

THE THREAT OF TRADE-BASED MONEY LAUNDERING TO THE AFRICAN CONTINENTAL FREE TRADE AREA *

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ABSTRACT

Africa has dedicated considerable effort to establishing a Continental Free Trade Area to facilitate intra-African trade and deepen economic integration. However, the liberalisation and facilitation of trade on the continent would increase trade openness significantly in the markets for goods and services, thereby expanding the threat of trade-based money laundering (TBML) and undermining the potential benefits the agreement would bring to economic growth, industrialisation and sustainable development in Africa. This paper focuses on the threat of TBML to the African Continental Free Trade Area (AfCFTA), typically perpetrated through trade mis-invoicing as the main vehicle for illicit financial flows. It deduces that increases in the volume of trade across the continent potentially increase the vulnerability of the AfCFTA to TBML.

Several global and regional initiatives by such bodies as the Financial Action Task Force, the Organisation for Economic Co-operation and Development, the World Customs Organisation, the Economic Commission for Africa, the African Union have attempted to curb diverse aspects of illicit financial flows. However, as yet there is no coherent and multi-faceted framework to combat the problem. Moreover, not all initiatives are universal or reflect the interests of the African continent. Hitherto, the African response to TBML has been almost non-existent. In order to combat the potential increase in TBML threats, this paper proposes a uniform African anti-TBML mechanism as an African solution to an African problem.

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1 INTRODUCTION: ILLICIT FINANCIAL FLOWS

The concept of illicit financial flows (IFFs)¹ has gathered momentum in Africa recently, reflecting an increasing concern with the apparent abuse of the international trade system by multinational corporations (MNCs) in their attempts to evade customs duties and taxes or to obscure illegal activity. Recently, also, the terminology has shifted from illegal capital flight to illicit financial flows in documents of the United Nations and other multilateral institutions, on the understanding that somewhere, at its origin or in its movement or use, the money broke the law and hence had to be considered illicit.² However, what is most important is to understand about IFFs is how and why money flows out of developing countries and to devise strategies to stem these flows.³

In the Addis Ababa Action Agenda (the Addis Agenda), domestic public resources are a central component of financing across the sustainable development goals (SDGs) and targets, which are essential to providing public goods and services, to increasing equity, and to helping manage macroeconomic stability.⁴ Domestic resource mobilisation (DRM) and IFFs are linked closely, as tax evasion⁵ hampers government efforts to mobilise domestic resources, thereby posing a huge challenge to the SDGs.⁶

The most immediate impact of IFFs is a reduction in domestic expenditure on and investment in both the public and private sectors of the economy, translating into fewer hospitals and schools, fewer police officers on the street, fewer roads and bridges, and also fewer jobs.⁷ Several reports have indicated that

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- 1 These have been defined as: "Money that is illegally earned, transferred, or used." See AU/UNECA (2015) *Report of the High Level Panel on Illicit Financial Flows from Africa*, available at http://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf (visited 4 March 2019).
 - 2 Kar D (16 August 2010) *Illicit Financial Flows from Developing Countries: The Absurdity of Traditional Methods of Estimation*, available at <https://www.gfintegrity.org/illicit-financial-flows-from-developing-countries-the-absurdity-of-traditional-methods-of-estimation/> (visited 4 March 2019).
 - 3 World Bank (7 July 2017) *Illicit Financial Flows*, available at <http://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs> (visited 4 March 2019).
 - 4 Choula P & Falcao T (5 December 2016) *Illicit Financial Flows: Concepts and Scope*, available at https://www.un.org/esa/ffd/wp-content/uploads/2017/02/Illicit-financial-flows-conceptual-paper_FfDO-working-paper.pdf (visited 4 March 2019).
 - 5 This is the practice of illegally hiding income from tax authorities and sending it abroad.
 - 6 World Bank (7 July 2017) para 5.
 - 7 OECD (2013) *Measuring OECD Responses to Illicit Financial Flows from Developing Countries*, available at <https://www.gfintegrity.org/wp-content/uploads/2014/05/OECD-IFF-Responses-2013.pdf> (visited 4 March 2019)

IFFs from developing countries are increasing.⁸ Although IFFs are difficult to measure, given the illegality of the flows and their underlying activities, there is widespread agreement that the amounts involved are significant, and that they pose serious problems, particularly in resource-rich countries and fragile and conflict-affected states.⁹

Consistent with its previous offerings, an April 2017 report from Global Financial Integrity, titled *Illicit Financial Flows to and from the Developing Countries: 2005-2014*, finds that IFFs remain persistently high.¹⁰ The study finds that over the period 2005 to 2014, IFFs likely accounted for about 14.1% to 24.0% of total developing country trade, with outflows estimated at 4.6% to 7.2% of total trade and inflows for 9.5% to 16.8%.¹¹ Total IFFs likely grew at an average rate between 8.5% and 10.1% a year over the ten-year period.¹² Outflows are estimated to have grown at an average annual rate between 7.2% and 8.1% and inflows at a slightly faster pace, between 9.2% and 11.4% per year.¹³ The High-Level Panel on IFFs (HLP) has estimated that Africa loses \$50 billion annually in IFFs through the practices of multinational corporations (MNCs),¹⁴ with the proceeds of commercial tax evasion constituting by far the largest component, at some 60% to 65% of the global total.¹⁵ Strikingly, these IFFs surpass not only the volume of official development assistance,¹⁶ but even the sum of such assistance and foreign direct investment.¹⁷

8 Kwavme F (3 May 2017) *New Study: Illicit Financial Flows in Developing Countries Large and Persistent*, available at <https://www.nupi.no/en/News/New-Study-Illicit-Financial-Flows-in-Developing-Countries-Large-and-Persistent> (visited 4 March 2019).

9 World Bank (7 July 2017) para 8.

10 Spanjers J & Salomon M (2017) *Illicit Financial Flows to and from Developing Countries: 2005-2014*, available at <http://www.gfintegrity.org/report/illicit-financial-flows-to-and-from-developing-countries-2005-2014/> (visited 4 March 2019).

11 Spanjers & Salomon (2017) at vii.

12 Spanjers & Salomon (2017) at vii.

13 Spanjers & Salomon (2017) at vii.

14 Nicolaou-Manias K & Wu Y (2016) "Illicit Financial Flows Estimating Trade Mispricing and Trade-Based Money Laundering for Five African Countries" *Discussion Paper* at 5.

15 Kar D & Cartwright-Smith D (6 March 2010) *Illicit Financial Flows from Africa: Hidden Resource For Development* available at http://www.gfintegrity.org/storage/gfip/documents/reports/gfi_africareport_web.pdf (visited 4 March 2019).

16 Official development assistance is defined as government aid designed to promote the economic development and welfare of developing countries.

17 Herkenrath M (2014) *Illicit Financial Flows and their Development Impact: An Overview*, available at <https://journals.openedition.org/poldev/1863> (visited 4 March 2019).

The FATF has identified three tactics to move money for the purpose of disguising its origins and integrating it into the formal economy by criminal organisations and terrorist financiers. These are:

- the use of the financial system;
- the physical movement of cash through cash couriers; and
- the movement of value through the trade system, that is, TMBL.

As is evident from its title, this paper is concerned with the threat which TBML poses to the AfCFTA.

2 TRADE-BASED MONEY LAUNDERING

The magnitude of international trade is large and growing.¹⁸ Unfortunately, this also creates an environment for abuse, as research findings indicate that an astounding 80% of IFFs from developing countries are perpetrated through TBML.¹⁹ The international trade system is susceptible to money launderers taking advantage of trade import and export transactions.²⁰ Currently, many competent authorities, including customs agencies, law enforcement agencies, financial intelligence units (FIUs), tax authorities and banking supervisors, appear less capable of identifying and combating TBML than they are of dealing with other forms of money laundering and terrorist financing.²¹ The problem is that TBML is highly sophisticated. Its perpetrators are able to hide their activities amongst massive volumes of legitimate trade involving multiple parties, jurisdictions and transactions, which make it difficult to uncover and trace.²²

TBML is accomplished through the deliberate disguising of the proceeds of crime and moving of value through the use of trade transactions.²³ The techniques

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- 18 See WTO (2017) *World Trade Statistical Review*, available at https://www.wto.org/english/res_e/statis_e/wts2017_e/wts17_toc_e.htm (visited 4 March 2019).
- 19 Kar D & Spanjers J (December 2015) *Illicit Financial Flows from Developing Countries: 2004-2013*, available at https://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf (visited 4 March 2019).
- 20 Hoffmann L (2010) "A Critical Look at the Current International Response to Combat Trade-Based Money Laundering: The Risk-Based Customs Audit as a Solution" 48(2) *Texas International Law Journal* 326–347 at 326.
- 21 FATF (2008) *Best Practices on Trade Based Money Laundering* at 1, available at <http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf> (visited 4 March 2019).
- 22 Trulio (27 February 2018) *Trade-Based Money Laundering — Ways to Detect & Prevent TBML*, available at <https://www.trulioo.com/blog/trade-based-money-laundering/> (visited 4 March 2019).
- 23 FATF (2008) para 5

of TBML traverse a wide range of complexity, from simple fraudulent invoicing to the sophisticated integration of trade in goods into complicated financial transactions that obscure the source of funds.²⁴ It can be accomplished in a variety of ways and commonly occurs through the deliberate misrepresentation of the price, quantity, or quality of traded goods.²⁵ The basic techniques of TBML:

- multiple invoicing of goods and services;
- over-and under-shipments of goods and services;
- falsely described goods and services; and
- over- and under-invoicing of goods and services (trade mis-invoicing).

3 TRADE MIS-INVOICING

The focus of the paper is on trade mis-invoicing. It is the most common technique of TBML and could be the biggest threat to the newly established AfCFTA. Trade mis-invoicing occurs when the true value of exports or imports deviates from the amounts declared to the authorities.²⁶ The key element of this technique is the misrepresentation of the price of the good or service in order to transfer additional value between the importer and exporter.²⁷ It is a technique which involves the deliberate over-invoicing of imports or under-invoicing of exports by two colluding entities in different countries, usually for the purpose of avoiding (higher) tax or levies in one of the countries.

3.1 Under-Invoicing

Under-invoicing of exports is the most common TBML method used to move money.²⁸ By invoicing the good or service at a price below the “fair market” price, the exporter is able to transfer value to the importer, as the payment for the good or service will be lower than the value that the importer receives when it is sold on the open market.²⁹ According to the report by the HLP on IFFs, it was discovered that the natural resources sector in Africa is most vulnerable to under-invoicing, as

24 Delston R & Walls S (2009) *Reaching beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside the Financial Sector*, available at <https://scholarlycommons.law.case.edu/jil/vol41/iss1/5> (visited 4 March 2019).

25 Delston & Walls (2009) at 87.

26 Kumanayake N (2015) *Trade-Based Money Laundering: An Obstacle to Trade Facilitation*, available at http://biblio.umsf.dp.ua/jspui/bitstream/123456789/2131/1/CJC_2015_02-48-59.pdf (visited 4 March 2019).

27 FATF (2006) “Trade Based Money Laundering” *FATF/OECD* 1–136 at 4.

28 FATF (2006) at 5.

29 FATF (2006) at 4.

the intention of MNCs involved in the sector is to reduce the amount to be remitted to the relevant authorities.³⁰

For example, Corporation XYZ (a foreign exporter) ships \$2 million worth of goods, but invoices Company ABC (a colluding domestic importer) for only \$1 million for said goods. Company ABC pays Corporation XYZ for the goods by sending a wire transfer for \$1 million. Company ABC sells the goods in the domestic market for \$2 million. The colluding domestic importer then receives instructions from Corporation XYZ to deposit the unaccounted variance of \$1 million into a foreign bank account. This would seem like a loss to Corporation XYZ initially, but the money now laundered into the domestic market would appear clean. By misrepresenting the price of the goods on the invoice and other documentation (below the true value) Company ABC gains excess value when the payment is made and the goods are sold in the domestic market far above the amount that was paid. Additionally, the foreign exporter benefits immediately. It is difficult for the customs agencies to verify the true value of the goods as against the declared value, thereby allowing Corporation XYZ to benefit from greatly reduced tax payments and duties. The end result for the exporter is that the unreported amount would now have a supposedly clean origin.

Figure 1: Under-Invoicing Technique

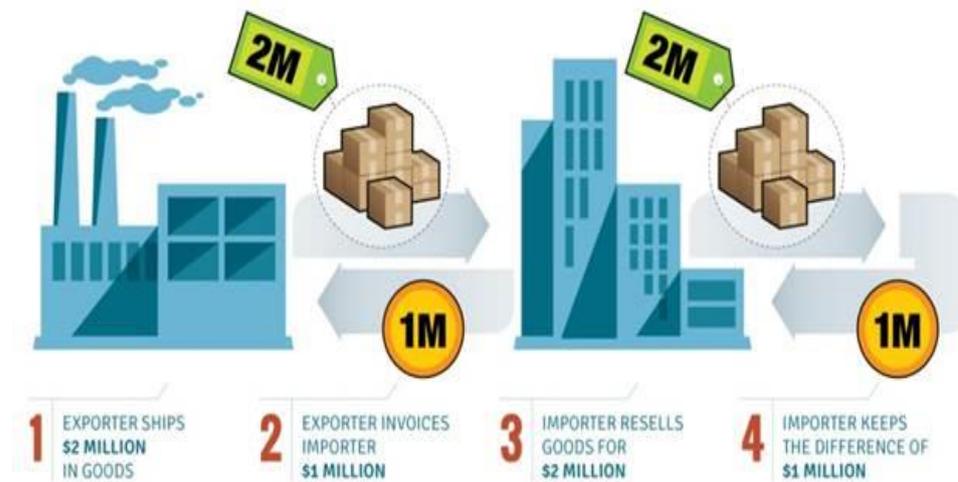


Image Credit: *US Combating Terrorism Technical Support Office*

30 AU/UNECA (2015) at 28.

3.2 OVER-INVOICING

This form of value transfer involves the deliberate over-invoicing of goods above their true market value, because the exporter is able to receive value from the importer as the latter's payment is higher than the actual value of the goods on the open market.³¹ This method can be used to move money out of the domestic market to offshore locations, thereby avoiding domestic capital and exchange controls.³²

Consider the following scenario of over-invoicing. An Indian importer intends to move \$500 000 illegally out of India.³³ Although he is buying only \$1 million worth of used cars from a US exporter, he uses a Mauritius intermediary to re-invoice the amount up to \$1 500 000.³⁴ The U.S. exporter is paid \$1 million but the \$500 000 that is left over then is diverted to an offshore bank account owned by the Indian importer.³⁵ Without knowing the true value of the cars shipped, it is very difficult to detect this as TBML as long as the trade documents are consistent with the transaction contract and the actual cars shipped. The danger of this technique is that an exporter or importer can be used in such a scheme without even knowing it.

Figure 2: Over-Invoicing Technique

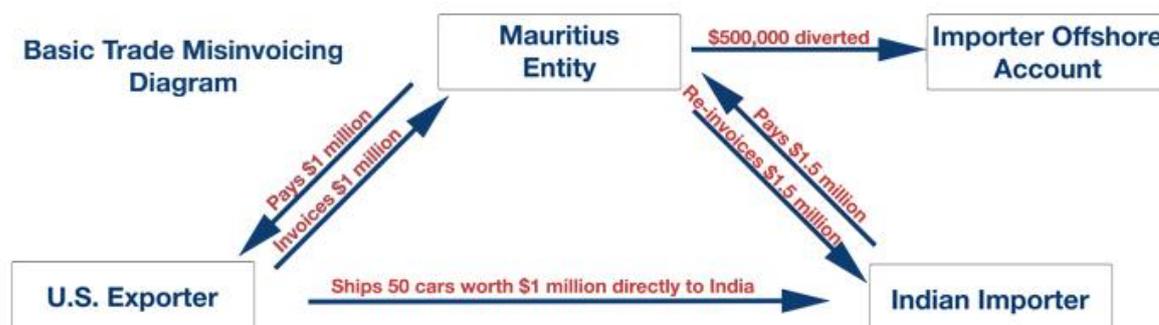


Image Credit: *Global Financial Integrity*

- 31 Simmons & Simmons *Trade Based Money Laundering*, available at <http://www.elexica.com/-/media/files/microsites/structures%20solutions%20in%20trade%20finance/chapters/07%20tbml.pdf> (visited 4 March 2019).
- 32 Simmons & Simmons at 7.
- 33 GFI *Trade Misinvoicing*, available at <http://www.gfintegrity.org/issue/trade-misinvoicing/> (visited 4 March 2019)
- 34 GFI para 7.
- 35 GFI para 7.

TBML has become increasingly attractive for laundering funds, as compared to misuse of the financial system and physical movement of cash. Detection of TBML transactions has become an uphill task, as it involves cross-border transactions and ready co-operation from other jurisdictions is not forthcoming, especially in civil matters.³⁶ The ability of customs authorities to identify incorrectly priced goods often is limited to those that are traded widely (at widely quoted prices) in international markets.³⁷

4 INTRA-AFRICA TRADE

In the past, African countries sought to integrate their economies through import-substitution industrialisation, as noted in the Lagos Plan of Action (LPA) — an Organisation of African Unity initiative — adopted by African Heads of State and Government in April 1980.³⁸ But with the rising trend of globalisation aimed at economic integration through strengthening of trade and financial links, countries have negotiated multilateral tariff reduction and trade liberalisation agreements.³⁹ However, over the years, Africa has been confronted by the challenges of a global economy and has had to make tough choices by negotiating new trade agreements, particularly with the European Union (EU) and the United States of America (USA), thereby limiting intra-Africa trade to regional economic communities.⁴⁰ This trade remains staggeringly low,⁴¹ compared to other trading

36 Gupta D, Mathuria S & Beramfram N (March 2015) *Trade Based Money Laundering*, available at http://fintelekt.com/files/documents/ED_TBML_March_2015-1-.pdf (visited 4 March 2019).

37 FATF (2006) at 5.

38 Beterlsmann Stiftung (2017) *Boosting Intra-African Trade Hindrances, Opportunities and the Continental Free Trade Area*, available at https://www.bertelsmann-stiftung.de/fileadmin/files/BSt/Publikationen/GrauePublikationen/NW_Boosting_Intra-African_Trade.pdf (visited 4 March 2019).

39 Ouattara A (21 May 1997) *The Challenges of Globalisation for Africa*, available at <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp052197> (visited 4 March 2019).

40 Ighobor K (August 2014) *Trade between Two Unequal Partners: Africa and Europe Search for an Elusive Agreement*, available at https://www.un.org/africarenewal/sites/www.un.org.africarenewal/files/Africa_Renewal_August_2014_en.pdf (visited 4 March 2019).

41 According to the WTO, the level of intra-African trade in 2012 was 12.8% and the share of Africa's total exports in global trade flows was 3.5%, which is extremely low compared to other regions. See AU *Update on the Continental Free Trade Area*, available at <http://www.tralac.org/images/docs/5869/update-on-the-continental-free-trade.pdf> (visited 4 March 2019).

blocs in Europe, Asia and Latin America.⁴² World Bank statistics put intra-African trade at just 11% of the continent's total trade between 2007 and 2011, and in 2015 intra-African trade was worth just \$170 million.⁴³ While developed countries still dominate African trade, recent trends indicate that developing economic regions are driving the growth in Africa trade and will continue to do so over the next 50 years.⁴⁴ The fact remains that the greatest opportunity for realising Africa's growth potential, namely, Africa's ability to trade and do business with itself, often is overlooked.⁴⁵ Africa needs to cement its place in the global economy through foreign investment and improved trading links, while driving regional trade integration.⁴⁶

Figure 3: Intra-Africa Trade

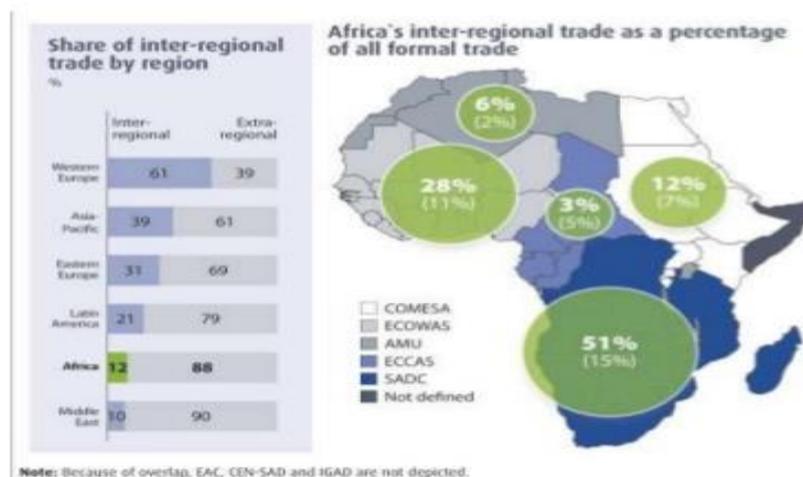


Image Credit: African Development Bank

- 42 Seid E (2013) *Regional Integration and Trade in Africa: Augmented Gravity Model Approach*, available at https://www.afdb.org/uploads/tx_lafdbpapers/Regional_Integration_Trade_in_Africa_1373530866.pdf (visited 4 March 2019)
- 43 Makhubela K (16 Jan 2018) *Africa's greatest economic opportunity: trading with itself*, available at (<https://www.weforum.org/agenda/2018/01/why-africas-best-trading-partner-is-itself/>) (visited 4 March 2019)
- 44 AfDB (2018) *Regional Integration, Trade, and Investment*, available at <https://www.afdb.org/en/knowledge/publications/tracking-africa%E2%80%99s-progress-in-figures/regional-integration-trade-and-investment/> (visited 4 March 2019)
- 45 Makhubela (16 January 2018) para 3.
- 46 Makhubela (16 January 2018) para 3.

4.1 The African Continental Free Trade Area

It was against the backdrop of these challenges that, on 21 March 2018, the African Union convened an Extraordinary Summit at which 44 of the 55 member states signed the text of a new African free trade agreement.⁴⁷ With a combined GDP of \$2.5 trillion across the member states of the African Union, the AfCFTA will be the world's largest free trade area country-wise, since the formation of the WTO.⁴⁸ According to world population projections, by 2050 the Africa population will exceed 2.5 billion.⁴⁹ Thus, the AfCFTA progressively aims to cut tariffs from the current average of 6.1% to zero, which would address the myriad non-tariff barriers, such as poor infrastructure and inefficient border posts.⁵⁰

The AfCFTA has the potential to hasten economic development in Africa and promote the prosperity of its citizens by creating a single continental and liberalised market for goods and services,⁵¹ and, by contributing to the movement of capital and natural persons, facilitate investments,⁵² including more foreign direct investment (FDI) to support African infrastructure development and increase productivity.⁵³ Through these measures, the establishment of the AfCFTA is expected to gather impetus to boost economic growth and attract investments from both within Africa and from the rest of the world.⁵⁴

However, as with any laudable initiative, the AfCFTA will come with its fair share of challenges. Africa has to design new economic development policies and safeguards to make the AfCFTA more effective and responsive to global challenges.

47 Hartzenberg T & Erasmus G (29 March 2018) *What Does the Adoption of the African Continental Free Trade Area Signify?* available at <https://www.tralac.org/discussions/article/12893-what-does-the-adoption-of-the-african-continental-free-trade-agreement-signify.html> (visited 4 March 2019). The AfCFTA will come into force, for those member states which have ratified the agreement, 30 days after the 22nd ratification has been deposited at the African Union Commission.

48 AU (2017) *The African Continental Free Trade Area*, available at https://au.int/sites/default/files/pressreleases/34017-pr-note_to_editors_-_questions_and_answers_on_the_african_continental_free_trade_area.pdf (visited 5 March 2019).

49 UN DESA (2017) *World Population Prospects*, available at https://esa.un.org/unpd/wpp/Publications/Files/WPP2017_KeyFindings.pdf (visited 5 March 2019).

50 AU (2017) para 4.

51 Article 3(A) & (B) of the Agreement Establishing the AfCFTA.

52 Article 3(C) of the Agreement Establishing the AfCFTA.

53 Kusamotu & Kusamotu (22 March 2018) *African Continental Free Trade Area Negotiations*, available at <http://www.kusamotu.com/african-continental-free-trade-area-afcfta-negotiations/> (visited 5 March 2019).

54 AU/EU (22 March 2018) *Africa Launches Its Continental Free Trade Area*, available at <https://www.africa-eu-partnership.org/en/stay-informed/news/africa-launches-its-continental-free-trade-area> (visited 5 March 2019).

In an effort to compensate for inadequate resources to finance sustainable industrial and economic development across various sectors, local companies can partner with foreign companies to bring FDI into the continent. These legal mechanisms can be utilised by foreign companies to form cross-border partnerships to trade on the continent through international joint venture agreements which, regrettably, likely will increase the risk of TBML.

4.2 Access to the AfCFTA through Joint Ventures

With the international trend toward the development of free trade areas, a popular mechanism for companies to take advantage of these new opportunities overseas is to form joint ventures.⁵⁵ Joint ventures (JVs) are legal arrangements in terms of which ownership and management of an organisation are shared by more than one entity.⁵⁶ Companies are realising that JV agreements offer an attractive and cost-effective mechanism for partnering with a local business to enter a foreign market.⁵⁷ A company that wants to expand its distribution network to new countries can enter into a JV agreement to supply products to a local business, thus benefiting from an already existing distribution network.⁵⁸ JVs between domestic companies in developing countries and foreign companies have become a popular means for both sides to satisfy their objectives.⁵⁹ Local partners bring knowledge of the domestic market and familiarity with government bureaucracies and regulations.⁶⁰ Foreign companies gain access into developing countries that otherwise would have restrictions on foreign capital. In developing nations, a JV is the best opportunity for a foreign company to invest directly into the domestic economy.

Although a key objective of the AfCFTA is progressively to remove tariffs and quotas on trade within the African region, each member state will keep its original trade restrictions against non-member states. As a single African market will allow the free movement of goods, services, capital and people within the continent, an international JV can be utilised to overcome these trade barriers and

55 Valentine C, Lew G, Poor R & Graubart S (1989) *Ten Key Questions for Entering into International Joint Ventures*, available at <https://onlinelibrary.wiley.com/doi/pdf/10.1002/jcaf.3970010203> (visited 5 March 2019).

56 Sparling D & Cook R *Strategic Alliances And Joint Ventures Under NAFTA: Concepts And Evidence*, available at <https://ageconsearch.umn.edu/bitstream/16778/1/ag000068.pdf> (visited 5 March 2019).

57 Investopedia (2018) *Joint Venture – JV*, available at <https://www.investopedia.com/terms/j/jointventure.asp> (visited 5 March 2019).

58 Investopedia (2018) para 10.

59 Miller R, Glen J, Aspersen F & Karmokolias Y (1997) "International Joint Ventures in Developing Countries" *Finance & Development* 26–29 at 26.

60 Miller R *et al* (1997) at 26.

gain full access to the continent. However, as suggesting earlier, such JV agreements raise the risks of TBML, particularly through trade mis-invoicing on a larger scale, given that there is no effective framework in place to prevent the abuse of the current trade regime. If an international JV is located in a member state of the AfCFTA, it will be operated by a local firm and a foreign firm. The product of the international JV will have access locally to all countries which have ratified the AfCFTA Agreement. Now, the possibility of trade mis-invoicing would expand in the AfCFTA when two colluding companies in a JV misrepresent the price on a trade deal to the relevant authorities in order to hide or accumulate wealth. Goods must pass through the border points of each entry country, expanding the opportunities for TBML as there is no AML/CFT mechanism in place to regulate TBML on the continent. A unified legal framework needs to be developed to checkmate the TBML threat that JVs and other investment vehicles could pose to the AfCFTA.

4.3 The Growth of Trade and the Threat to the AfCFTA

As trade is the “engine of growth” in any economy, the need to have a “free and fair” trade regime cannot be over-emphasised.⁶¹ The dilemma faced by policy makers lies in the requirement to balance the needs of a free, fair and predictable trade regime with the need for regulation of trade so as to prevent its abuse.⁶² For instance, world merchandise exports have increased in value by about 32% since 2006, reaching \$16 trillion in 2016, and world exports of commercial services have accelerated by about 64 per cent, reaching a total of \$4.77 trillion.⁶³ Similarly, world exports of manufactured goods increased from \$8 trillion in 2006 to \$11 trillion in 2016.⁶⁴ Unfortunately, these figures also indicate the potential for absorption and movement of funds of criminal origin through international trade, increasing the opportunities for companies to misuse the trade system to launder money and escalate illicit outflows from AfCFTA upon trade expansion.

61 APG (20 July 2012) *APG Typology Report on Trade Based Money Laundering*, available at http://www.fatf-gafi.org/media/fatf/documents/reports/Trade_Based_ML_APGReport.pdf (visited 5 March 2019).

62 APG (2012) at para.34

63 WTO (2017) at 5

64 WTO (2017) at 10

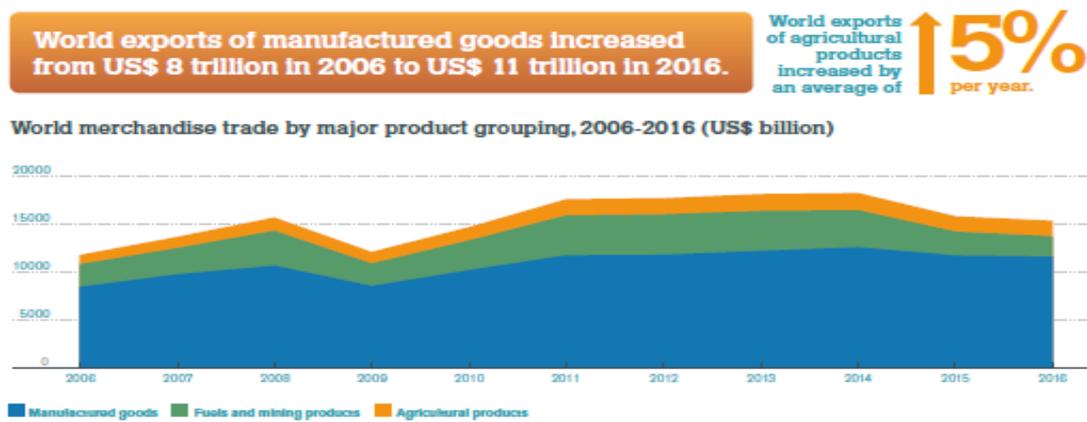
Figure 4: Merchandise Trade

Image Credit: WTO Secretariat

At present, the exact scale of the problem of IFFs is unknown.⁶⁵ What is known, however, is the cost and devastating effects IFFs have on developing countries, with the vast majority being the result of trade mis-invoicing, which is possible in part because trading partners write their own trade documents.⁶⁶ These features of trade make it highly attractive to money launderers. The chain of supply comprises many links, including transport, insurance and finance, which provide many opportunities to launder money.⁶⁷ International trade also involves different legal systems, procedures and languages, engendering discrepancies in communication and exchange of information between jurisdictions which provide fertile ground for money laundering.⁶⁸ The potential increase in volume of intra-Africa trade amongst the AfCFTA by member states promises significant benefits for the continent. However, given the detection and enforcement challenges which continue to plague the continent, these benefits will stand in danger of being eroded by TBML.

65 EUROPA (21 June 2016) *The inclusion of financial services in EU free trade and association agreements: Effects on money laundering, tax evasion and avoidance*, available at [http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU\(2016\)579326](http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU(2016)579326) (visited 5 March 2019).

66 EUROPA (2016) at 9.

67 AIC (3 November 2017) *The Nature of Trade-Based Money Laundering*, available at <https://aic.gov.au/publications/rpp/rpp115/nature-trade-based-money-laundering> (visited 5 March 2019).

68 AIC (2017) para 42.

Figure 5: Trade in Commercial Services

World exports of commercial services totalled US\$ 4.8 trillion in 2016, up from US\$ 2.9 trillion in 2006.

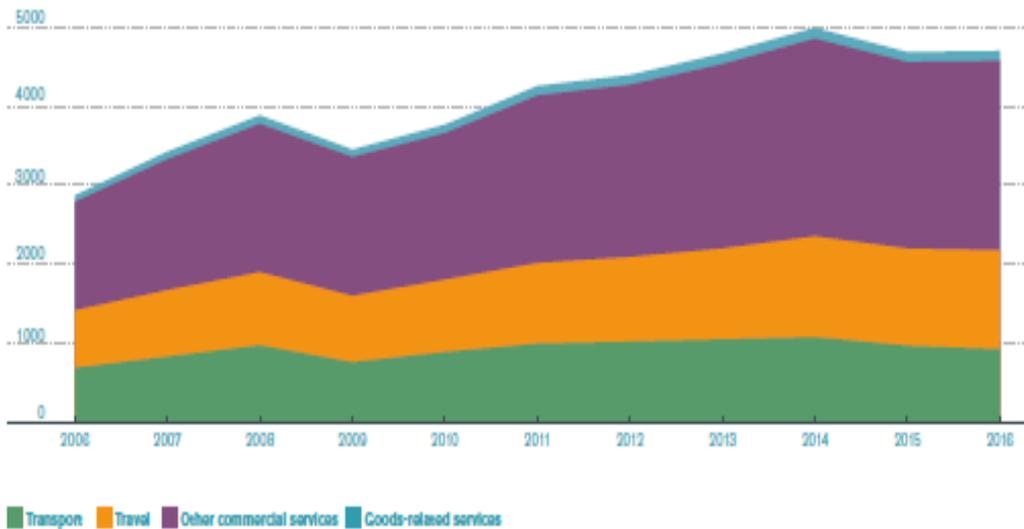
World trade in commercial services by category, 2006-2016 (US\$ billion)

Image Credit: *World Trade Organisation Secretariat*

4.4 Understanding the Effects of Mis-invoicing on the AfCFTA

From 2005 to 2014, total illicit financial outflows grew at an average annual rate of 7.2% to 8.1%, reaching estimated⁶⁹ levels of \$620 billion and \$970 billion in 2014.⁷⁰ Over that period, total developing country trade grew at an annual average of 10.1% and, because growth in estimated outflows was less than growth in total trade, outflows are likely to have declined slightly as a share of total developing country trade, from 5.4%—7.9% in 2005 to 4.2%—6.6% in 2014.⁷¹ GFI estimates that in 2012 alone the global volume of trade mis-invoicing was \$730 billion,⁷² and

69 The ultimate aim of empirical analyses of trade mis-invoicing is to quantify the extent of misbehaviour by traders, potentially allowing for the assessment of the relevance and the policy implications of such unlawful practices. Given the hidden nature of these activities, indirect estimation approaches are applied which depend critically on assumptions.

72 Spanjers & Salomon (2017) at vii.

71 Spanjers & Salomon (2017) at vii.

72 Clough C (13 July 2015) *New Program to Address Damage of IFFs by Supporting Developing Governments in Fighting Trade Misinvoicing*, available at <http://www.gfintegrity.org/press-release/new-program-to-address-damage-of-iffs-by-supporting-developing-governments-in-fighting-trade-misinvoicing/> (visited 5 March 2019).

the HLP on IFFs estimates that a capital outflow from Africa due to trade mis-invoicing stood at \$40 billion in 2010.⁷³

Figure 6: Estimates of Illicit Financial Outflows, 2005—2014



Image Credit: *Global Financial Integrity*

The UNECA modelling exercises indicate that the AfCFTA has the potential to lift intra-African trade by 52.3% between 2010 and 2022, with trade in industrial products expected to receive the largest boost in the form of an additional increase of 53.3% over the period.⁷⁴ The estimates also find that supportive trade facilitation measures could more than double intra-African trade, stimulating industrial products the most.⁷⁵

The purpose of this paper is not to project an estimate of the impact of trade mis-invoicing on the AfCFTA. However, it recognises that, logically, trade mis-invoicing and other forms of TBML will more than double the current alarming figures, assuming an increase of more than 50% in volumes of trade by 2022. Without any radical policy changes to the current regime to tackle TBML, the use of trade to manipulate and move illicit money will undermine the economic benefits of the AfCFTA.

The attractiveness of the trading system for transferring illicit capital is based on the relative ease with which individual transactions can be obscured amongst enormous volumes of trade and increasingly complex transactions.⁷⁶ In this regard, it is highly probable that MNCs will exploit the AfCFTA on a larger scale. In its report, the HLP on IFFs referred to the lack of adequate regulatory

⁷³ AU/UNECA (2015) at 92.

⁷⁴ ERA (2017) *Recent Economic Developments in Africa*, available at https://www.uneca.org/sites/default/files/uploaded-documents/ERA/ERA2017/chap1_03.pdf (visited 5 March 2019).

⁷⁵ ERA (2017) at 21.

⁷⁶ FATF (2006) at 25.

frameworks to address the problem at both national and regional level. The Executive Secretary of UNECA, Ms. Vera Songwe, highlighted several issues affecting the African continent, including IFFs to African ambassadors in Ethiopia, and urged support for the continent's quest for economic and structural transformation.⁷⁷

If you don't close your door and you wake up every day saying your goats have been taken, everybody will say but you didn't close your door. We have a sort of pretend problem because we have not closed our doors.⁷⁸

Now, with the establishment of the AfCFTA, the door is about to open wider.

5 CURRENT FRAMEWORK TO TACKLE TBML

Opening the doors to international (and intra-Africa) trade provides a number of benefits, one of which is the opportunity for countries to expand their markets in order to obtain goods and services that may not have been available ordinarily.⁷⁹ In theory, one cannot fault the advantages of intra-Africa trade. But, in practice, trade openness could affect economic growth on the continent, as there is a causal link between the AfCFTA, trade liberalisation, FDI and TBML.

The response of the global community to TBML thus far has been inadequate due, in part, to the limited knowledge available on the subject matter. This dearth of knowledge, in turn, limits the ability of many countries to implement an effective regulatory framework to address the problem. It was to be expected, since the launching of the FATF, that the international community would embark on a co-ordinated effort to block the obvious avenue which trade provides to criminal networks. However, there still is no single global architecture for tackling TBML.⁸⁰ The FATF 40 Recommendations, meant to be the international standard for combating money laundering, include no express provision to address TBML. In 2006 the FATF did issue a report on TBML, recognising the threat posed by criminals to the trade system; and followed that with a Best Practice Paper on TBML in 2008, including a report on money laundering vulnerabilities of free trade

77 UNECA (27 February 2018) *CFTA, Migration & Illicit Financial Flows Discussed in Songwe's Meeting with African Ambassadors*, available at <https://www.uneca.org/stories/cfta-migration-illicit-financial-flows-discussed-songwe%E2%80%99s-meeting-african-ambassadors> (visited 5 March 2019).

78 UNECA (2018) para 12.

79 Darrel C (7 April 2016) *Trade-Based Money Laundering: The Need for an Effective Regulatory Framework*, available at <http://www.keepcalmtalklaw.co.uk/trade-based-money-laundering-the-need-for-an-effective-regulatory-framework/> (visited 5 March 2019).

80 AU/UNECA (2015) at 73.

zones in 2010. Surprisingly, there have been no further reports or any attempts to include TBML preventive measures in the 40 Recommendations — although there are legitimate questions about whether the FATF’s mandate extends to the trade system and whether it is the best forum to propagate reform, given the existence of international organisations devoted specifically to trade security and border control.⁸¹

Be that as it may, there are a number of commendable initiatives and instruments to deal with the commercial, criminal and corrupt activities related to IFFs. However, they often are disparate and handled in separate processes and forums, which is a challenge even for developed countries.⁸² There is evidently no specific framework to counter TBML, including trade mis-invoicing at the international level.⁸³ Countries have had to adopt AML guidelines and regulations specific to the financial sector in order to combat TBML. Reporting obligations by financial institutions are the primary focus of AML policies in the financial sector, whereas the trade sector is inherently different, making it virtually impossible for the same approach to work. There is also a concern that the introduction of a requirement compelling traders to undergo the same level of regulation as financial institutions would be very costly and very difficult logistically.⁸⁴ In order to reduce the impact of TBML, the AML strategy must reach beyond financial institutions. The international trade system cuts across various actors in the value chain, which include importers and exporters, freight forwarders, shippers and air couriers — companies referred to as “traders” in the FATF Best Practices Paper.⁸⁵ An effective TBML strategy must be developed to include non-financial institutions under the trade system, as the major MNCs are not being regulated closely under the current AML/CFT regime of the FATF.

81 McSkimming S (2010) *Trade-Based Money Laundering: Responding to an Emerging Threat*, available at <http://classic.austlii.edu.au/au/journals/DeakinLawRw/2010/2.html#fnB55> (visited 5 March 2019).

82 AU/UNECA (2015) at 73.

83 FATF (March 2010) *Money Laundering Vulnerabilities of Free Trade Zones*, available at <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf> (visited 5 March 2019).

84 AIC (2017) para ii.

85 FATF (2008) para 10.

5.1 Need for a Comprehensive Legal Framework to Combat TBML in the AfCFTA

A unified anti-TBML legal framework for the AfCFTA will have common policies which are the essence of multinational integration based on legislation which binds all AU member states. Such a framework will give the common institutions the legal means to implement common policies, enforce their decisions and impose sanctions on all errant parties. For a problem of the magnitude of TBML in Africa, soft law⁸⁶ is inadequate. It is recognised that states choose soft law when they are uncertain about whether the rules they adopt today will be desirable tomorrow and when it is advantageous to allow a particular state or group of states to adjust expectations in the event of changed circumstances.⁸⁷ However, soft law is something that dims in importance as the commitments of states weaken, eventually disappearing altogether.⁸⁸ Of course, states may use soft law to solve straightforward issues in which the existence of a focal point is enough to generate compliance. Indeed, banks and banking related issues are suited well to soft law in the international sphere because they are universally subject to a plethora of rules generated by their regulators.⁸⁹ But, as mentioned earlier, the trade system is qualitatively different from the banking sector, hence a more potent AML approach would be more suitable to confronting the magnitude of trade irregularities. In fact some of the objections to the use of soft law in the EU are that it lacks the clarity and precision needed to provide predictability and a reliable framework for action.⁹⁰ Also, it is said, soft law is a device which is used to obtain an effect, but which by-passes normal systems of accountability and undermines EU legitimacy because it creates expectations without actual change.⁹¹

Despite African integration being high on the agenda of African legal scholars, politicians and bureaucrats, the term “African Union law” is largely unknown, with the focus remaining on the national legal systems of individual AU

86 Soft law refers to quasi-legal instruments which do not have any binding force legally or have carry a binding force which is somewhat weaker than that of traditional law.

87 Guzman A & Meyer T (1 January 2010) *International Soft Law*, available at <https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1694&context=facpubs> (visited 5 March 2019).

88 Guzman & Meyer (1 January 2010) para 4.

89 Guzman & Meyer (1 January 2010) para 4.

90 Trubek D, Cottrell P & Nance M (21 April 2005) “*Soft Law,*” “*Hard Law,*” and *European Integration: Toward a Theory of Hybridity*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=855447 (visited 5 March 2019).

91 Trubek, Cottrell & Nance (21 April 2005) at 2.

members.⁹² The AU will have to take a firm stance in implementing the required framework to address the major contingencies in economic policy-making if it is to meet its 2063 Agenda.

5.2 Trade Transparency Units

As to addressing what a unified TBML framework should embrace, the AU could adopt the approach of other jurisdictions albeit with variations appropriate to African circumstances. For instance, the USA is one of few jurisdictions that has recognised a difference between TBML and other forms of money laundering; and the United States Immigration and Customs Enforcement (USICE) has established trade transparency units (TTUs) to identify global TBML trends and conduct ongoing analysis of transnational trade data.⁹³ The TTUs are authorised to exchange and analyse import/export and financial data — obtained through partnerships with TTUs of other countries — between the USA and its foreign trading partners, which enables them to detect suspicious TBML transactions by way of documentation and financial irregularities.⁹⁴

Although not externally verified, the USICE claims that one of the most effective ways of identifying instances and patterns of TBML is through the analysis of trade data for anomalies that would become apparent only by examining both sides of a trade transaction.⁹⁵ As an aid to data analysis, the USICE has developed a specialised computer system called the Data Analysis and Research for Trade Transparency System, which contains both domestic and foreign trade data. This allows users to see both sides of a trade transaction, making it transparent to both countries.⁹⁶ The USICE also claims that the effectiveness of this investigative tool in identifying international trade anomalies and financial irregularities indicative of TBML, customs fraud, contraband smuggling and tax evasion has been proved.⁹⁷ TTUs identify abnormalities related to cross-border trade that are suggestive of international TBML and generate, initiate and support the related investigations

92 Olivier M (15 December 2015) *The Role of African Union Law in Integrating Africa*, available at <https://www.tandfonline.com/doi/full/10.1080/10220461.2015.1119718> (visited 5 March 2019).

93 USICE (3 January 2018) *Trade Transparency Unit*, available at <https://www.ice.gov/trade-transparency#wcm-survey-target-id> (visited 5 March 2019).

94 Darrel (7 April 2016) para 18.

95 USICE (3 January 2018) para 3.

96 USICE (2018) para 3.

97 USICE (2018) para 5.

and prosecutions, thereby assisting in the crusade against international money laundering organisations.⁹⁸

As one of the objectives of the AfCFTA is to lay the foundation for the establishment of a Continental Customs Union,⁹⁹ the AU could establish TTUs and form partnerships with its trading partners to exchange trade data for the purpose of identifying and analysing trade transactions for evidence of TBML.

5.3 Sanctions Enforcement Regime

The AU ought to develop measures to monitor, detect, prosecute and sanction TBML abuses in the AfCFTA and ensure that African trade transparency units (ATTUs) are authorised to supervise traders. An African unified TBML framework should entrench effective, proportionate and dissuasive sanctions against companies which violate AML requirements by failing to declare or making false representations on invoices or any documentation related to the import of goods into and export of goods from the continent. Compliance is encouraged when a sanctions regime imposes penalties that are sufficiently stiff to act as a deterrent.¹⁰⁰ Sanctions do not have to be of a penal nature necessarily, since an economic cost for non-compliance creates an incentive for compliance.¹⁰¹

A useful example, although unrelated to TBML, is the imposition by the Federal Government of Nigeria, through the Nigerian Communications Commission (NCC), of a fine of \$5.2 billion¹⁰² on MTN Group¹⁰³ for failure to meet a deadline to disconnect subscribers identification modules (SIM) with improper registration.¹⁰⁴ As a result of the fine, the MTN Group was forced to make sweeping changes to its leadership, which included the resignations of the head of its Nigerian operations, Michael Ikpoki, the head of Regulatory and Corporate Affairs, Akinwale Goodluck,

98 US BINLEA (March 2009) *International Narcotics Control Strategy Report*, available at <https://www.state.gov/documents/organization/120055.pdf> (visited 5 March 2019).

99 Article 3(D) of the Agreement Establishing the AfCFTA.

100 ILO *Dissuasive Sanctions Regime*, available at http://www.ilo.org/moscow/areas-of-work/wages/WCMS_439055/lang--en/index.htm (visited 5 March 2019).

101 ILO para 2.

102 Adepetun A (27 October 2015) "MTN in talks with NCC over N1.04tr Fine on Telecoms Firm" *The Guardian*, available at <http://guardian.ng/lead-story/mtn-in-talks-with-ncc-over-n1-04tr-fine-on-telecoms-firm/> (visited 5 March 2019).

103 The MTN Group is a major multinational telecommunications company based in Johannesburg, South Africa.

104 Azeez K (1 February 2018) "SIM Infraction: MTN to Pay N55bn Fine in March" *New Telegraph*, available at <https://newtelegraphonline.com/2018/02/sim-infraction-mtn-pay-n55bn-fine-march/> (visited 5 March 2019).

and the Chief Executive Officer, Sifiso Dabengwa.¹⁰⁵ Such is the impact which a sanctions regime can have on errant MNCs, deterring them from further non-compliance.

Additionally, a framework under the AU could learn valuable lessons from the enforcement of the Foreign Corrupt Practices Act (FCPA) of 1977 by the US Securities and Exchange Commission (SEC) and the US Department of Justice (DoJ). The FCPA generally prohibits the payment of bribes to foreign officials to assist in obtaining or retaining business.¹⁰⁶

Figure 7: SEC and DoJ Fines

| Company | Settlement | Year |
|------------------------------------|----------------|------|
| Petróleo Brasileiro SA (Petrobras) | \$1.78 billion | 2018 |
| Telia | \$965 million | 2017 |
| Braskem S.A. | \$957 million | 2016 |
| VimpelCom | \$795 million | 2016 |
| Teva Pharmaceutical | \$519 million | 2016 |
| Och-Ziff | \$412 million | 2016 |
| JPMorgan | \$264 million | 2016 |
| Embraer | \$205 million | 2016 |
| Panasonic Corp. | \$143 million | 2018 |
| Avon Products Inc. | \$135 million | 2014 |

Source: *US Securities and Exchange Commission*

It provides for different criminal and civil penalties for companies and individuals. FCPA sanctions are significantly high. The AU would do well to take heed of the practices of the SEC and the DoJ which are jointly responsible for the implementation of the provisions of the FCPA.

105 Business News (3 December 2015) "MTN Nigeria CEO Resigns as FG Slashes Fine to N674b" *The Guardian*, available at <http://guardian.ng/business-services/mtn-nigeria-ceo-resigns-as-fg-slashes-fine-to-n674b/> (visited 5 March 2019).

106 US SEC (2 February 2017) *Spotlight on Foreign Corrupt Practices Act*, available at <https://www.sec.gov/spotlight/foreign-corrupt-practices-act.shtml> (visited 5 March 2019).

The United States has achieved considerable success in the area of civil and criminal sanctions against MNCs and their agents. For such a complex problem as TBML, it would make sense for Africa to design a rather simple solution in the form of an identifiable regime which could be the catalyst to unlocking the challenges of TBML in Africa and the AfCFTA in the future. The AU must adopt strict measures for the AfCFTA through a single framework which can sanction companies for violating its provisions. However, it will require significant expansion of resources and oversight responsibilities to combat TBML. What is more, over-reliance upon international initiatives or countries to solve African problems has yielded limited results and must be approached with caution.

6 CONCLUSION

Money laundering and financing of terrorism ML/FT continue to be a significant challenge around the world, and as old loopholes are plugged new ones are created.¹⁰⁷ The AfCFTA depends heavily on trade and foreign investment to meet its objectives, bringing with it the danger of TBML. It is a danger which ought to be a significant concern for African policy-makers, researchers, governments, civil society and engaged citizens, as well as for the international community.

Any strategy to prevent and combat TBML in Africa needs to be based on dismantling TBML structures while allowing genuine trade to occur unfettered.¹⁰⁸ Further, inter-agency co-ordination, international co-operation, sectoral peculiarities, jurisdiction disparities and agency specialisation need to be taken into account before any comprehensive framework to tackle TBML can be adopted to address the threats of TBML to the AfCFTA. Be that as it may, a uniform anti-TBML mechanism for the AfCFTA and its trading partners is a priority for Africa. It would help to bridge the gaps in the domestic implementation of international AML/CFT standards, such as those laid down in the FATF Recommendations for the financial sector. It would contribute also to preventing regional and global fragmentation linked to inconsistent harmonisation. It is foreseeable that the success of the AfCFTA will depend crucially on the enforcement of an integrated legal framework to repulse the threats posed by TBML.

107 UNODC (2017) *Independent In-depth Evaluation of the Global Programme against Money Laundering, Proceeds of Crime and the Financing of Terrorism 2011-2017*, available at https://www.unodc.org/documents/evaluation/indepth-evaluations/2017/GLOU40_GPML_Mid-Term_In-Depth_Evaluation_Final_Report_October_2017.pdf (visited 20 March 2019).

108 APG (2012) para 19.