SUBMISSION ON THE EFFECTS OF ILLICIT FINANCIAL FLOWS ON THE BUDGET AND ITS SUSTAINABILITY

Submitted to the Planning and Budgeting committee

February 2023

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1. Introduction

This memorandum was prepared by the Zambia Institute for Policy Analysis and Research (ZIPAR), in response to a request made by the Planning and Budgeting committee on 17th October, 2023. The request was for ZIPAR to prepare and submit a memorandum commenting on the effects of illicit financial flows on the budget and its sustainability. In line with the Committee's request, this memorandum presents ZIPAR's analytical views on the aforementioned.

The rest of the memorandum is structured as follows: the second section provides a background to illicit financial flows and this is followed by section three which highlights the legal and policy framework governing illicit financial flows in Zambia. Section four analyses the causes of illicit financial flows in Zambia. Section five highlights the extent and impact of illicit financial flows on the fiscus for the past 10 years and this is followed by section six which highlights the best practices in curbing lllicit financial flows. Section seven identifies the challenges in abating financial flows and this is followed by section eight where recommendations are provided.

2. Background

Historically, there has been no firm agreement on conceptual and definitional issues relating to the term Illicit Financial Flows (IFFs). However, in March 2022 the UN statistical commission endorsed a definition that appears in the Sustainable Development Goals. Here, IFFs are defined as "***financial flows that are illicit in origin, transfer or use, that reflect an exchange of value and that cross country borders.***" Essentially, in its conceptual framework for the statistical measurement of IFFs, the UN classifies IFFs into four types namely: tax and commercial activities, illegal markets, corruption, exploitation-type activities and financing of crime and terrorism.

It goes without saying that IFFs have a crippling effect on societies and economies not only in Africa but at a global scale. Given the devastating impact of recent global catastrophes such as COVID-19, climate change and the more recent Russia-Ukraine war on African economies, the need to close the financing gap resulting from IFFs is important now more than ever. Illegal activities such as tax evasion, trade misinvoicing and corruption deprive resources from needy sectors such as health and education to the overall detriment of developing countries. The poor are often the most affected as they have to rely on the Government for social services. Research has shown that countries with high IFFs spend on average 25% less on health and 58% less on education[1]. In Zambia, IFFs have continued to plague revenue mobilisation efforts thereby affecting service delivery.

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[1] United Nations Conference on Trade and Development. Tackling IFFs for Sustainable Development in Africa. Economic Development in Africa Report, 2020.

3. Legal and Policy framework governing illicit financial flows in Zambia

The Zambian Government has enacted Anti-Money Laundering/ Countering Terrorism and Proliferation Financing (AML/CTPF) legislation to deal with IFFs. Further, the country has enacted complementary laws to form part of the AML/CFTP legal framework in Zambia.

3.1 Legal framework

In this context, the AML/CFTP legal framework includes;

i. ***The Financial Intelligence Centre (FIC) Act No. 46 of 2010 (as amended).*** The FIC Act establishes the Financial Intelligence Centre (which is the Zambian financial intelligence unit). Further, the FIC Act provides for duties of supervisory authorities and AML/CFTP obligations of reporting entities.

ii. The Prohibition and Prevention of Money Laundering Act No. 14 of 2001 (PPMLA) (as amended by Act No. 44 of 2010). The PPMLA adequately criminalizes the offence of ML consistent with the expectations under international standards.

iii. ***The Forfeiture of Proceeds of Crime Act (FPCA) No. 19 of 2010***. The FPCA provides for civil and criminal forfeiture and seizure of proceeds of crimes.

iv. ***The Anti-Corruption Act No. 3 of 2012.*** This Act provides for the existence of the Anti-Corruption Commission and its powers and functions. The Act further provides for the prevention, detection, investigation, prosecution and punishment of corrupt practices and related offences.

v. ***The Companies Act No. 10 of 2017***. The Companies Act provides for the formation and maintenance of companies and for the incorporation, categorization, management and administration of different types of companies. The Companies Act further provides for the creation and maintenance of beneficial ownership register.

vi. ***The National Prosecution Authority (NPA) Act No. 34 of 2010***. The Act provides for the establishment of the National Prosecution Authority and its powers and functions. It further provides for a framework for the effective administration of criminal justice and establishment of the Witness Management Fund. Following the enactment of the NPA Act, all prosecution powers in Zambia were consolidated in the NPA which is headed by the Director of Public Prosecutions.

vii. ***The Public Interest Disclosure (Protection of Whistleblowers) Act No. 4 of 2010*** provides for disclosure of conduct inimical to public interest.

viii. ***Mutual Legal Assistance in Criminal Matters Act (MLACMA) , 1993, CAP 98*** of the Laws of Zambia as amended by Act No. 14 of 2020. The Act provides for the implementation of treaties for mutual legal assistance in criminal matters and to provide for matters connected with or incidental to the foregoing.

ix. ***The Plea Negotiations and Agreements Act, No. 20 of 2010***. The Act provides for the introduction and implementation of plea negotiations and plea agreements in the criminal justice system and for matters connected with, or incidental to, the foregoing.

x. ***The Penal Code Act, Cap 87 of the Laws of Zambia***. The penal code is an Act to establish a Code of Criminal Law in Zambia.

3.2 Institutional framework

The institutional framework in Zambia comprises of policy bodies, law enforcement agencies, statutory agencies, supervisory authorities, reporting entities and inter-agency working groups. The institutional framework is summarised below:

i. The Anti-Money Laundering Authority (AMLA).

ii. The National Task Force of Senior Officials on AML/CFT matters.

iii. The Financial Intelligence Centre (FIC)

iv. Law Enforcement Agency (LEAs)

v. Supervisory Authorities. Supervisory authorities as prescribed under the FIC Act include:-

vi. Reporting Entities.

vii. The Judiciary.

viii. Others Government Agencies. The Office of the Auditor General, Ministry of Home Affairs, Ministry of Mines, Ministry of Defense, Registrar of Societies and the department for the registrar of NPOs under the Ministry of Community Development and social services among others.

4. Causes of illicit financial flows in Zambia

Based on available information, IFFs in Zambia are caused by trade misinvoicing, corruption, tax evasion and transfer pricing, illegal market activities, poaching and wildlife trafficking as well as illegal mining.

(i) Trade mis-invoicing

Generally, international trade has emerged as a conduit for IFFs. **In Zambia, copper which accounts for a staggering 85 percent of exports has become prone to IFFs through trade misinvoicing.** During the period 2016 to 2021, Zambia's top 5 major export trading partners were Switzerland, China, Congo DR, Singapore and South Africa. Collectively, these five countries accounted for 76 percent of Zambia's exports with the most exported commodity being copper. Therefore, Switzerland and China are curious cases for IFFs. Over 40% of Zambia's exports are invoiced to Switzerland. However, Switzerland does not record any imports from Zambia. This results in substantial over invoicing. Zambia also shows significant export under invoicing especially with respect to its trade in copper with China. The value of Zambia's exports to China, unfortunately, is under-recorded, leading to illicit financial flows. There are many more cases of trade misinvoicing across Zambia's trading partners as shown in a report published by ZIPAR and the Financial Intelligence Centre[2].

(ii) Corruption

In Zambia, corruption is regarded as the second most prevalent form of IFFs just behind trade misinvoicing. **Corruption is mostly perpetrated by public sector officials through public procurement and public investments.** For instance, corruption accounted for the largest share of IFFs according to the Financial Intelligence Centre's (FIC) typology reports for the period 2017 to 2020 as shown in table 1

Table 1: Typology of IFFs in Zambia (2017- 2020)

	2017	2018	2019	2020
Tax Evasion	3,900	1,000	144	717
Corruption	500	4,795	332	2,228
Fraud	3	110	53	26
Money Laundering	91	195	450	4
Illegal mining in precious metals and stones	0	0	0	165
Others	0	0	5	2
Total	4,494	6,100	984	3,142

Source: Authors' construction using FIC typology reports

(iii) Tax evasion and Transfer pricing

Tax evasion is the illegal activity in which an individual or entity deliberately avoids paying or under pays for taxes. Equally, transfer pricing is when parts of the same company trade with each other at artificial prices determined by themselves, to minimize or completely evade tax payments. Global Financial Integrity, a US-based organization that has pioneered recent research into illicit financial flows, estimates that $8.8 billion left Zambia from the proceeds of crime, corruption, and tax evasion in the ten years between 2001 and 2010 - an average of $880 million per year. **The extractive industry is identified as the biggest culprit in tax evasion and transfer pricing**. Transfer mispricing is perceived as a major issue in Zambia, particularly in the extractive industries, and is difficult to detect.

There are other causes of IFFs in Zambia such. The smuggling of rosewood logs is orchestrated by high profile, politically connected individuals who are driving the species to the point of extinction. In terms of illegal mining, this is prevalent with respect to emerald, manganese and gold mining. Illegal market activities pertaining to wildlife and poaching are exacerbated by Zambia's vast national parks and game management areas. Zambia is located at the centre of Southern African transit networks. Illegal wild life products are transported from and through Zambia for a variety of transit routes often ending up in Asia.

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7. Challenges in abating illicit financial flows

In recent years, the Government has made some positive strides in curbing IFFs. However, challenges still persist as follows:

(i) Low levels of funding

Most Government institutions have been underfunded in recent years with variances existing between planned and executed budgetary allocations. The institutions responsible for curbing IFFs have been no exception. The low levels of funding have negatively impacted investigations, enforcement, and sensitisation among other activities.

(ii) Data availability and confidentiality

This challenge has arisen from limited information exchange between reporting entities and competent authorities despite the creation of frameworks that allow for information sharing across institutions.

(iii) Limited exchange of information between local and foreign financial institutions

Due to the international nature of IFFs, information exchange between local and foreign institutions is essential in curbing the vice. However, there is limited exchange of such information between local and foreign financial institutions.

(iv) Insufficient information on other reporting entity beneficiaries or senders due to privacy laws

In some cases, privacy laws in other jurisdictions have been a hindrance to reporting as beneficiaries are protected by these privacy laws.

8. Recommendations

To enhance efforts aimed at curbing IFFs in Zambia, we recommend the following:

(i) Undertake comprehensive assessment of IFFs in Zambia

While studies have been conducted by ZIPAR, FIC and UNECA to quantify trade based money laundering in Zambia, there is need for a comprehensive assessment of the magnitude of IFFs in Zambia. This will facilitate decision making especially from the policy angle. The Government must therefore fund research institutions in collaboration with the existing technical working groups on IFFs to conduct a comprehensive study aimed at assessing the magnitude of IFFs in Zambia.

(ii) Devote more resources to curbing IFFs in Zambia

As shown in our study, IFFs are a complex undertaking that require the allocation of resources to curb them. As such, Law Enforcement Agencies need to be equipped with additional financial resources to enable them to tackle the scourge through increased human resource capacities and infrastructure among others.

(iii) Multi-stakeholder approach to TBML

A multi-stakeholder approach is cardinal in curbing IFFs. It is in the interest of the Government, private sector and foreign partners to ensure that IFFs are curbed. As such, cooperation amongst these stakeholders must be enhanced. This cooperation must extend beyond MoUs and existing technical committees to collaboration and information sharing in day to day operations.

(iv) Capacity building for Competent Authorities

Continuous capacity building is essential for officers engaged in curbing IFFs. This will develop the expertise required for identification, investigation, and prosecution of IFFs.

(v) Develop a National AML/CFT Policy and Strategy

The Government must develop an Anti-Money Laundering National Policy to set the tone and direction at national level on combating money laundering which essentially is at the centre of IFFs. Further, the Policy should be the basis on which the country develops a National Strategy on combating money laundering. The strategy will coordinate the efforts of various competent authorities and ensure resources are directed towards areas of greatest risk