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Addressing Illicit Financial Flows in East and Southern Africa

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About the author

Michael McLaggan is an analyst at the Global Initiative against Transnational Organized Crime working primarily at the organisation's East and Southern Africa Observatory. His work focuses on illicit markets and their intersection with criminal governance and political economy and has included specific focus on the markets for illicit drugs, excisable goods, and charcoal, to name a few.

About SOC ACE

The Serious Organised Crime & Anti-Corruption Evidence (SOC ACE) research programme aims to help 'unlock the black box of political will' for tackling serious organised crime, illicit finance and transnational corruption through research that informs politically feasible, technically sound interventions and strategies. Funded by the UK's Foreign, Commonwealth & Development Office (FCDO), SOC ACE is a new component in the Anti-Corruption Evidence (ACE) research programme, alongside Global Integrity ACE and SOAS ACE. SOC ACE is managed by the University of Birmingham, working in collaboration with a number of leading research organisations and through consultation and engagement with key stakeholders.

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Acronyms and abbreviations

AfCFTA African Continental Free Trade Area

AU African Union

BRI Belt and Road Initiative

CITES Convention on International Trade in Endangered Species of Wild Fauna and Flora

EEZs Exclusive Economic Zones

EPZs Export Processing Zones

ESAAMLG Eastern and Southern Africa Anti-Money Laundering Group

FATF Financial Action Task Force

FTZs Free Trade Zones

GFI Global Financial Integrity

GI-TOC Global Initiative against Transnational Organized Crime

ICIJ International Consortium of Investigative Journalists

IUU fishing Illegal, unreported and unregulated fishing

IFFs Illicit financial flows

IMF International Monetary Fund

OCCRP Organized Crime and Corruption Reporting Project

SEZs Special Economic Zones

TBML Trade-based money laundering

UNCTAD United Nations Conference on Trade and Development

Summary

Prominent throughout the world, illicit financial flows (IFFs) not only undermine the ability of states to collect revenue, but they also pose challenges to governance and the rule of law and provide avenues for the funding of further illicit activity. Although a global occurrence, IFFs may manifest differently at the regional level, making a uniform approach difficult. This calls for a model that is more inclusive of different types of flows than traditional understandings of IFFs, which tend to focus on financial flows within the formal system.

In regions such as East and southern Africa, where informality is much higher than in the developed nations of the 'global north', the greater focus on formal systems does not find the same degree of applicability. This is not to downplay the necessity of observing and countering formal financial flows of an illicit nature but rather to emphasise the need to pay greater attention to informal and trade flows, which are prolific in less developed regions.

This paper draws on extensive research by the Global Initiative against Transnational Organized Crime (GI-TOC) – in particular, the Observatory of Illicit Economies in East and Southern Africa – in addition to research by other international organisations, to analyse whether the 'IFFs pyramid' proposed by the GI-TOC (Reitano, 2022) is applicable to and useful for researchers seeking to understanding illicit financial flows in various settings around the world but especially in regions where greater levels of informality exists, such as East and southern Africa.

The paper finds that the pervasive informality of markets in the East and southern African region, and their abuse by criminal actors, means that greater attention to IFFs is necessary in this sphere. Common also is the use of illicitly acquired, or otherwise illicitly traded commodities, in barter (that is, goods for goods) markets. Identified as particularly relevant is the pernicious influence of state-embedded actors, who often play substantial roles in the facilitation of IFFs and act as obstacles to policies to address them. Furthermore, vested interests of criminal actors in keeping certain industries and markets informal serve as barriers to formalisation and highlight the greater need to pay attention to informal financial flows especially.

The due consideration to trade and informal flows is what makes the IFFs pyramid a useful model for understanding these flows in both global and regional settings. At the very least, the pyramid model highlights the need for holistic approaches and policy reform when considering IFFs in less developed regions.

1. Introduction

IFFs pose a serious threat to economic growth and human development in Africa. In 2020, the United Nations estimated that the continent loses US$88.6 billion per year in illicit capital flight alone, equivalent to 3.7% of African GDP (Chalier, 2021). Between 1980 and 2009, an approximate amount of US$1.2 to 1.4 trillion left the continent in illicit fashion according to a joint report by the African Development Bank and Global Financial Integrity (GFI) (2013).

Corruption and fraud are common themes that arise when analysing illicit flows of money, but even more problematic is the irregular movement of funds through international trade and underhanded tactics employed by multinational corporations. According to groups such as GFI, bribery and other forms of corruption in isolation account for only a small portion of illicit outflows when compared with flows associated with trade; such as transfer mispricing, trade misinvoicing and other forms of trade-based money laundering (TBML), and with informal illicit endeavours such as drug trafficking and trade in other contraband products (Tafirenyika, 2013). As will be discussed, evidence from East and southern Africa collected by the GI-TOC suggests that the latter markets and other forms of illicit trade, notably minerals and wildlife, continue to increase, broadening the potential scope and scale of associated IFFs.

Other literature points out how the involvement of big corporations continues to facilitate illicit outflows in the region, how some states (and sometimes regions within states) act as tax havens for dirty money, and how Free Trade Zones (FTZs) could cost more than the benefits they provide. The number of Special Economic Zones (SEZs), including FTZs, has markedly grown throughout Africa since the turn of the millennium (UNCTAD, 2021). Although potentially useful initiatives for reducing barriers to trade and enhancing economic development potential, these zones are often open to abuse and are potential facilitators of TBML. Compounding these factors is the lack of transparent financial institutions, as well as underdevelopment and ubiquitous informality.

Vulnerabilities in East and southern Africa

East and southern Africa is a region experiencing underdevelopment together with contrasting pockets of development. The region is characterised by widespread informality, with more than 80% of those employed in sub-Saharan Africa estimated to be working in the informal sector. The International Monetary Fund (IMF) estimated the percentage of total GDP at between 25 and 65% for the region as of 2017 (Medina et al., 2017). Simultaneously, there are small areas of well-developed information technology infrastructure and banking systems. The somewhat polarised situation lends itself to abuse by criminal actors who often take advantage of both formal and informal markets, frequently using one to facilitate their dealings in the other.

South Africa, for example, has both a well-developed financial system, which is currently heavily susceptible to abuse through money laundering and other crimes (Merten, 2022), and a large informal economy (Masuku & Nzewi, 2021), which enables the associated financial flows to avoid the scrutiny of authorities. This also allows money made illicitly to be laundered in the formal system by corrupt actors.

The confluence of the three forms of IFFs identified by the GI-TOC are notably present in East and southern Africa. In this paper, the 'IFFs pyramid', outlining the three types of IFFs (financial, informal and trade), will be used to better understand how these flows occur and operate in the region, as well as the consequences they have.

1.1. Research aim

Rather than describing the proportionality of each flow, the 'IFFs pyramid' proposed by Reitano (2022) suggests that there is a wealthy cadre at the top that can access the mechanisms of global finance, while parts of society at the bottom of the pyramid are excluded from the formal financial system. In addition, Reitano argues that the pyramid is vertically integrated and shows that kleptocratic elites are able to extract money from state budgets for private benefit while, at the same time, payments at the street level (such as bribes) can be linked to the highest level of the state. Similarly, systems of shadow banking, such as hawala, allow the offsetting of value against TBML systems, thereby reinforcing the movement of both goods and funds.

The IFFs pyramid presents a new framework for analysis of IFFs in different geographical regions throughout the world.[1] This paper serves as a test of the usefulness of the IFFs pyramid in describing the presence, extent and operation of IFFs in East and southern Africa. It draws on available literature dealing with IFFs in the region, seeking to establish whether the understandings of different types of IFFs espoused by the IFFs pyramid are applicable to the region and whether there are gaps that it does not cover.

1.2. Research methodology

Searches were conducted on both academic and general search engines, and search terms were refined according to relevance. Sources consulted include peer-reviewed journals, research reports and policy briefs, policy documents and other works by noteworthy or otherwise reputable organisations. GI-TOC's own research on illicit markets in the region, which includes aspects directly dealing with IFFs, or relating thereto, was widely consulted. Specifically, 28 of GI-TOC's research reports on East and southern Africa were consulted and collated and aspects relevant to IFFs were included in this paper. Given GI-TOC's sizeable database on the region, this evidence base provided the starting point for research into IFFs in East and southern Africa. General media reporting was widely consulted, especially where thorough evidence-based analysis was absent in other sources and where incidents were either recent or conducted by investigative units of major publications.

The nature of sources consulted was wide to ensure incorporation and analysis of as much detail as possible, always considering the veracity of each source concerned and

[1] Please see Amerhauser, K. (2023). *Illicit Financial Flows in the Mekong.* SOC ACE Research Paper No.30 University of Birmingham, for an assessment of the 'IFFs pyramid' in the Mekong.

lending appropriate credence thereto depending on the thoroughness and credibility of each.

As the study is aimed at testing the applicability of the IFFs pyramid, the three levels of the pyramid were used as lenses through which illicit financial flows identified in the literature were compared and analysed. To avoid tunnel vision, each form of IFF identified was evaluated to ensure that criteria were met for classification under one of the three headings of the pyramid. Where gaps occurred, these would be considerations in determining the extent of the applicability of the pyramid.

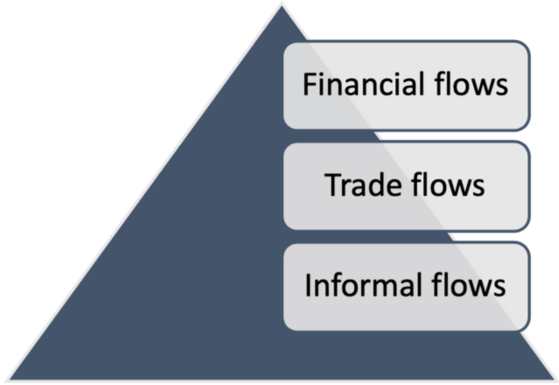
The finding is that, rather than gaps, lines are often blurred between the different types of flows, especially in a setting like East and southern Africa, where lines between formal and informal, and trade and informal flows, are often thin. The pyramid is considered as vertically integrated, meaning that money from the informal economy or trade flows often makes its way into the formal system, and vice versa, as part of a connected ecosystem of money flows. However, where overlap occurs, distinguishing between the different types of flows can be sometimes difficult. Hence, a need to understand this overlap, and the markets in which it may often be present, is required.

2. The illicit financial flows pyramid

In 'Political won't? Understanding the challenges of countering IFFs', Reitano (2022) proposed a new framework for analysis of IFFs. From a review of existing literature and other evidence, the 'IFF pyramid' was conceived. Intended to be used by researchers, analysts and policymakers, the so-called 'IFFs pyramid' (Figure 1) identifies three dominant means by which IFFs are enabled, moved and held: financial flows, trade flows and informality.

The idea behind the model is to understand differences in each of the types of flow, but more importantly to understand how they operate together in moving value and/or the proceeds of crime illicitly.

Figure 1: The illicit financial flows pyramid (Reitano, 2022)



Financial flows, at the top of the pyramid, refer to a system of offshore jurisdictions with preferential tax regimes that has been created and allowed to grow with different countries competing to attract elites to shift their global wealth into these jurisdictions. Facilitated by a range of professional service providers, including bankers, lawyers and real estate agents, it enables the bypassing of anti-money laundering regulations and undermines the rule of law.

Trade flows capture the over- and underpricing of the value of physical commodities across borders as a means to illicitly transfer money, evade taxes and customs duties as well as launder the proceeds of crime through the use of trade transactions. While the focus of trade flows is on the physical movement of goods, the purpose of misinvoicing is to register the financial value of the discrepancy in a new jurisdiction.

Informality, at the bottom of the pyramid, looks at transactions in the informal economy, such as earnings, transactions from remittances, cash, or other unregistered financial value services. By having no identifiable and traceable owner, these transactions go below the radar of the formal financial system.

By looking at financial flows, trade flows and informality, the following sections explore examples and dynamics of IFFs in East and southern Africa and test the applicability of the IFFs pyramid in the region.

2.1. Financial flows

Financial flows include transfers of value which encompass illegal practices like money laundering, and others that use loopholes in national and international legal regimes to unduly transfer wealth from one jurisdiction to another. Through the formal financial system, money is transferred to jurisdictions with preferential tax regimes to avoid payment of duties in countries with higher tax regimes or otherwise unfavourable regulations. This practice, while not illegal, deprives states, often poorer ones like those in East and southern Africa, of much needed revenue for developmental purposes. Persons from a plethora of backgrounds and industries, including politics, organised crime, multinational corporations, and otherwise wealthy individuals utilise this system to hide and amass wealth at the expense of their countries of operation. This is often facilitated by professional service providers in the formal financial system, as evidenced by leaks like the Panama Papers and FinCen Files, and projects like Mauritius Leaks. What is more, some of these offshore jurisdictions are located in the region concerned, with Mauritius and Seychelles being prominent among them. South Africa, the largest economy in the region, was also recently 'grey-listed' as a jurisdiction under increased monitoring by the Financial Action Task Force (FATF) for failure to fully implement measures against money laundering and terrorist financing.

Regional scandals involving financial flows

Numerous countries in the East and southern African region were (and are) subject to scandals involving financial flows. These almost always involve state-embedded actors high up in government. Private sector actors are also commonly involved, often acting in concert with the state. This is perhaps most notable in South Africa, in what is termed 'state capture', where relationships between private sector actors and the state have led to vast amounts of state finances irregularly finding their way into the pockets of well-connected elites and into offshore havens (Haffajee, 2022). A handful of well-known multinational corporations were alleged beneficiaries, and sometimes actively complicit in the capture of state resources, the dismantling of state institutions, and influence campaigns aimed at undermining whistleblowers and anti-corruption activists. These include Bell Pottinger, Bain & Co., McKinsey, Glencore and KPMG, to name a few (Haffajee, 2022; Van Loggerenberg, 2019).

South Africa is not isolated in this dynamic. The emergence of the 'loans scandal' in Mozambique in 2016 involved international banks Credit Suisse and VTB Capital (a sanctioned, state-owned Russian bank) providing loans to the government ostensibly to improve fishing and harbour infrastructure. However, this money was diverted to state security services and bankrolled a web of kickbacks to various beneficiaries associated with Mozambican politicians, allegedly with the knowledge of the two banks involved (Mosiana, 2021). The value of the loans was US$2.2 billion and, by one estimate, cost the country a total of US$11 billion between 2016 and 2019 (Mahadevan & Nelson, 2022). National debt ballooned by 30% and slowed economic growth from 6.6% in 2015 to

3.8% the following year. By 2018, this was still languishing at 3.3% (Mahadevan & Nelson, 2022). Other noteworthy regional scandals include Fishrot in Namibia and the Finance Ministry scandal in Lesotho.

Fishrot emerged in 2019 and entailed an Icelandic fishing company, Samherji, paying millions of US dollars in bribes to politicians and businesspeople for access to fishing rights in Namibia, initially granted to other companies, in a cash-for-quotas scheme (Kleinveld, 2019). Money was laundered through Den norske Bank in Norway and through offshore havens such as Mauritius (Corruption Watch, 2020).

The Lesotho Finance Ministry scandal involved various employees in the ministry siphoning money meant for service providers to their own companies to the value of ZAR50 million (approximately US$3 million) and depositing it into South African bank accounts (Mabuza, 2022).

In another example, Diamond Trust Bank in Kenya is alleged to have facilitated transfers implicated in terrorist financing, including the DusitD2 hotel attack in Nairobi, and has allegedly funnelled money to the Islamic State in Syria (Otieno, 2019). The bank's branch in Eastleigh, an area known for its large Somali community, was identified as facilitating large transfers of money to Jilib Town in Somalia, an al-Shabaab stronghold (Otieno, 2019).

The irregular awarding of state contracts is a common theme in places with state-embedded actors and weaker institutions. This is noted in GI-TOC research on Mozambique, where family members of politicians often sit on the boards of mining companies (Mahadevan & Nelson, 2022), and in South Africa, where research on politics and crime in Nelson Mandela Bay has demonstrated how tenders are awarded to criminal gangs who have cultivated relationships with fixers in the state apparatus (Thomas et al., 2020). This 'tenderpreneurship', as it is sometimes called, is not always illegal, as contracts are often awarded through open-bidding processes. However, the favouritism demonstrated to politically connected companies, whose bids often far exceed those of others, highlights the role of corruption in these flows, making them illicit.

Spoilers in the system: Delinquent states, regions, and zones facilitating IFFs

The island nations of Mauritius and Seychelles have long been regarded as offshore tax havens (Agyemang, 2022; Hudson & Shear, 2014). Mauritius, for example, is described by legal and consultancy group, Offshore Protection, as 'on par with Liechtenstein, Jersey, Panama, and similar offshore jurisdictions as being a good place to do business' (2022). In recent years, the country's financial regime and increase in drug trafficking have left it susceptible to money laundering relating to the latter market (Bird et al., 2021). It also served as a haven for illicit proceeds from the scandals mentioned above. The Fishrot saga, for example, saw money laundered through Samherji accounts in Mauritius, among others (Corruption Watch, 2020). 'Mauritius Leaks', a project in 2019 by the International Consortium of Investigative Journalists (ICIJ), revealed how the island's systems divert tax revenue from poor nations, many in Africa, to the accounts of elites in both Africa and the rest of the world (Fitzgibbon, 2019).

The risk associated with laundering was a major reason for Mauritius' 'grey listing' by the Financial Action Task Force (FATF) in 2020 (Bird et al., 2021). Through reforms to its legislation and policy, Mauritius was removed from this list in 2021 (Calcutteea & Sahai, 2021). Mauritius is making efforts to shed this image of ambiguous legality through legal reform aimed at greater transparency and scrutiny, but without dropping its advantageous tax regime (Agyemang, 2022).

The Panama Papers listed the Seychelles as the fourth most popular tax haven in the world in terms of number of offshore accounts (Kende-Robb, 2016). In late 2021, it was removed from the EU list of non-cooperative jurisdictions and was moved to the 'grey list pending review (Bonnelame, 2021). Like Mauritius, the rise in drug trafficking on the islands lends itself to increased risk of laundering proceeds of this trade (Bird et al., 2021).

Common to all the examples cited above are corruption, limited political will and the ready involvement of private sector actors taking advantage of these dynamics. The actions of Glencore, for instance, are not limited to South Africa, as the company has engaged in nefarious activity throughout the continent (Stoddard, 2022). One of these countries of note is Zambia, where Glencore exported copper to a sister company in Switzerland at pre-arranged prices. The price paid for copper locally was suspiciously low while freight costs to Switzerland were inflated, the end goal being to reduce taxable profits made in Zambia and shifting those profits to favourable jurisdictions. Zambia lost an estimated tax revenue of US$174 million in this manner (Nicolaou-Manias & Wu, 2016).

Although these scandals have been uncovered, efforts to hold perpetrators to account vary from country to country as legal processes are often frustrated by political interference, including delays over jurisdictional issues given the transnational nature of these crimes. This is most prominent, unsurprisingly, where the separation of powers doctrine is weak and the executive wields substantial influence over the judiciary and legislature. However, for most of the countries concerned, the focus on financial flows is often so great as to conceal, from watchdog oversight and civil society scrutiny, other flows that could be more prominent. This is where the importance of highlighting the role of trade and informal flows enters the picture, as will be discussed in following sections.

2.2. Trade flows

This type of flow includes the transfer of value from one jurisdiction to another through the transfer of physical commodities where the value of said goods is misrepresented. This is most often achieved through practices like trade misinvoicing, where the value of the commodities being traded is either underpriced or overpriced. This allows value to be unduly transferred across borders and duties avoided/evaded. The discrepancy between the purported and actual value accrues off the books to the parties colluding in the endeavour. Proceeds of predicate offences can also be laundered in this way, often by inflating the price of the goods traded to account for the extra value illicitly obtained. As the value transferred is registered in another jurisdiction, this type of flow prejudices states in the same manner financial flows do, by depriving states of origin of commodity value and tax revenue. States with weaker law enforcement and customs regimes, which are also usually poorer, are often the most adversely affected by this practice. Money is not moved directly, but, through the transfer of undervalued or overvalued goods, the financial value is illicitly transferred between jurisdictions. GI-TOC research notes this as a common practice across the East and southern Africa region.

Hidden gems

This is often identified to be the case with minerals, while wildlife products and excisable goods are common vehicles for trade flows too. The practice frequently overlaps with general smuggling. For example, gemstones from Mozambique are regularly smuggled to other countries, such as Malawi. From there, certification is fraudulently obtained, which identifies the other country (in this case, Malawi) as the country of origin and the gemstones are exported further along to a final destination, often in Asia (Walker & Restrepo, 2022). In this dynamic, the resource is made quasi-legal through fraud, and the value thereof is unduly transferred from one jurisdiction to another. This underlines the link between smuggling, financial crimes (in this case fraud) and trade flows. While the export from Africa to Asia is legal in the strict sense, the illegal extraction of value deprives its state of origin of its value unlawfully and taints the entire value chain, making it illicit. Essentially, such quasi-legal flows are fruit of a poisoned tree.

Golden opportunities

The above is observed in other countries (and with regard to other markets) with weak enforcement and high levels of informality. In South Sudan, for example, gold is mined cheaply by locals, but foreign traders capture most of its value through price-fixing agreements (Hunter et al., 2021). This keeps the purchase price in the country of origin low, allowing a much higher resale value outside the country. This unduly exploits workers in the country of origin and deprives the country itself of large amounts of revenue by relocating most of the commodity's value to neighbouring states, or further abroad (Hunter et al., 2021). This is observed in South Africa and Zimbabwe, too, where armed gangs or security forces demand that the price of the commodity at the site be kept low before moving it along the value chain (Hunter et al., 2021).

'Formal' cover is often accessed to facilitate extraction. For example, exploration permits are frequently used as cover to extract gold without officially transitioning to mining (Hunter et al., 2021). At other times, corrupt relationships are leveraged to perform extraction directly (Hunter et al., 2021).

Various nationalities are involved in the gold trade, but Chinese buyers are particularly prominent. They are often alleged to have good relationships with state actors in countries of operation, and to both mine and purchase gold illegally (Hunter et al., 2021). These relationships also facilitate expedient export, allegedly often illicit, from the countries of origin. The proceeds yielded by Chinese companies selling the commodity is said to be deposited in banks in China or Kenya or invested in real estate (Hunter et al., 2021).

Undeclared production is allegedly commonly used in the evasion of tax. The export of more gold than what is declared to authorities results in undue transfer of value from the jurisdiction of origin to another. VAT schemes are also employed in this regard.

Second-hand or recycled gold is tax exempt in South Africa, for example, so fraudulent certification of smuggled gold as second hand is allegedly common (Hunter et al., 2021). This pads profits with tax rebates, skews the price of gold and demonstrates how the trade is used to launder smuggled gold from other jurisdictions.

Compounding this are regulations and regulatory bodies that are either too lax or too stringent. For example, bureaucratic red tape resulting in the lack of issuance of gold licences in Kenya prompts many traders to seek illicit channels for selling. In contrast, the Diamond and Precious Metals Regulator in South Africa operates opaquely, enabling an environment in which trade misinvoicing, in addition to undeclared production, is reportedly common through export to Dubai, often via Antwerp or Mumbai (Hunter et al., 2021). These examples highlight the need for balance of regulation with timeous issuance of rights to minerals and resources to small-scale actors specifically.

The extraction of the minerals provides little benefit to local populations compared with the profits reaped by foreign actors and the political elite. Local traders are sometimes used as fronts for foreign traders, such as in Zimbabwe. Here, foreign traders, acting through their local conduits, can exchange gold for US dollars, the currency currently used in Zimbabwe (Chibamu, 2022).

Also common is the domination of markets ancillary to the trade in and around extraction sites, such as the local drug trade and stores selling mining equipment, by foreigners who benefit from relationships with elites or through the ease of acquiring residency permits through bribery. This is exemplified by the example of Montepuez, Mozambique, where foreign actors are prolific in the trade of equipment and in illicit markets such as drugs, whereas local populations make up the cheap labour used in minerals extraction (Walker & Restrepo, 2022).

Excisable goods

Excisable goods regularly feature among flows where trade misinvoicing is common. Undeclared production and ghost exporting are often employed where such goods, notably cigarettes, are concerned. GI-TOC research has highlighted how the false declaration of goods for export, return of goods illegally to the country of origin, and non-declaration of manufactured stock to the authorities are ubiquitous practices in the tobacco industry, among others. This behaviour was most pronounced during the COVID-19 pandemic. The prime example in this case is South Africa, when the South African government outlawed the domestic sale of tobacco products for a five-month period, ostensibly to mitigate the spread of the virus (McLaggan, 2020).

The decision augmented an already significant illicit trade. Importantly, it contributed to the exponential increase in tobacco products declared as exported from South Africa, mostly to neighbouring countries.[2] However, the volumes exported far exceeded possible demand and consumption in the purported export destinations (notably countries with very small populations, such as Lesotho and Namibia), indicating that

[2] Email correspondence with Nikita Chagan and Corné van Walbeek of the Research Unit on the Economics of Excisable Products, 11 October 2022.

stock either never arrived or was filtered back into South Africa where it would be sold tax-free (McLaggan, 2020), depriving the state of revenue. Perhaps even more worrying is a dynamic by which large volumes of cigarettes were exported from South Africa to Mali. Far fewer were declared by Malian authorities as imported than were declared exported thereto. The Organized Crime and Corruption Reporting Project (OCCRP) found that the unrecorded imported stock made its way onto shadow markets in the Sahel and that the proceeds were used for funding armed groups (Down et al., 2021). This episode shows not only how states are unduly deprived of revenue but also how the misappropriated value of goods is used illicitly for purposes that cause further harm.

Importantly, differences in legal regime between states in the region, combined with issues such as compromised territorial integrity (Africa Organized Crime Index, 2021), makes moving goods illicitly between countries in Africa relatively easy.

Wildlife

Shellshocked

Live animals are commonly laundered through Zanzibar; this is enabled by limited management via the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) and the presence of captive-breeding facilities on the islands, which declare wild-caught species as 'captive-bred'. For example, Malagasy tortoises are often misinvoiced as being captive-bred. Very low prices are paid at the source (US$2–10), and very high prices (USD1,000–2,000) are paid at retail level (Nelson & Cochrane, 2020). This indicates a similar pattern with other commodities, whereby prices are kept very low at the source, but greater profit is reaped further along by dealers with a competitive advantage (Nelson, 2020). This dynamic accelerated after a trade ban on wild animals on the mainland, which continues indefinitely after a decision to end the ban was reversed after just one day in June 2022 (Rédacion Africanews, 2022). Throughout the trade ban, Zanzibar became entrenched as a backdoor laundering spot due to its lax controls and the presence of captive-breeding facilities.

Illicit fishing

Illegal, unreported and unregulated (IUU) fishing off the Somali coast demonstrates similar dynamics in how fraudulent licences are issued through corrupt relationships, which allows foreign vessels into Somalia's Exclusive Economic Zone (EEZ), often depriving local fishers of catch. This is another example of elite capture at the expense of ordinary civilians. Fishing boats from Iran often venture from that country illegally but nonetheless receive licences to fish in Somali waters, often entering the EEZ (Bahadur, 2021).

Charcoal

Charcoal in East Africa is mostly unregulated. Fraudulent certificates of origin obfuscate where the trees were harvested to avoid legal ramifications, and illegally harvested products are often batched with legally obtained charcoal. This laundering makes the legal indistinguishable from the illegal, tainting the batch. This is also a market in which price-fixing by 'brokers' and other 'agents' is rife, keeping value accrued at the bottom of the value chain low and reaping greater profits further along the chain. Involvement by politicians is also rife, tying in with the theme of elite capture (Haysom et al., 2021). The removal of the resource also results in environmental degradation, thus simultaneously depriving a state and community of value while also limiting prospects for future value.

Fraud is a recurring theme in the examples explored in this section and its subsections. As a financial crime, it is a regular facilitator of financial flows in each of the categories identified. This points to an issue that is facilitated less through deficiencies in national policies and laws (although this aspect does play a role) but more so through shortcomings in regulatory oversight and political will.

Special Economic Zones

According to the United Nations Conference on Trade and Development (UNCTAD), there were approximately 237 SEZs in 38 of the 55 African Union (AU) member states as of September 2021, with more under construction (UNCTAD, 2021). These include various types, such as Export Processing Zones (EPZs), Free Zones, Special Economic Zones (which are a specific kind of SEZ, differentiated from the umbrella term 'SEZ'), industrial parks, industrial zones and free ports (UNCTAD, 2021). Only about half of these were operational at the time of the UNCTAD handbook's release in 2021 (UNCTAD, 2021).

Kenya (61), Nigeria (38), Ethiopia (18), and Egypt (10) have the greatest number of SEZs. In Africa, 43% are publicly run, 41% are private and 16% are hybrid. More than 200 single enterprise zones also existed across the continent as of September 2021 (UNCTAD, 2021).

EPZs, sometimes referred to as an 'enclave-like model', are the most common type of SEZ in Africa. This zone usually takes the form of fenced-in land external to the national customs territory. The UNCTAD handbook on SEZs in Africa notes that more than 70% of policies relating to SEZs in Africa include special customs regimes, which allow duty-free imports on selected goods and machinery. This is most common in the EPZ model favoured by the states hosting EPZs which is designed for the re-export of manufactured goods, rather than the expansion and development of local industry (UNCTAD, 2021). According to the UNCTAD handbook, African SEZs:

> [T]ypically host few firms, and their contributions to national employment remain marginal, except in small countries located along major trade routes that have successfully deployed SEZs as a main source of domestic employment, e.g. Djibouti […] For instance, in Djibouti, all established SEZs are governed under hybrid models. Moreover, zone development in that country has increasingly included capital from Chinese firms […] China is planning to build – directly or through joint ventures – seven overseas SEZs in Africa, including the $3.5 billion Djibouti International FTZ, developed by the Government of Djibouti in partnership with three Chinese companies. (UNCTAD, 2021).

In the few studies that have been conducted on SEZs in Africa, the general picture is that they have failed to improve the economic fortunes of the states hosting them and do not typically generate noteworthy employment (Rodríguez-Pose et al., 2022). However, there are some successes observed where the zones introduced focused on markets or commodities in which host states had comparative advantages, where the industry involved was labour-intensive rather than hi-tech, and where the zones were integrated into the local economies concerned (Rodríguez-Pose et al., 2022). These are exceptions rather than the rule though.

Despite the limited benefit yielded by SEZs, they continue to grow in number on the continent. Given these outcomes, it is perhaps fair to suggest that elites are probable beneficiaries along with foreign actors who profit from tax breaks and relaxed customs practices. SEZs have the potential to benefit the continent but the models chosen are most often ill-suited to a specific country's context (Rodríguez-Pose et al., 2022). If the assertion that select groups of elites are major beneficiaries of these zones is correct, however, further establishment and use of SEZs is to be expected.

Transfer mispricing

Transfer mispricing is another means by which finances are illicitly moved to evade tax and deprive host states of revenue. In studies on Nigeria and Zambia, Otusanya et al. (2022) describe how big multinationals use related companies or subsidiaries to trade with each other at prices not market-related and move money between jurisdictions where they can legally avoid payment of tax. Corporations such as Vedanta and Associate British Foods are among those accused of using subsidiaries in secrecy jurisdictions, including Mauritius, to avoid tax liability. Around the mid-2010s, for example, the money lost by Zambia to tax havens through practices like this was estimated to be 10 times greater than what the country received each year in educational subsidies from the UK (War on Want, 2015).

This flow is a cause for concern and has increased with the COVID-19 pandemic providing a catalytic effect. The proliferation of Special Economic Zones (SEZs), which include Free trade Zones (FTZs), throughout Africa has provided more means for trade misinvoicing and tax avoidance without a strong corresponding impact on local economic development. The impact is enrichment of large corporate entities and local political elites, while undermining enforcement regimes.

2.3. Informal flows

Informal economies in places like East and southern Africa are large. As most transactions in these environments are conducted using cash or through mobile money transfer services where tracing transactions is difficult, this type of flow represents possibly the largest challenge to addressing IFFs in poorer regions. Unregistered financial services and remittance systems like *hawala* and *fei chien* pose noteworthy obstacles to enforcement regimes.

Although large in scale, addressing this type of flow is often a lower priority than addressing formal flows. While formalising economies should be a priority, the stringent requirements that come with it often deter persons from buying into formal systems. Practices like derisking, aimed at reducing the exposure of credit providers and banks to risk, has the effect of leaving large numbers of people unable to access formal banking. The effect is continuation and growth of informal systems, where illicit activity is often rife but more difficult to detect.

A 2018 report by the International Labour Organization, titled 'Women and Men in the Informal Economy', estimated that approximately 85.8% of working people in Africa are employed in the informal sector (International Labour Organization, 2018). In 2020, the World Bank estimated this figure to be 80.8% (Guven & Karlen, 2020; World Economics, n. d.). As a percentage of total GDP, this ranges from 20% to 65% in sub-Saharan Africa, depending on the country (IMF, 2017). This illustrates how the informal sector is of profound importance for the livelihoods of most Africans, especially as the formal sector is not growing quickly enough to provide employment to a region with a rapidly increasing youth population (Melis & Karlen, 2020). This means that the traditional focus of groups like the FATF and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) on formal banking systems and financial flows is a heavily limited approach in an African context, as large amounts of IFFs occur in the informal economy. This economy is also used as a vehicle for funding other illicit activities, such as terrorist financing, hiring assassins and purchasing weapons, to name a few.

Taken for a ride

GI-TOC publications have identified a plethora of informal industries and methods in which finances, including both money and commodities, are moved illicitly. The taxi industries in Kenya (where it is known as the *matatu* industry) and South Africa, respectively, provide examples of industries that are almost entirely informal and where the intersection of various forms of criminality occurs.

The cash-based nature of the taxi industry makes it an easy vehicle for money laundering for other markets and a source for other illicit transactions, such as the hiring of hitmen, and extortion. In Kenya, drug money is allegedly commonly laundered through this system (Haysom & Opala, 2020). It is also an industry that exists in a vacuum of limited and/or absent regulation. This makes it vulnerable to violence. In South Africa, most assassinations documented by the GI-TOC occurred in the taxi industry (GI-TOC, 2022). The hitmen, or *izinkabi* as they are locally known, are often hired from outside the province where the hit occurs and are most often paid in cash (Shaw, 2017), demonstrating how proceeds from an informal business, even if legally accrued, can be used for illicit purposes.

Extortion within the taxi industry operates on multiple levels. One avenue for extortion involves industry personnel forcing commuters to use their services as opposed to those of others. This is commonly observed in Cape Town (Gastrow, 2021). Violence against operators of other forms of transport, notably buses, has been documented (Parliamentary Monitoring Group, 2022), with members of the taxi industry allegedly often the instigators (GI-TOC, 2022).

Another avenue for extortion is common in Kenya, whereby organised syndicates, often comprising police officers, extort money from drivers (Haysom & Opala, 2021). Efforts at introducing a cashless system have failed, allegedly due to vested interests of various parties involved in maintaining the sector's informality (Ndii, 2019). A similar initiative was recently started in South Africa (Price, 2022), but it is too early to assess its efficacy. Given the interests vested in keeping the South African taxi industry informal, it is likely to face similar issues as in Kenya.

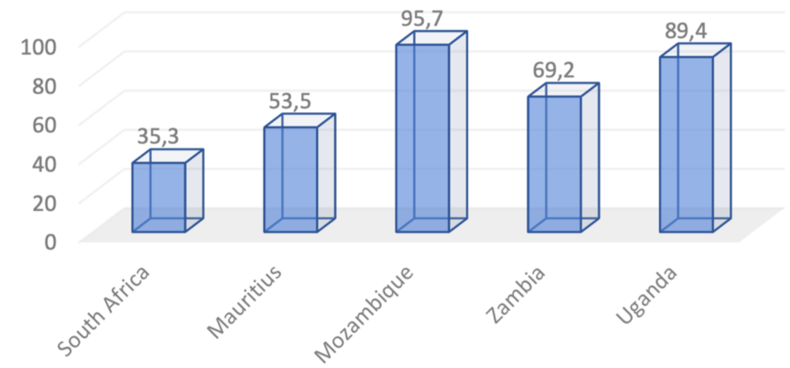
The role of remittances

Remittance systems are commonly used to send money to, and within, Africa, particularly for those living in places with difficulty accessing formal banking systems. The *hawala* system, for example, is commonly used, especially among Islamic populations (Bahadur, 2020). Unfortunately, this system is open to abuse, as money does not actually move from one account to another, making tracing almost impossible. The system is, for instance, used by armed groups in Somalia for the illicit purchase of armaments, as evidenced by GI-TOC research (Bahadur, 2020). It is also so culturally entrenched and of value to such a large population that disrupting these flows would probably do more harm to already vulnerable populations than good. In response to findings by the GI-TOC for a study on the purchase of arms through the *hawala* system, some operators in Somalia closed their services (Bahadur, 2020).

A noteworthy issue is the high cost of remittances sent to Africa. Sending money to Africa is expensive, with an average cost of 8.17% of the transaction cost per transaction in sub-Saharan Africa for the last quarter of 2020 (MFW4A, 2021). This pushes people to seek informal channels away from scrutiny to avoid high costs and, in so doing, deprives African states of another potential stream of revenue. The criminalisation of migration further compounds remittance issues as it is another factor pushing migrants to use informal, often illicit channels, to send money home.

The population of Africa is rapidly growing but Africa's economy continues to lag. In 2020, for example, the continent had 17.2% of the world's population but its economy made up only 3.2% of the world's total (Le Roux, 2022). By 2040, Africa is projected to have 22.9% of the world's population but make up only 4.7% of the world's economy (Le Roux, 2022). One consequence of this disparity is that migration from Africa (especially irregular migration) will proceed at high levels and remittances will continue to be relied upon. If measures are not taken to make payments easier and more cost effective, regulation and formalisation will become more difficult as informal and illicit channels will continue to be sought.

Figure 2: Informal employment as a percentage of total employment for selected countries.[3]



[3] This graph utilises the most recent World Bank data available for each country, which, for most, is from 2018. A link to the database can be found here: https://www.worldbank.org/en/research/brief/informal-economy-database.

3. Assessing the pyramid and its applicability in East and southern Africa

3.1. Observations of interlinkages between flows

The IFFs pyramid is not rigidly stratified; overlap between sections is prominent and noted in examples from research provided. Most of the flows identified in the GI-TOC literature fall under one of the three sections of the IFFs pyramid. Gold presents an example of where the three flows operate in tandem, with smuggling (informal), fraudulent certification of origin (trade), and the laundering of money through use of these commodities (financial) all coming together.

Gold is commonly used in the laundering of money, indicated by unnaturally high prices and buyers willing to pay above market rates (Hunter et al., 2021). This makes it difficult for legally compliant companies to compete, as the need to pay tax and due diligence costs means the room for profit is small (Hunter et al., 2021). Trade and informal elements intertwine as the often cash-intensive nature of the industry and general lack of oversight in the region make it vulnerable to TBML schemes. This is evidenced in a country like Uganda where recent comparisons made between import, export, and local production data highlight noteworthy inconsistencies. The difference between US$3.47 billion exported and US$1.97 million imported in 2020 is not made up for by local production or local reserves (GFI et al., 2023), indicating a high possibility of smuggled gold among licit stocks. Here, informally mined and traded gold becomes 'formalised' by mingling with licit product and value is moved across borders through trade in the commodity, highlighting how different segments of the IFFs pyramid cohere.

There are elements that operate in ancillary fashion to a particular flow without being fully included in that flow. Extortion, for example, is often heavily embedded in illicit markets in which informal flows are common, and these informal flows could be either licit or illicit. As the money paid to the extortionist is frequently made under duress, even if a service is provided, the flow itself is illicit. Where IFFs exist, they can be susceptible to target by extortionists when beneficiaries of the IFFs present are either unable to exercise force to prevent this or see the use of violence as contrary to their interests, thus settling to pay extortion fees to prevent conflict.

Those involved in illicit transactions are also targeted by kidnapping syndicates to elicit ransom payments. Research on kidnappings in South Africa and Mozambique highlights how people regularly making large payments through *hawala* or unregistered financial transfer networks are often targeted (Hosken et al., 2022). As those kidnapped would have been engaging in a potentially illicit activity, there is a decreased likelihood that they will report the crime.

Geographic spaces

Sometimes it is not just countries, but provinces, cities or special administrative zones that act as facilitators of IFFs. One example is the city of Nampula in north-eastern Mozambique. Nampula is known as a smuggling hub, and commerce in the city operates almost entirely out of the purview of the legal regime. In addition to the smuggling of fish, gemstones, gold and drugs, the city's relatively well-developed banking infrastructure and the numerous international flights operating in and out of it make it an ideal destination for the laundering of illicit proceeds. The substantial investment in shopping centres and five-star hotels, which go beyond the needs of the city, provide evidence of potential laundering activity (Mahadevan & Nelson, 2022). Nampula presents an example of a geographic space where all manner of IFFs take place and where each flow identified coheres with others. For example, cash from the informal economy laundered in real estate is 'formalised', then allowing for the transfer of this wealth with limited scrutiny.

In some criminal markets payments are made either using cash or using mobile money transfer services, such as M-Pesa. Mobile money does not use traditional bank accounts. Instead, money moves directly from one party's account to another's in a secure manner, making these transfers difficult to trace. Thus, while utilising digital means of transfer and having some form of electronic trace, the transactions most often remain hidden from financial institutions. Many of these services are legally registered, but others are not. Even those that are legal are identified as being utilised in illicit transactions. Despite the risks, these services provide important roles in developing economies where access to formal financial systems can be difficult. For example, 44% of Kenya's GDP in 2018 constituted M-Pesa transactions (Gore, 2021).

Use of mobile money transfer services in illicit transactions and the facilitation thereof

Poaching of elephants in East Africa is performed for as little as US$20, with payment often sent using mobile money transfers. Such low payments easily go undetected by anti-money laundering officials.

M-Pesa is also noted as being used for the payment of bribes and in the financing of illicit activity. For instance, 52 payments made via the service were linked to financing of the DusitD2 terrorist attack in Nairobi in 2019 (Gore, 2021).

A dynamic observed in Zambia is the use of mobile money transfer apps to pay for heroin and receiving text instructions for delivery and pick-up on the same platforms. A similar dynamic is observed in Zimbabwe in the payment of sex workers (Eligh, 2020).

Hawala, fei-chien, and overlap between informal and trade-based flows

To avoid scrutiny from financial institutions, transnational bartering is sometimes used for illicit goods. A prominent and long-standing example of this is the illicit trade in abalone from South Africa in exchange for methamphetamine precursors, mostly from China. This dynamic persists even if reportedly not as prominent as it was historically (Haysom & De Greef, 2022), owing largely to flows of high quality meth from

Afghanistan and West Africa taking over from local production (Eligh, 2021). However, other types of illicit barter economies exist. Some of these form part of the underexplored concept of 'Chinese flying money' or *fei-chien*. This entails the transfer of value from one jurisdiction to another without money being moved, in a system very similar to *hawala.* The goods are exchanged between countries, with received goods later converted to monetary value through domestic transactions, such as the sale thereof.

According to John A. Cassara (2016), Chinese business communities often function in a non-transparent fashion, operating largely with cash. The 'China shop', usually convenience stores run by Chinese nationals, is identified as a common facilitator of TBML, often through *fei-chien* networks (Cassara, 2016, Chapter 5, pp. 73-88). Cassara notes that this style of banking allows smaller import-export businesses to circumvent financial regulations in both China and Africa, the strictness of which are perceived as impeding commercial efficiency (2016).

These controls include restriction on capital movement in China to US$50,000 per individual per year. GI-TOC research notes that, in response to this limitation, goods for goods exchange involving wildlife products is reportedly common. The use of acquaintances' banks accounts, domestic transfers and shell companies, particularly in Hong Kong, are other common means of circumventing regulations (Gore, 2021).

GI-TOC research has highlighted how conditions conducive to illicit bartering with Asian countries are notably present in East African states, specifically Tanzania and Kenya. Containers loaded with contraband are observed as being exchanged for incoming shipments of machinery, motor vehicles and other goods (Gore, 2021).

Informal flows appear to be responsive to problems as they arise and they maintain a high degree of prominence and importance in the region in places where financial institutions are either underdeveloped or not digitised. However, these flows are very susceptible to infiltration by criminal elements. They are useful in the obfuscation of profits from illicit dealings and are frequently used for laundering purposes. They also provide opportunity for actors involved in 'provision of services' inserting themselves as 'agents' (often unnecessary middlemen) in value chains, as observed in the East African charcoal industry (Haysom et al., 2021), and at other times engaging in outright extortion, such as in the *matatu*/minibus taxi industry (Haysom & Opala, 2020).

What the above examples demonstrate is how separate criminal ecosystems can form around IFFs, essentially leeching off them, creating separate flows. Conversely, the three flows often operate together in a more integrated fashion.

4. Observations of responses

What analysis of each flow demonstrates is that there are instances in which these flows overlap; for example, trade flows can mesh with informal flows, and informal flows can merge with financial flows. The IFFs pyramid is therefore a Neapolitan construction in which the various layers melt into one another. Responses should be formulated to consider this overlap and address multiple flows as part of the same action.

To date, responses by African governments focus mainly on FATF compliance (mostly to avoid 'grey-listing') and on anti-money laundering measures (GFI et al., 2023; Azinge-Egbiri, 2022). This entails heavy focus on the formal sector, which is inadequate to curtail IFFs in a region with widespread informality. Some countries and regional blocs have developed responses with a greater emphasis on trade flows, notably the East African Community (EAC) and countries therein. The single customs territory of the EAC includes cross-border electronic data exchange, a cargo tracking monitoring system, tax payment at first point of entry, and declaration at the destination (Azinge-Egbiri, 2022). This approach is demonstrative of a regional focus on countering trade flows through focus on tax-related crimes like contraband and counterfeit goods where tax is avoided (GFI et al., 2023).

The formation of a High Level Panel on IFFs by the African Union in February 2012, as well as other groups and initiatives like the African Tax Administration Forum, Asset Recovery Inter-Agency Network of Southern Africa, and others, demonstrates that the issue is given attention and that political will exists across the region. The High Level Panel's report on continental IFFs, delivered in July 2021, highlights the issue and outlines recommendations for an African setting. Special attention is paid to TBML and the scope for investigation and action is cast wider than simply FATF obligations (AU High Level Panel Report, 2021). However, the focus is on how TBML is often a facilitator for money laundering, and limited attention is paid to other forms and nuances of trade flows. Africa's large informal markets were given only token acknowledgement rather than substantial attention. Nevertheless, the Panel report, among other reporting on IFFs in the region, demonstrates growing consideration of the presence and perniciousness of trade flows in the region.

It appears that, like previous approaches, the focus on informality is not as strong as on 'traditional' understandings of IFFs, as understood by partner organisations from developed nations. This highlights the problem of 'mimicry', that African governments may follow a 'cut-and-paste' approach to what partner organisations from developed nations describe as best practice. While they form useful guidelines, approaches from elsewhere might not be fit for purpose in an African setting, particularly as regards the high levels of informality in the continent and low levels of documentary finance. What works in countries with largely formalised economies will not necessarily work for those with high levels of informality. The informal aspect of trade is acknowledged, including by the AU High Level Panel, but given limited attention.

There are serious barriers to documentary financing in Africa. According to the African Development Bank Group, documentary financing accounted for only 18% of intra-

African trade in 2015 (African Development Bank Group, 2015). This prompts seeking of alternative means of financing which are often outside the purview of banks, and not as robust against money laundering.

Dealing with informality

As informality is virtually unquantifiable through observation alone, estimations are relied upon using various indicators. Given difficulties with policing and regulating informality, efforts at bringing more businesses and citizens into the formal sector is a means of ensuring greater oversight and curtailing IFFs that occur in informal settings. This was achieved in varying degrees in some East and southern African countries.

Mauritius, for example, improved access to financing for small businesses, computerised registration of businesses, and moved to an ex-post authorisation system, allowing retroactive legal recognition of activity that previously may not have been lawfully recognised, and thus not penalising any activity that occurred during this period. The Minister of Finance's discretionary powers were removed, allowing for more certainty in the starting and conducting of business, and tax reforms were enacted to make compliance easier and more desirable (International Monetary Fund, 2017). Rwanda similarly achieved success in formalisation through improving access to credit alongside improving regulation (International Monetary Fund, 2017).

The informal economy remains essential to the region given that most employment occurs in this sector. Unfortunately, it is where the potential to obscure the licit from the illicit is greatest. Other attempts at formalisation have been made in specific settings where criminality is notable, such as the matatu, or taxi, industry in Kenya, but in that case the attempt was scuppered by vested interests of actors therein.

Informality and linkages with trade flows

Illicit money accrued in the informal sector is often laundered through trade in goods, a classic example being gold. An example of this link was evident in Al Jazeera's recent documentary 'Gold Mafia', where the proceeds from illicit tobacco products in South Africa and Zimbabwe are laundered through gold exported or smuggled to the UAE (Al Jazeera, 2023), demonstrating the interwovenness of these respective aspects of the IFFs pyramid. Given this dynamic, the approach to empowering tax authorities in countering counterfeit and contraband goods, as seen in Kenya, Uganda (Azinge-Egbiri, 2022), and South Africa, to use some examples, can have an impact on countering informal flows.

Intra-continental and intra-regional focus

With a high emphasis on IFFs leaving the continent, the movement of illicit funds within the continent, which can be utilised for other illicit purposes, might be overlooked. Focus is required not just on IFFs leaving the continent but also on those occurring within East and southern Africa and the continent more broadly.

The GI-TOC position that there is disproportionate focus on financial flows should not deter compliance with the recommendations of FATF or other international bodies.

Rather, a more holistic response, focusing on each flow concerned, is merited. For example, investigations into financial crimes have led to some successes in combating wildlife trafficking in East Africa. However, the informal nature of much of this trade in the countries concerned means that traditional understandings of financial flows are limited in their impact when investigating these sorts of crimes (Gore, 2021). This is where expanding the purview of understanding IFFs through acknowledgement of different flows as outlined by the IFFs pyramid, and how each operates in tandem, is useful to researchers, policymakers and law enforcement officials in understanding and curtailing IFFs.

The development of initiatives, action plans and high-level panels, among others, demonstrates political will and openness to collaboration over strategic avenues to addressing IFFs. Limitations exist in that approaches are mostly focused on money laundering and how each aspect of IFFs stimulates money laundering. Trade flows, particularly trade misinvoicing and TBML, are receiving increasing focus as this aspect is perceived to be the largest avenue through which revenue is lost from the continent and through which illicit funds are moved.

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