial intelligence units should have the authority to coordinate action and collect information from different arms of government.[96] This also requires adequate funding. Additionally, concerted efforts must be made to ensure that those charged with tackling IFFs have the necessary skills and resources to conduct financial investigations.[97]

b) Coordinate agency efforts

Units involving agencies from across government will be key to establishing and coordinating action. In addition to financial intelligence agencies, multi-agency units should include law enforcement, customs, prosecutors, and judicial authorities, anti-corruption authorities, natural resources and mining authorities. Civil society could also be engaged. Such units will enable agencies to come together to coordinate and to develop policy. To ensure multi-agency units function effectively, regular meetings should take place and laws should be enacted which allow for an exchange of information.[98]

3. Ensure appropriate legal frameworks are in place

Laws clearly prohibiting IFFs, money laundering and predicate crimes need to be in place. Given the rise of TBML, anti-money laundering regimes need to cover both the finance and trade sectors. Laws outlawing trade mispricing are needed to put businesspersons on notice and to empower prosecutors.[99] Prosecution under economic crimes legislation may increase the prospects of success and carry weightier custodial sentences than predicate crimes, reducing the likelihood of impunity.[100]

Also, factors specific to the African context need to be accounted for in designing regulatory frameworks, in particular large informal economies and efforts to increase financial inclusion. De-risking practices by banks which may be desirable in wealthy states in the northern hemisphere may have adverse impacts in Africa, increasing financial exclusion and pushing people to use MTVSes which are more difficult to regulate. Efforts to combat IFFs must account for these other developmental concerns. Innovative responses and investment in the development of technology (such as that which could help to better regulate mobile money systems) are needed.

4. Improve transparency around beneficial ownership, especially in the extractives sectors

Corruption and criminality are difficult to detect and prosecute when legal frameworks and regulatory systems lack mechanisms for integrity, transparency, and accountability. This is especially true of the extractives sector, where transactions are often opaque, complex, and transnational. Greater transparency around beneficial ownership, particularly in the extractives sector, is needed to combat African IFFs.[101]

Trust Africa makes a number of recommendations on this point, including: establishing or enhancing online corporate registries and making information publicly available; requiring all government contract bidders to provide information on beneficial ownership; and requiring disclosure of beneficial ownership information in political asset declarations. In relation to natural resources, Trust Africa also calls for independent mechanisms to verify beneficial ownership.[102]

Recent action by the Extractive Industries Transparency Initiative (EITI) is encouraging. By 2020, all EITI countries have to ensure that companies that apply for or hold a participating interest in an oil, gas or mining licence or contract in their country disclose their beneficial owners. The EITI Standard also requires PEPs to be transparent about their ownership in oil, gas and mining companies. This information will be publicly available and will be published in EITI Reports and/or public registries. By joining the EITI and complying with its requirements, African governments can take affirmative action against IFFs. Law enforcement, civil society, international organisations, and others can also aid anti-IFFs efforts by scrutinising information and taking action against those who misuse anonymous companies.[103]

5. Tighten financial regulations in major transit and destination jurisdictions for African IFFs, including the UK, the US and the UAE

The UK, US and UAE have all proven to be desirable locations to plant IFFs earned and moved out of Africa, enabled by weaknesses in the international financial system. In particular a lack of transparency around ownership of properties and companies is a major hurdle to identifying IFFs and their owners, so that action can be taken. Public beneficial ownership registries and an expansion of the range of legal and administrative tools available to identify and investigate suspicious financial and property transactions are needed.[104]

In 2018 the UK took a number of proactive steps, including the creation of the Unexplained Wealth Order. The order empowers UK prosecutors to force individuals to explain how they acquired wealth in excess of their salary and if the individual refuses or inadequately responds, the government may seize the official's suspect assets under the Proceeds of Crime Act.[105] Also, the British government announced that they would create a register of owners of overseas companies buying property in the UK. It is due to go live by early 2021.[106]

> The UK, US and UAE have all proven to be desirable locations to plant IFFs earned and moved out of Africa

Such efforts are a step in the right direction and must be continued and replicated by other governments to strengthen the fight against IFFs.

6. Foster partnerships with the private sector

Efforts should be made to strengthen partnerships with private sector actors, in particular with financial institutions. The financial sector plays a pivotal role in combatting IFFs. Since the efforts of financial institutions are unobservable and costly, enforcement frameworks ought to be designed in a way that produces not only costs for non-compliance, but also positive incentives to engage. One way in which governments may better support the financial sector is through increasing the flow of information to private sector actors and better facilitating coordination.

States can also encourage financial institutions to file suspicious activity reports, which may provide authorities with additional information useful for identifying and targeting IFFs and illicit actors, including kleptocrats. Governments, as well as international bodies like the FATF, can provide feedback to institutions so that they may 'fine tune' their transaction monitoring and reporting of suspicious activity and are better able to identify money laundering and IFFs.[107]

7. Strengthen regional and international cooperation

Regional and continental approaches are essential, as inequities between states create opportunities for criminal economies to develop and move to new countries or sub-regions. Due to the transnational nature of IFFs, countries of origin, transit and destination must also engage in coherent and coordinated policy action. Cooperation may include the development of common strategies, policies, legislation, and trade and taxation regimes, as well as criminal penalties.

Greater information sharing and support for capacity building would be useful, both formally and informally, especially between key source and destination countries. This could take the form of memorandums of understanding, mutual legal assistance treaties, and regular gatherings. Also, connecting financial intelligence units to international networks, such as the Egmont Group, can help facilitate cooperation.[108]

When IFFs have been identified, they are often in different jurisdictions and asset seizure is a challenge. As proposed by Trust Africa, the establishment of an asset recovery office within the African Union would be of value. The African Development Bank has also committed to supporting a regional network on recovery of stolen assets. The office could assist with and facilitate asset repatriation requests among states.[109]

Western diplomats may also provide assistance by notifying their governments of the identity of kleptocrats and other illicit actors, thus preventing the movement of IFFs to locations such as London and the US. Visa bans could be used more frequently to target known kleptocrats as part of anti-corruption strategies.

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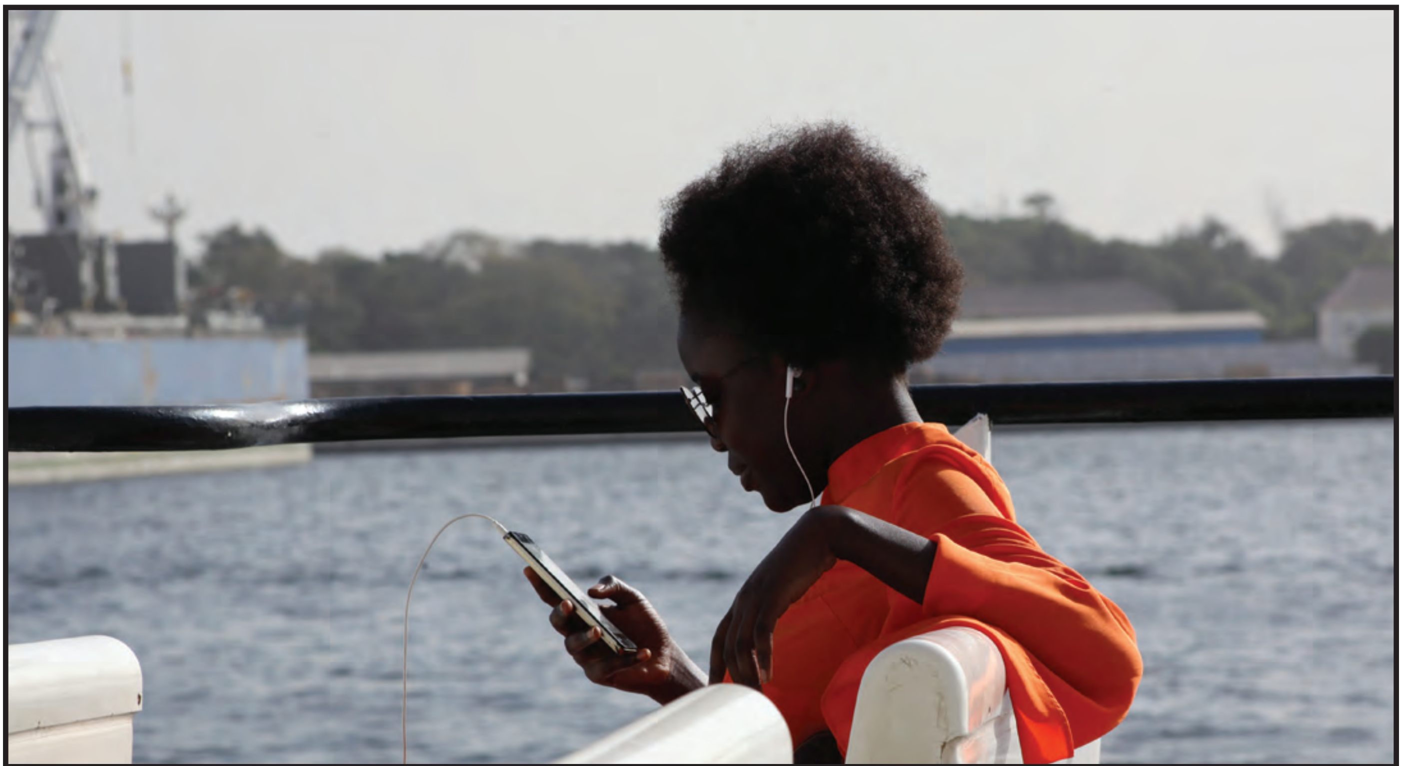

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About the author

Marcena Hunter is a Senior Analyst at the Global Initiative Against Transnational Organized Crime, which she has been with since 2012. Marcena provides research for a number of Global Initiatives projects, analysing a diverse range of organized crime flows, including illicit financial flows, and developing responses. While her work covers a wide scope of material and geographic spread, her current work has focused on gold-related crime and development responses to organised crime. Marcena previously worked with STATT, a boutique global consulting firm, where she analysed migration flows and guided security sector and criminal justice reform. Her past work also includes projects improving access to justice, analysing gender issues, and supporting the Voluntary Trust Fund for Victims of Human Trafficking at the UNODC. Marcena has a JD from Washington and Lee University, and a BA in Political Science from the University of Denver. She is currently based in Queensland, Australia.

About ENACT

ENACT builds knowledge and skills to enhance Africa's response to transnational organised crime. ENACT analyses how organised crime affects stability, governance, the rule of law and development in Africa, and works to mitigate its impact. ENACT is implemented by the ISS and INTERPOL, in affiliation with the Global Initiative Against Transnational Organized Crime.

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