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RISKS OF ILLICIT FINANCIAL FLOWS IN ZAMBIA

Understanding vulnerabilities to corrupt money
flows in Zambia

Transparency International Zambia (TI-Z) is a local chapter of the global movement – Transparency International. It is dedicated to the fight against corruption and the promotion of good governance. TI-Z is a non-profit and non-governmental organization with a registered office in Lusaka and has existed since June 2000.

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Every effort has been made to verify the accuracy of the information contained in this Brief. All information was believed to be correct as of September 2024. Nevertheless, Transparency International Zambia cannot accept responsibility for the consequences of its use for other purposes or in other contexts.

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1 - BACKGROUND

Illicit financial flows (IFFs) are flows of funds across borders, which originate from illicit activities, transferred through illicit transactions or stem from a licit activity but used in an illicit manner.¹ IFFs are hugely detrimental to Africa’s potential to achieve the Sustainable Development Goals as they cause a major drain on capital and revenues, undermine just fiscal systems and reduce resources available to governments to provide key public services. According to Global Financial Integrity (GFI), Zambia cumulatively lost US\$9.3 billion to IFFs from trade mis-invoicing and leakages in the balance of payments between 1970 and 2008² and an annual average of US\$2.9 billion between 2004 and 2013.³

Given the inherent challenges in calculating the volume of IFFs, especially those emanating from corruption, this study sought to identify some of the key risk factors, which make Zambia vulnerable to outflows of IFFs. We selected Zambia, as part of eight other countries, including the Republic of the Congo (Congo), Côte d'Ivoire, Ethiopia, Kenya, Mauritius, Morocco, Nigeria, and South Africa, due to economic aspects such as reliance on economic sectors known to be linked to high levels of IFFs (e.g., extractives). Another consideration was the country’s potential attractiveness as a transit or final destination for IFFs. This report therefore explores existing knowledge about the types, sources and destinations of IFFs in Zambia, and identifies some of the governance and structural drivers, which exacerbate the risks of IFFs. It also explores efforts to combat IFFs in Zambia, focusing on key elements of the anti-money laundering (AML) regime.

1.1 TYPES AND SOURCES OF IFFS

The United Nations Conference on Trade and Development–United Nations Office on Drugs and Crimes Task Force on the statistical measurement of illicit financial flows has identified four main categories of activities that can lead to IFFs. These include the following (Fig. 1).

Figure 1: Categories of Illicit Financial Flows (IFFs)



TAX AND COMMERCIAL IFFS:

Including tariff, duty and revenue offences, tax evasion, corporate offences, market manipulation and other selected practices, as well as tax-avoidance practices such as transfer mispricing, debt shifting, relocation of intellectual property, tax treaty shopping, tax deferral, changes in corporate structure or economic residence and other profit-shifting schemes.



IFFS FROM CORRUPTION:

Including bribery, embezzlement, abuse of functions, trading in influence, illicit enrichment and other acts.



THEFT-TYPE ACTIVITIES AND FINANCING OF CRIME AND TERRORISM:

Including theft, extortion, illicit enrichment and kidnapping. In addition,

Figure 1: Categories of Illicit Financial Flows (IFFs)

the financing of terrorism or crime involves the illicit, voluntary transfer of funds between two actors with the purpose of funding criminal or terrorist actions.



IFFS FROM ILLEGAL MARKETS:

Including domestic and international trade in illicit goods and services, including illegal trafficking of goods, such as drugs and firearms, or services, such as smuggling of migrants.

This report focuses specifically on the second category – IFFs from corruption – as one of the least understood areas, although we acknowledge that there is some degree of overlap between the four. For example, the methods used to siphon off corruptly acquired funds may involve commercial and trade-based means.

1.2 METHODS OF IFFS

Corrupt actors might hide their money in foreign jurisdictions as a form of insurance policy against political instability at home, such as the prospect of losing power and consequently facing prosecution for historical corruption. Transferring the proceeds of corruption to other jurisdictions can also provide better access to foreign goods and help to build relationships with authorities in the foreign jurisdiction, which could potentially serve as a safe haven in the future.⁴ According to the Financial Action Task Force (FATF), there are three main methods used to move money for the purpose of disguising its origins and integrating it into the formal economy.

The first is through the financial system; the second involves the physical movement of money (e.g., through cash couriers); and the third is through the physical movement of goods through the trade system.⁵

2 - METHODOLOGY

The study focuses on IFFs resulting from corruption, although findings may apply to some extent to other areas – such as IFFs related to tax and commercial activities, criminal activity or illegal markets. In order to assess the IFF risk factors, we analysed a series of quantitative data on governance and structural factors that are likely to make a country more susceptible to outgoing IFFs. These included levels of political instability, corruption and institutional capacity, the reliance of the economy on extractive industries, the size of the informal sector, and the nature of transnational business ownership structures. Further, we also conducted interviews with key stakeholders from law enforcement and public agencies, representatives of the financial and commercial sectors and civil society representatives, to provide additional insights on the types, sources and destinations of IFFs and as well as vulnerabilities and prevention efforts. The methodology comprised of the following three components:

- **Quantitative data analysis:** This aimed at producing a composite indicator of IFF risk factors and was centred on the identification of factors that determine or signal IFFs in Zambia. The analysis made use of Principal Component Analysis (PCA), operationalized on a dataset of potential risk factors in order to generate the composite risk indicators.

- **Qualitative data analysis:** This aimed at investigating the methods used to siphon capital out of Zambia and the connections between predicate offences (in particular corruption) and IFFs. The qualitative analysis included the conducting of key informant interviews through which we obtain detailed information from experts and stakeholders.
- **Case-study analysis:** This aimed at validating the knowledge produced by the quantitative and qualitative analyses, by means of analysis of actual cases of IFFs in Zambia. We however did not include the case studies in this issues brief.

Note: We generated these results using Principal Component Analysis (PCA). The scree plot indicated that three eigenvalues were greater than one.




Following identification of the three components, we established that the prevalence of cash transactions (component 3) and the large size of the informal sector (component 1) are high risk factors for Zambia, where there are no restrictions on the use of cash and the informal sector accounts for over 40 percent of GDP⁶. Although informality is a greater risk for IFFs from sources other than corruption, such as illegal trade and illicit drug trafficking, it does nevertheless present opportunities for the illicit transfer of funds generated through corruption. Further, we also established that a breakdown in the rule of law as characterized by a failure to control corruption and a rise in corruption in the mining sector (component 2) also possess a risk of IFFs.

3 - KEY FINDINGS

3.1 RISK FACTORS AND VULNERABILITIES FOR IFFS IN ZAMBIA

The Quantitative analysis identified three channels or components and ten risk factors for illicit financial flows in Zambia. **Table 1** presents the risk factors for IFFs in Zambia.

Table 1: Risk Factors and Vulnerabilities in Zambia

	component 1	component 2	component 3
			
RANK	INFORMAL ECONOMY	INFORMALITY IN THE MINING SECTOR	USE OF CASH
1	Informal Activity	Rule of Law	Regulatory Quality
2	Political Stability	State of Corruption (CPI)	Money Supply
3	Control of Corruption	Mineral Rents	
4	Government Effectiveness	Control of Corruption	

3.2 SOURCES OF IFFS IN ZAMBIA

Zambia’s first National Risk Assessment (NRA) in 2017/2018 identified the five highest proceeds-generating predicate offences in Zambia as corruption, tax evasion, theft, fraud and drug trafficking.⁷ Public procurement is also significantly vulnerable to corruption according to Financial Intelligence Centre⁸. Our analysis further indicates that contract overpricing and bribery are the leading sources of IFFs related to corruption, and politically exposed persons have been targeting extractive industry contracts and infrastructure projects, such as road construction, due to the volume of funds involved and the availability of willing foreign nationals.⁹ Zambia’s extractive sector is also at risk due to its large informal and largely unregulated artisanal or small-scale sub-Sector

The sector is a source of IFFs generated through the sale of precious stones and other minerals transited across borders.¹⁰

3.3 SUSPECTED IFFS METHODS AND DESTINATIONS

According to the Financial Action Task Force (FATF), the channel most vulnerable to money laundering activity is the banking sector. This is due to several characteristics of the banking sector, including the range and types of products offered, the transaction volumes handled and the connection of the banking sector with the international financial system. In addition, the legal profession in Zambia is also one of the most vulnerable channels, mainly due to its involvement in activities exposed to high risk (e.g., real estate transactions, creating legal persons and financial arrangements). Other entities or channels that are vulnerable to money laundering and IFFs in Zambia include casinos; precious stones, metal dealers; and second-hand motor vehicle dealers. The widespread use of cash further increases the risk of money laundering.¹¹

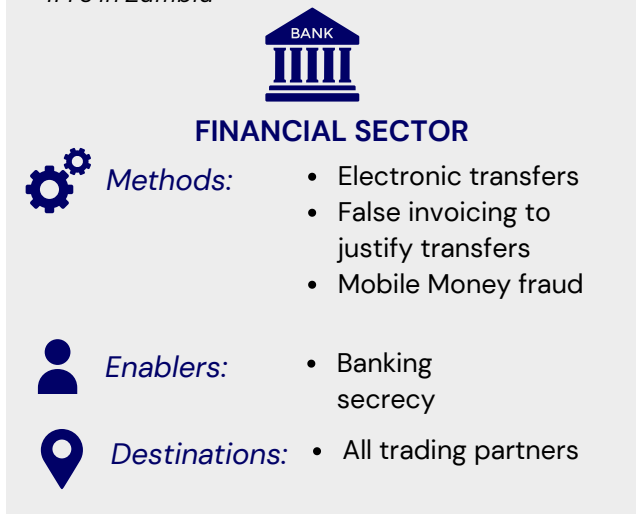
Our analysis also revealed that structured payments, where people make a series of small cash payments for a good or service, as well as cash couriers, are common methods used to launder and transfer cash outside the country.¹² Those we interviewed also noted that people seeking to move illicit funds often purchase precious stones and precious metals such as gold and then smuggle them across borders to places like India and Dubai, where they are in high demand. Upon arrival, these people sell the stones on the black market or semi-formal markets, which do not require sellers to produce a certificate of origin. Finally, they then send the proceeds of the sale back to Zambia or mask them as investments.

Figure 2 presents a summary of the sources and methods of IFFs in Zambia.

Figure 2: Summary of Sources and Methods of IFFs in Zambia



Figure 2: Summary of Sources and Methods of IFFs in Zambia



Source: Developed by the Author using Key Informant Interviews.

As indicated by **Figure 2**, in terms of destinations, the main destination countries for IFFs generated from Zambia are China, Sweden, Denmark, Switzerland, Ireland, France, and the United Kingdom. The local stakeholders also identified Kenya, Tanzania and Nigeria as main designation countries on the African Continent.¹³

3.4 EFFORTS TO CURB IFFS IN ZAMBIA

3.4.1 Compliance with FATF Recommendations

Zambia is compliant or largely compliant with seven out of ten IFF-related preventive measures, with the exception of wire transfers and beneficial ownership information, where it is only partially compliant. Both of these are of concern given the inherent risks in the banking sector noted above. In 2019, Zambia enacted the regulations to the Companies Act, which obliges companies to provide their beneficial ownership information at the time of registration.

In 2020, an amendment to the Companies Act started the creation of a centralised and public beneficial ownership register under the Patents and Companies Registration Agency (PACRA). As for trusts and similar arrangements, the Lands and Perpetual Succession Act of 2020 requires the submission of a declaration containing beneficial ownership information of all parties associated with the trust. One important gap is the lack of a comprehensive money laundering risk assessment on all forms of legal persons.¹⁴ **Table 2** presents the status of Zambia’s compliance with selected FATF recommendations.

Table 2: Status of Zambia’s Compliance with Selected FATF recommendations

FATF recommendations	FATF ranking
Assessing Risks and Applying a Risk-Based Approach	● Largely compliant
National Cooperation and Coordination	● Partially compliant
Financial Intelligence Units	● Compliant
Powers of Law Enforcement and Investigative Authorities	● Largely compliant
Responsibilities of Law Enforcement and Investigative authorities	● Largely compliant
Cash Couriers	● Compliant

3.4.2 AML Policy and Cooperation

In 2023, Zambia launched its National Anti-Money Laundering (AML) and Countering Terrorism Financing and Proliferation Financing (CTPF) Policy and established the National Task Force on Asset Recovery, tasked with supporting collaboration between competent authorities in tackling serious offences and asset recovery. The Policy outlines a clear direction for the effective combating of money laundering, terrorism financing and proliferation financing.¹⁵ Further, according to the FATF, the authorities in Zambia have a relatively good understanding of money laundering risks, informed by the results of the National Risk Assessment, and there is good cooperation and coordination both at policy and operational levels, which include all relevant competent authorities.¹⁶ Other factors that hinder institutional capacity in Zambia are limited technological solutions to deal with financial crime, insufficient funding, high employee turnover and limited communication between the Financial Intelligence Centre and reporting entities.¹⁷

3.4.3 Financial Intelligence and Investigations

LEAs in Zambia effectively use financial intelligence from the Financial Intelligence Centre and other sources, which has reasonably contributed to the investigation and prosecution of all types of money laundering. The quality of financial intelligence and analysis reports is useful in effectively supporting the operational needs of LEAs.¹⁸ However, there has been limited update on the status of cases disseminated to LEAs by the FIC and a slow pace of investigating and prosecution of cases. As a result, the number of investigations and prosecutions relative to the predicate offences reported and processed is low.¹⁹

However, following the establishment of the Economic and Financial Crimes Court, there has been notable progress.²⁰

3.4.4 International Cooperation and Exchange of information

Zambia has in place a good legal and institutional framework to cooperate and exchange information with foreign counterparts with respect to Mutual Legal Assistance (MLA) and other forms of international cooperation.

However, the lack of an effective case management system that can enable effective monitoring and accounting for cases is hindering the effectiveness of cooperation. Without a case management system, it is difficult to determine the time taken to handle the requests, the number of requests handled and the quality of information received. Further, differences in laws across countries or jurisdictions are also limiting the efficiency of international cooperation through MLA, and information exchange.²¹

4 - CONCLUSION AND RECOMMENDATIONS

Given the inherent challenges in calculating the volume of IFFs, especially those emanating from corruption, this study sought to identify some of the risk factors, which make Zambia vulnerable to outflows of IFFs. We selected Zambia, as part of eight other countries, due to its reliance on IFF prone economic sectors such as extractives. This study finds that the prevalence of cash transactions and the large size of the informal sector are important risk factors for Zambia. Therefore, a thriving informal economy poses high risk, especially if government is ineffective in controlling corruption, amidst political instability.

Further, we also establish that a breakdown in the rule of law as characterized by a failure to control corruption or informality in the missing sector is also a significant risk factor. Our analysis also indicates that contract overpricing and bribery are the leading sources of IFFs related to corruption, and politically exposed persons have been targeting extractive industry contracts and infrastructure projects, such as road construction, due to the volume of funds involved and the availability of willing foreign nationals.

Zambia launched its National Anti-Money Laundering (AML) and Countering Terrorism Financing and Proliferation Financing (CTPF) Policy in 2023 and established the National Task Force on Asset Recovery, tasked with supporting collaboration between competent authorities in tackling serious offences and asset recovery. Nonetheless, Zambia still faces several challenges that limit this institutional capacity. These include limited technological solutions to combat financial crime, insufficient funding, high employee turnover and limited communication on the status of cases disseminated to Law Enforcement.

In light of these findings, Transparency International Zambia makes the following recommendations:

1. The Government, through the Bank of Zambia, should **tighten the regulation of cash in conducting financial transactions**. There is need to introduce a threshold, beyond which, it will be illegal to make payment or transact using cash.

2. The Government, through the Zambia revenue Authority, should accelerate its efforts to **formalize economic activities and strengthening border management** to address trade-based money laundering and smuggling.

3. The Law Association of Zambia (LAZ) should **strengthen its oversight on law firms** in order to reduce the risk of IFFs and money laundering facilitated by legal professionals.

4. Government should address the risk of corruption in the public procurement process by **prosecuting officials cited in FIC Intelligence Reports** as well as the Auditor General's Reports.

5. The Government, through the Ministry of Mines and Mineral Development, should accelerate efforts aimed at **formalizing small-scale and artisanal mining operations** across the country in order to reduce the IFFs enable by illegal mining and smuggling of minerals.

6. The Government should **strengthen the institutional capacity of Anti-Money Laundering (AML) institutions** in order to reduce staff turnover and increase investments in digital systems.

7. The Government should **strengthen the coordination, corporation and exchange of information among AML Institutions and LEAs** by strengthening the operation of the National Task Force on Asset Recovery.

8. Government should **review the Companies Act No. 10 of 2017**, to strengthen aspects of beneficial ownership to ensure alignment with FATF recommendations, and to harmonize disclosure requirements across sectors.

9. Transparency International Zambia, and other civil society actors, should enhance **collaboration, policy engagement and advocacy, as well as citizen sensitization** on Anti-Money Laundering and IFFs in Zambia.

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